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NOTES

LEAPING OVER THE GREAT WALL: EXAMINING CROSS-BORDER INSOLVENCY IN CHINA UNDER THE CHINESE CORPORATE BANKRUPTCY LAW

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In these matters the only certainty is that nothing is certain.[1]

ABSTRACT

Historically, cross-border bankruptcy has caused a great deal of confusion and uncertainty. Due to the lack of binding uniform multinational rules, in most cases, worldwide bankruptcies are inefficient and uncoordinated, and often result in inequitable distributions of the debtor's assets. While the new Chinese Corporate Bankruptcy Law is generally considered a significant step forward, it contains vague and imprecise language addressing cross-border insolvency proceedings that is likely to lead to concerns about enforceability of foreign bankruptcy judgments in China.

This Article examines the cross-border insolvency provisions of the Chinese Corporate Bankruptcy Law within the context of the primary academic approaches to cross-border insolvency: territorialism and universalism. It compares the Chinese approach to the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency and the U.S. approach under Chapter 15 of the U.S. Bankruptcy Code. The Article concludes with a proposal for adjustments to China's bankruptcy law to more effectively deal with the problems associated with cross-border insolvency cases.

I. INTRODUCTION

Historically, cross-border bankruptcy has caused a great deal of confusion and uncertainty. Due to the lack of binding uniform multinational rules, in most cases, worldwide bankruptcies are inefficient and uncoordinated, and often result in inequitable distributions of the debtor's assets. As one commentator noted, "[I]nternational insolvency is an administrative nightmare when no country holds complete jurisdiction over the debtor, its assets, or its creditors."[2]

Legal scholars have considered two primary approaches to deal with cross-border insolvency cases: territorialism,[3] which has been the historical

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1. PLINY THE ELDER, THE NATURAL HISTORY, BOOK II. AN ACCOUNT OF THE WORLD AND THE ELEMENTS 7 (John Bostock & H. T. Riley eds. 1855).

2. Evelyn H. Biery, Jason L. Bolund, & John D. Cornwell, *A Look at Transnational Insolvencies and Chapter 15 of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 47 B.C. L. REV. 23, 48 (2005) (citing M. Cameron Gilreath, Recent Development *Overview and Analysis of How the United Nations Model Law on Insolvency Would Affect United States Corporations Doing Business Abroad*, 16 BANKR. DEV. J. 399, 402 (2000)).

3. *See infra* notes 15-28 and accompanying text.

response based on national sovereignty concerns, and universalism,[4] which is generally regarded as the most efficient approach, but one that is not necessarily politically viable. A version of universalism, called modified universalism,[5] attempts to create a compromise between the two extremes. The United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross Border-Insolvency adopted modified universalism.[6] UNCITRAL Model Law on Cross-Border Insolvency was incorporated into Chapter 15 of the U.S. Bankruptcy code[7] with the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.[8]

On August 27, 2006, the Standing Committee of the National People's Congress adopted the Corporate Bankruptcy Law of the People's Republic of China, which went into effect on June 1, 2007.[9] The new law replaced the existing enterprise bankruptcy law, originally enacted in 1986. The Corporate Bankruptcy Law is a significant step forward in Chinese bankruptcy law and should provide firms seeking to invest in China with more confidence that their investments will be protected. That confidence should assist China in continuing to attract foreign economic investment activity.[10] However, the Corporate Bankruptcy Law contains vague and imprecise language addressing cross-border insolvency proceedings[11] that could lead to concerns about enforceability of foreign bankruptcy judgments in China.

This Article examines the cross-border insolvency provisions of the Chinese Corporate Bankruptcy Law. Part II examines the primary academic approaches to cross-border insolvency, including territorialism and universalism and the UNCITRAL Model Law. Part III provides an

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4. *See infra* notes 30–41 and accompanying text.

5. *See infra* notes 32–35 and accompanying text.

6. Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law, G.A. Res. 52/158, Annex, U.N. Doc. A/RES/52/158/Annex (Jan. 30, 1998).

7. 11 U.S.C. § 1501-1532 (2010).

8. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23, 135-145.

9. [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007) art. 1.

10. *See Short Takes: Foreign Investment*, THE CHINA BUS. REV.: THE MAG. OF THE US–CHINA BUS. COUNS. (May–June 2010), http://www.chinabusinessreview.com/public/1005/ shorttakes.html (describing the plans announced by the PRC State Council to improve the environment for foreign investment by streamlining approval processes, updating the Catalogue Guiding Foreign Investment in Industry, and promoting investment in central and western China); *China Tweaks Foreign Investment Rules*, THE CHINA BUS. REV.: THE MAG. OF THE US–CHINA BUS. COUNS. (Nov.–Dec. 2009), http://www.chinabusinessreview.com/public/0911/ cmi.html (describing efforts by the PRC Ministry of Commerce and other agencies to encourage private foreign investment).

11. [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007) art. 5; *see infra* notes 152-157 and accompanying text.

overview of the U.S. approach under Chapter 15. Part IV examines China's Corporate Bankruptcy Law and the cross-border insolvency provisions contained therein. Part V provides a proposal for adjustments to China's bankruptcy law to deal more effectively with the problems associated with cross-border insolvency cases.

II. APPROACHES TO CROSS-BORDER BANKRUPTCY: TERRITORIALISM, UNIVERSALISM AND THE UNCITRAL MODEL LAW

Legal scholars have considered two primary approaches[12] to deal with cross-border insolvency cases: territorialism and universalism. [13]

A. Territorialism

Territorialism is the traditional approach to cross-border insolvency cases.[14] Under this approach, the debtor's assets physically present in each separate country are subject to control and distribution by local courts under the local rules of that jurisdiction.[15] This approach has sometimes been called the grab rule, referring to the process of selling a debtor's local assets and distributing the proceeds under the law of the local jurisdiction without regard to other international bankruptcy proceedings.[16] Commentators have suggested that when a multinational company has assets in multiple countries, a particular form of territorialism, called cooperative territorialism,[17] will resolve the issues involving the disposition of that firm's assets. Under this approach, bankruptcy proceedings are instituted in each country where the company has assets, the bankruptcy authorities in

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12. Under a third approach called contractualism, a debtor may select in advance which approach to take for cross-border bankruptcy issues depending on the debtor's circumstances. *See* Robert K. Rasmussen, *Transnational Insolvencies Through Private Ordering*, 98 MICH. L. REV. 2252 (2000). Because this approach is currently entirely academic, this article does not consider it in detail.

13. Samuel L. Bufford, *Global Venue Controls are Coming: A Reply to Professor LoPucki*, 79 AM. BANKR. L.J. 105, 108 (2005).

14. John J. Chung, *The New Chapter 15 of the Bankruptcy Code: A Step Toward Erosion of National Sovereignty*, 27 NW. J. INT'L L. & BUS. 89, 93 (2006).

15. *Id.*; Lynn M. LoPucki, *The Case for Cooperative Territoriality in International Business*, 98 MICH. L. REV. 2216, 2218 (2000) [hereinafter LoPucki, *Case for*]; Frederick Tung, *Fear of Commitment in International Bankruptcy*, 33 GEO. WASH. INT'L L. REV. 555, 561 (2001).

16. Kevin J. Beckering, *United States Cross-Border Corporate Insolvency: The Impact of Chapter 15 on Comity and the New Legal Environment*, 14 LAW & BUS. REV. AM. 281, 284 n.6 (2008); *see* Jay Lawrence Westbrook, *Multinational Enterprises in General Default: Chapter 15, The ALI Principles and the EU Insolvency Regulation*, 76 AM. BANKR. L.J. 1, 5 (2002).

17. LoPucki, *Case for, supra* note 15, at 2221; Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-Universalist Approach*, 84 CORNELL L. REV. 696, 742-44 (1999) [hereinafter LoPucki, *Cooperation in*].

each of those countries appoint a representative for the bankruptcy estate in that country, and the representatives then attempt to negotiate a resolution.[18] If the assets of the entity are worth more on a continuing basis, the representatives will agree to combine them.[19] If they cannot agree, then the rules of each jurisdiction will apply to determine how the assets in that jurisdiction are distributed.[20]

Those who advocate the territorialism approach claim several advantages. First, because the cooperative territorialism approach is used in most of the world today,[21] the results are predictable and align with the expectations of creditors at the time they extend credit to the debtor.[22] Second, while it is possible to transfer assets from one jurisdiction to another and thereby affect the ultimate distribution, such transfers are subject to local bankruptcy rules that would limit or reverse such transfers.[23] Finally, bankruptcy representatives in each country have sufficient incentive to cooperate in order to achieve the most value for the assets of the entity on a global basis.[24]

Conversely, critics of the territorialism approach point to the high costs involved in maintaining separate insolvency proceedings in each country where assets are located.[25] They also claim that the distribution results are uneven and unpredictable, increasing the cost of capital due to the uncertain outcomes of insolvency.[26] Furthermore, critics claim that incentives exist, for both the debtor and the various creditors, to engage in strategic positioning to enhance their individual interests at the expense of the general creditors of the insolvent debtor.[27] Finally, while cooperation may be logical, it may not be authorized under the bankruptcy laws of a particular country involved. Additionally, the representative or bankruptcy court in a given country may choose not to cooperate even if it makes

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18. LoPucki, *Case for*, *supra* note 15, at 2219.

19. *Id.*

20. *Id.*

21. Lynn M. LoPucki, *Universalism Unravels*, 79 AM. BANKR. L.J. 143, 162 (2005) [hereinafter LoPucki, *Unravels*].

22. Edward S. Adams & Jason Fincke, *Coordinating Cross-Border Bankruptcy: How Territorialism Saves Universalism*, 15 COLUM. J. EUR. L. 43, 57 (2008/2009).

23. *Id.* at 58. *See, e.g.*, 11 U.S.C. § 547(b) (2010) (allowing the bankruptcy trustee under U.S. law to avoid most transfers of property to or for the benefit of a creditor for a debt owed by the debtor before the transfer made while the debtor was insolvent and within the ninety day period before the filing of the bankruptcy petition); *see also* [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007) art. 31-34 (providing the receiver under Chinese bankruptcy law to recover improperly transferred property).

24. Adams & Fincke, *supra* note 22, at 57 (citing LoPucki, *Unravels*, *supra* note 21, at 161-62).

25. Bufford, *supra* note 13, at 105.

26. *Id.*

27. *Id.*

economic sense to do so.[28]

B. Universalism

Universalism takes a very different approach to the international insolvency problem.[29] Under this approach, a single bankruptcy court in the debtor's home country has jurisdiction over the debtor's worldwide assets; those assets are distributed in accordance with the laws of that supervising jurisdiction.[30] Based solely on economic analysis, this approach makes sense because it will minimize the costs inherent in the insolvency proceedings and make the most efficient distribution of the debtor's assets.[31] Despite these economic advantages, this pure version of universalism is not viable due to "the practical recognition of the enduring differences among political and economic systems, legal regimes, and court systems, as well as among enforcement of those regimes."[32] Thus, advocates of universalism generally endorse a modified version of the approach in which local courts have some discretion as to whether compliance with the requests of the debtor's home country is appropriate. Courts base the decision on an analysis of whether compliance alters the legal entitlements of the parties or offends the country's public policy.[33] Under this approach, a single main insolvency case is maintained in the debtor's home country, governed by the home country laws. Secondary, or ancillary, cases are maintained in other countries where the debtor's assets exist.[34] In these ancillary cases, courts apply local law and retain discretion to evaluate the fairness of the main case proceedings and to protect the interests of local creditors.[35]

Supporters of universalism point to a more efficient allocation of capital, lower costs due to a reduction in the number of separate bankruptcy proceedings, avoidance of forum shopping, facilitated reorganizations, and

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28. Adams & Finke, *supra* note 22, at 59.

29. *See generally* Nigel John Howcroft, *Universal vs. Territorial Models for Cross-Border Insolvency: The Theory, the Practice, and the Reality that Universalism Prevails*, 8 U.C. DAVIS BUS. L.J. 366 (2008) (discussing the theory and practice underlying the territorialism-universalism debate).

30. *Id.*; Adams & Finke, *supra* note 22, at 48.

31. Adams & Finke, *supra* note 22, at 49; *see* Liza Perkins, Note, *A Defense of Pure Universalism in Cross-Border Corporate Insolvencies*, 32 N.Y.U. J. INT'L L. & POL. 787, 788 (2000); Robert K. Rasmussen, *A New Approach to International Insolvencies*, 19 MICH. J. INT'L L. 1, 6-10 (1997).

32. Adams & Fincke, *supra* note 22, at 48.

33. *Id.* at 48-49. This is the approach taken by the United States under the recently enacted Chapter 15 of the U.S. Bankruptcy Code. 11 U.S.C. § 1501-1532 (2010); *see infra* notes 79-111 and accompanying text.

34. Adams & Fincke, *supra* note 22, at 50; Jay L. Westbrook, *A Global Solution to International Default*, 98 MICH. L. REV. 2276, 2300-01 (2000).

35. Westbrook, *supra* note 34, at 2301.

greater clarity and certainty to interested parties.[36] They also claim that universalism promotes fairness and equality in the distribution of assets to creditors by administering the case in a single central forum.[37]

However, critics suggest that governments are reluctant to adopt universalism because it requires giving up a degree of national sovereignty, and generally countries tend to be unwilling to have foreign laws apply within their territory.[38] Additionally, under the universalism approach, because most large multinational companies are based in developed countries, filing for bankruptcy protection would result in the laws of developed countries being applied over the laws of less-developed countries.[39] Finally, critics urge that it is not always clear which jurisdiction is the home country for corporations that have business interests worldwide.[40] In addition to the place of incorporation, other factors must be considered when determining the home country, including location of assets and creditors and the location where the debtor's business is primarily conducted.[41]

C. The UNCITRAL Model Law

The United Nations General Assembly established UNCITRAL in 1966[42] "to further the progressive harmonization and unification of the law of international trade."[43] In an effort to promote consistency in international insolvency proceedings, UNCITRAL adopted the UNCITRAL Model Law on Cross-Border Insolvency.[44] The UNCITRAL Model Law was designed to: 1) promote cooperation between courts of different countries in cross-border insolvency; 2) provide greater legal certainty for trade and investments; 3) provide fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and the debtor; 4) protect and maximize the value of the debtor's assets; and 5) facilitate

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36. Adams & Fincke, *supra* note 22, at 52.

37. *Id.*

38. *Id.* at 53; Frederick Tung, *Is International Bankruptcy Possible?*, 23 MICH. J. INT'L L. 31, 46 (2001). For a detailed discussion of these arguments, see Chung, *supra* note 14, at 93.

39. Adams & Fincke, *supra* note 22, at 54.

40. *Id.*

41. *Id.* (citing Barclays Bank v. Maxwell Commc'n Corp., 170 B.R. 800, 817, n.22 (Bankr. S.D.N.Y. 1994)).

42. G.A. Res. 2205 (XXI), U.N. Doc. A/RES/2205 (Dec. 17, 1966).

43. *See Origin, Mandate and Competition, About UNCITRAL*, UNCITRAL, http://www.uncitral.org/uncitral/en/about/origin.html (last visited Dec. 21, 2010). UNCITRAL's website indicates that "[t]he Commission has since come to be the core legal body of the United Nations system in the field of international trade law." *Id.*

44. Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law, G.A. Res. 52/158, Annex, U.N. Doc. A/RES/52/158/Annex (Jan. 30, 1998).

the rescue of financially troubled businesses.[45] The law addresses the cross-border insolvency problem by providing foreign assistance for an insolvency proceeding taking place in an enacting country, foreign representatives with access to the courts of the enacting country, and recognition of foreign proceedings, cross-border cooperation, and coordination of concurrent insolvency proceedings.[46] Both the International Monetary Fund and the World Bank have recommended that countries adopt the UNCITRAL Model Law.[47] Eighteen countries have adopted legislation based on UNCITRAL Model Law provisions.[48] While a detailed discussion of all the provisions of the UNCITRAL Model Law is beyond the scope of this Article, a brief discussion of several points is useful in understanding U.S.[49] and Chinese bankruptcy laws.[50]

Under the UNCITRAL Model Law, a foreign representative is provided direct access to the courts of the enacting State.[51] In addition to this general right of access, the foreign representative may commence a local insolvency proceeding,[52] participate in an insolvency proceeding,[53] or intervene in proceedings concerning individual actions in the enacting State that affect the debtor or its assets.[54] Likewise, the UNCITRAL Model Law authorizes the courts of the enacting State to seek assistance from foreign

45. *Id.*

46. Biery, Boland & Cornwell, *supra* note 2, at 50.

47. *See* INT'L MONETARY FUND LEGAL DEP'T, *Cross-Border Insolvency Issues*, *in* ORDERLY & EFFECTIVE INSOLVENCY PROCEDURES: KEY ISSUES (1999), *available at* http://www.imf.org/external/pubs/ft/orderly/index.htm; WORLD BANK PRINCIPLES AND GUIDELINES FOR EFFECTIVE INSOLVENCY AND CREDITOR RIGHTS SYSTEMS (2001), *available at* http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2004/11/16/000160016_20041116125658/Rendered/PDF/306470v.10DC200100008.pdf.

48. *See* Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law, G.A. Res. 52/158, Annex, U.N. Doc. A/RES/52/158/Annex (Jan. 30, 1998). Countries adopting the Model Law include Eritrea (1998); Japan, Mexico and South Africa (2000); Montenegro (2002); British Virgin Islands, Poland and Romania (2003); Serbia (2004); United States (2005); Columbia, Great Britain, New Zealand and Republic of Korea (2006); Slovenia (2007); Australia (2008); and Canada and Mauritius (2009). Rep. of the Comm'n on Int'l Trade Law, June 21-July 9, 2010, U.N. Doc A/CN.9/694; 43d Sess. (2010). *See generally* Jenny Clift, *The UNCITRAL Model Law on Cross Border Insolvency—A Legislative Framework to Facilitate Coordination and Cooperation in Cross-Border Insolvency*, 12 TUL. J. INT'L & COMP. L. 307, 333-39 (2004) (discussing the legislation enacted by various countries).

49. *See infra* notes 80-111 and accompanying text.

50. *See infra* notes 112-157 and accompanying text.

51. Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law, G.A. Res. 52/158, Annex, art. 9, U.N. Doc. A/RES/52/158 (Jan. 30, 1998). These types of requests are commonly referred to as inbound requests.

52. *Id.* art. 11.

53. *Id.* art. 12.

54. *Id.* art. 24.

jurisdictions on behalf of a local insolvency proceeding.[55]

The UNCITRAL Model Law addresses two kinds of foreign proceedings: foreign main proceedings and foreign non-main proceedings.[56] A foreign main proceeding takes place in the state where the debtor's "centre of main interests" is located.[57] Centre of main interests is not defined in the UNCITRAL Model Law. But the Guide to Enactment of the UNCITRAL Model Law on Cross-Border Bankruptcy[58] indicates that the term, drawn from the European Union Convention on Insolvency Proceedings,[59] is meant to "correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties."[60] A foreign non-main proceeding is any foreign proceeding, other than a main proceeding, taking place in a state where the debtor has a place of operations and carries out a non-transitory economic activity within that place of operations.[61]

In a foreign main proceeding, the court may issue relief including a stay of actions of individual creditors against the debtor, a stay of enforcement proceedings against the debtor's assets, and a suspension of the debtor's right to transfer or encumber assets.[62] The granting of exceptions to this type of relief is left to the laws of the enacting State.[63] In a foreign non-main proceeding, the court may grant the same type of relief upon application from the foreign representative.[64] The court may also grant additional discretionary relief for the benefit of a foreign proceeding, whether main or non-main, at the request of the foreign representative.[65] This additional relief may include appointing an administrator for the debtor's assets, providing access to information about the assets and liabilities of the debtor, and any other relief available under the laws of the

55. *Id.* art. 25. These requests are often referred to as outbound requests.

56. *Id.* art. 2.

57. *Id.* art. 2(b).

58. U.N. COMM'N ON INT'L TRADE LAW (UNICTRAL) MODEL LAW ON CROSS-BORDER INSOLVENCY WITH GUIDE TO ENACTMENT, U.N. Sales No. E.99.V.3 (1997) *available at* http://www.uncitral.org/pdf/english/texts/insolven/insolvency-e.pdf [hereinafter GUIDE TO ENACTMENT]. The Guide to Enactment was prepared by the Secretariat at the request of UNCITRAL and was designed to provide background and explanatory information in order to make the UNCITRAL Model Law a more effective tool for legislators. Guide to Enactment, paras. 9-10.

59. *Id.* paras. 72-73.

60. Council Regulations (EC) 1346/2000, 2000 O.J. (L 160) 1, para. 13.

61. Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law, G.A. Res. 52/158, Annex, art. 2(c), 2(f), U.N. Doc. A/RES/52/158/Annex (Jan. 30, 1998).

62. *Id.* art. 20(1).

63. *Id.* art. 20(2).

64. *Id.* art. 21(1)(a)-(c).

65. *Id.* art. 21.

enacting State.[66]

The UNCITRAL Model Law also contains articles directing both the courts of the enacting State and the person or body administering the insolvency proceedings in the enacting State to cooperate to the maximum extent possible. These articles also authorize them to communicate directly with foreign courts or foreign representatives.[67] Such cooperation may be implemented by any appropriate means, including communication of information, coordination of administration and supervision of the debtor's assets and affairs, approval or implementation of agreements concerning the coordination of proceedings, coordination of concurrent proceedings regarding the same debtor,[68] and other forms or examples of cooperation the enacting State may wish to add.[69] These cooperation provisions are intended to address a perceived gap in many national bankruptcy laws by providing express authorization for courts to extend cooperation in the areas covered.[70]

III. OVERVIEW OF THE U.S. APPROACH TO CROSS-BORDER BANKRUPTCY

A. 11 U.S.C. § 304

Until recently, U.S. bankruptcy law addressed international bankruptcy proceedings through 11 U.S.C. § 304.[71] The purpose of 11 U.S.C. § 304 was to "administer assets located in [the United States], to prevent dismemberment by local creditors of assets located here, or for other appropriate relief."[72] Under this provision, a foreign representative in a foreign insolvency case could file an ancillary proceeding in U.S. bankruptcy court. The ancillary case allowed a foreign representative to gather U.S. assets, obtain discovery, and otherwise protect and facilitate administration of the foreign bankruptcy case.[73] Once the ancillary case was filed, the bankruptcy court could order "appropriate relief,"[74] thus providing bankruptcy judges with broad authority over U.S. insolvency cases.

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66. *Id.* art. 21(1)(b)-(d).

67. *Id.* arts. 25(1)-(2), 26(1)-(2).

68. The UNCITRAL Model Law also provides more specific suggestions concerning the coordination of concurrent proceedings involving the debtor. *See* Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law, G.A. Res. 52/158, Annex, arts. 28-32, U.N. Doc. A/RES/52/158/Annex (Jan. 30, 1998).

69. *Id.* art. 27(a)-(e).

70. GUIDE TO ENACTMENT, *supra* note 58, paras. 39-41.

71. 11 U.S.C. § 304 (repealed 2005).

72. H.R. Rep. No. 95-595, at 324-25 (1977).

73. Adams & Fincke, *supra* note 22, at 73 (citing ALAN N. RESNICK & HENRY J. SOMMER, COLLIER ON BANKRUPTCY, ¶ 304.04[1] (15th ed. 2004)).

74. 11 U.S.C. § 304(b)(3) (repealed 2005).

In determining appropriate relief, the court was required to consider six factors: 1) just treatment of all claims holders in the bankrupt estate, 2) protection of U.S. claims holders against prejudice and inconvenience in the foreign proceeding, 3) prevention of preferential or fraudulent dispositions of property in the estate, 4) distribution of the proceeds of the estate substantially in accordance with U.S. bankruptcy law, 5) comity, and 6) provision of an opportunity for a fresh start for the individual (if appropriate).[75] Inherent conflicts are contained in these factors. For example, distributing the estate according to U.S. bankruptcy law and granting comity to the foreign bankruptcy law are two factors likely to conflict. In applying these two factors, U.S. courts sometimes favored the interests of U.S. creditors over foreign creditors and debtors,[76] inconsistently granting relief to foreign representatives.[77]

B. Chapter 15

In 2005, because of the inconsistent application of 11 U.S.C. § 304 and general dissatisfaction with its results,[78] Congress repealed 11 U.S.C. § 304 and adopted a new chapter of the bankruptcy code entitled Ancillary and Other Cross-border Cases (Chapter 15) codified at 11 U.S.C. § 1501-1532.[79] This new chapter was specifically designed to incorporate the UNCITRAL Model Law.[80] Chapter 15 applies in four cases: 1) a foreign court or representative seeks assistance in the United States in connection with a foreign proceeding; 2) assistance is sought in a foreign country in connection with a U.S. bankruptcy case; 3) a foreign case and a U.S. bankruptcy case involving the same debtor are pending concurrently; or 4)

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75. 11 U.S.C. § 304(c)(1)-(6) (repealed 2005).

76. Adams & Fincke, *supra* note 22, at 73 (citing Todd Kraft & Allison Aranson, *Transnational Bankruptcies: Section 304 and Beyond*, 1993 COLUM. BUS. L. REV. 329, 340 (1940), and Anne Norby Nielsen, Note, *Section 304 of the Bankruptcy Code: Has it Fostered the Development of an "International Bankruptcy System"?*, 22 COLUM. J. TRANSNAT'L L. 541, 554 (1984)).

77. *See* Kevin J. Beckering, *United States Cross-Border Corporate Insolvency: The Impact of Chapter 15 on Comity and the New Legal Environment*, 14 LAW & BUS. REV. AM. 281, 291-299 (2008) (discussing the inconsistent application of 11 U.S.C. § 304 (repealed 2005)). *See also* Lesley Salafia, *Cross-Border Insolvency Law in the United States and its Application to Multinational Corporate Groups*, 21 CONN. J. INT'L L. 297, 305-316 (2006).

78. *See* Jennifer Greene, *Bankruptcy Beyond Borders: Recognizing Foreign Proceedings in Cross-Border Insolvencies*, 30 BROOK. J. INT'L L. 685 (2005) (critiquing 11 U.S.C. § 304 (repealed 2004) and discussing how the then proposed Chapter 15 could provide a solution).

79. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23. *See* Aaron L. Hammer & Matthew E. McClintock, *Understanding Chapter 15 of the United States Bankruptcy Code: Everything You Need to Know About Cross-Border Insolvency Legislation in the United States*, 14 LAW & BUS. REV. AM. 257 (2008) (discussing Chapter 15).

80. 11 U.S.C. § 1501(a) (2010).

creditors in a foreign country have an interest in requesting the commencement of, or participation in, a U.S. bankruptcy case.[81]

1. Commencement of the Ancillary Case and Provisional Relief

An ancillary case under Chapter 15 is commenced when a foreign representative[82] files a petition[83] for recognition of a foreign proceeding[84] under 11 U.S.C. § 1515.[85] Once the petition is filed, the foreign representative may request, and the court may grant, provisional relief to protect the assets of the debtor or interests of the creditors.[86] Unless specifically extended, any provisional relief granted terminates when the petition for recognition is granted.[87]

2. Recognition of the Foreign Proceeding and Granting Relief

Once the petition is filed, the U.S. court must enter an order recognizing the foreign proceeding if three requirements are met: 1) the foreign proceeding to be recognized is a foreign main proceeding or a foreign non-main proceeding under Chapter 15, 2) the foreign representative applying for recognition is a person or body, and 3) the

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81. 11 U.S.C. § 1501(b)(1)-(4) (2010).

82. A foreign representative is "a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs as a representative of such foreign proceeding." 11 U.S.C. § 101(24) (2010). Chapter 15 specifically provides that filing a petition under 11 U.S.C. § 1515 does not, by itself, subject the foreign representative to the jurisdiction of any U.S. court for any other purpose. 11 U.S.C. § 1510 (2010).

83. The petition must be accompanied by a certified copy of the decision commencing the foreign proceeding and appointing the foreign representative, a certificate from the foreign court affirming the existence of the foreign proceeding and the appointment of the foreign representative, or other evidence acceptable to the court of the existence of the foreign proceeding and the appointment of the foreign representative. 11 U.S.C. § 1515(b)(1)-(3) (2010). These documents must be translated into English. 11 U.S.C. § 1515(d) (2010). Also, the petition must be accompanied by a statement identifying all foreign proceedings regarding the debtor known to the foreign representative. 11 U.S.C. § 1515(c) (2010).

84. A foreign proceeding is "a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which the proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation." 11 U.S.C. § 101(23) (2010).

85. 11 U.S.C. § 1504 (2010).

86. 11 U.S.C. § 1519 (2010). The relief that may be granted includes staying execution against the debtor's assets, entrusting administration or realization of the debtor's assets in the U.S. to the foreign representative or another person authorized y the court to protect and preserve the value of assets that are perishable, susceptible to devaluation or otherwise in jeopardy. § 1519(a)(1)-(2).

87. § 1519(b).

petition meets the requirements of 11 U.S.C. § 1515.[88] Under Chapter 15, a foreign main proceeding is a foreign proceeding pending in the country where the debtor has the center of its main interests.[89] A foreign non-main proceeding is a foreign proceeding other than a foreign main proceeding pending in a country where the debtor has an establishment.[90]

Once the case is recognized as a foreign main proceeding, 11 U.S.C. § 1520 provides the foreign representative with certain relief, including an automatic stay with regard to the debtor and its property within the United States, the right to operate the debtor's business, and the right to deal with the debtor's property in the same manner as a trustee or debtor-in-possession in the United States.[91]

In both foreign main proceedings and foreign non-main proceedings, the court may grant additional relief at the request of the foreign representative when necessary to effectuate the purpose of Chapter 15 and to protect the assets of the debtor or interests of the creditors.[92] This additional relief may include: 1) staying any actions concerning the debtor's assets, rights, obligations, or liabilities; 2) staying execution against the debtor's assets to the extent not already stayed under 11 U.S.C. § 1520(a); 3) suspending the right to transfer, encumber or otherwise dispose of the debtor's assets; 4) providing for examination of witnesses, taking of evidence or delivery of information concerning the debtor's assets, affairs, rights, obligations, or liabilities; entrusting the debtor's assets within the United States to the foreign representative or another person authorized by the court; 5) extending the provisional relief granted under 11 U.S.C. § 1519(a); and 6) granting any additional relief available to a trustee, with certain exceptions.[93] In granting such relief in a foreign non-main proceeding, the court must be satisfied that the relief relates to assets that, under U.S. law, should be administered in the foreign non-main proceeding or concerns information required in that proceeding.[94]

3. Cooperation and Administration of Concurrent Proceedings

Chapter 15 also has specific modified universalism provisions that impart cooperation with foreign courts and foreign representatives, as well

88. 11 U.S.C. § 1517(a) (2010).

89. 11 U.S.C. § 1502(4) (2010). The definition of foreign main proceeding and foreign non-main proceeding are based on, though not identical to, the definitions of those terms under the UNCITRAL Model Law. *See supra* notes 56-61 and accompanying text.

90. 11 U.S.C. § 1502(5) (2010). An establishment is defined as any place of operation where the debtor carries out a non-transitory economic activity. 11 U.S.C. § 1502(2) (2010).

91. 11 U.S.C. § 1520(a)(1)-(4) (2010).

92. 11 U.S.C. § 1521(a) (2010).

93. § 1521(a)(1)-(7).

94. 11 U.S.C. § 1521(c) (2010).

as procedures governing the administration of concurrent proceedings.[95] Consistent with the goals set forth in 11 U.S.C. § 1501, the U.S. bankruptcy court is directed to cooperate, to the maximum extent possible, with a foreign court or foreign representative, either directly or through the bankruptcy trustee.[96] The U.S. court is authorized to communicate directly with, or request information or assistance from, a foreign court or foreign representative, subject to the rights of notice and participation for a party in interest.[97] The same requirement of cooperation and authorization for communication applies to the bankruptcy trustee or other person authorized by the court, subject to the bankruptcy court's supervision.[98] These cooperation mandates may be implemented by "any appropriate means," including appointment of a person or body to act at the discretion of the court, communication of information by any means considered appropriate by the court, coordination of the administration of the debtor's assets and affairs, approval or implementation of agreements concerning such coordination, and coordination of concurrent proceedings regarding the debtor.[99]

When a foreign proceeding and a case under Chapter 15 concurrently regard the same debtor, the bankruptcy court is directed to seek cooperation and coordination as described above.[100] Additionally, the court is also subject to specific rules regarding coordinating the U.S. and foreign cases.[101]

When the U.S. case is pending at the time the petition for recognition of the foreign proceeding is filed, any provisional or permanent relief granted must be consistent with the relief granted in the U.S. bankruptcy case.[102] Also, 11 U.S.C. § 1520 will not apply to provide the relief described within that section,[103] even if the foreign proceeding is recognized as a foreign main proceeding.[104]

When U.S. Chapter 15 commences after recognition of the foreign proceeding or after the filing date of the petition for recognition, the relief granted under 11 U.S.C. §§ 1519 and 1521 must be reviewed by the court and either modified or terminated if it is inconsistent with the U.S. case.[105]

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95. These provisions parallel the UNCITRAL Model Law provisions. *See* Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law, G.A. Res. 52/158, Annex, arts. 25-32, U.N. Doc. A/RES/52/158/Annex (Jan. 30, 1998).

96. 11 U.S.C. § 1525(a) (2010).

97. 11 U.S.C. § 1525(b) (2010).

98. 11 U.S.C. § 1526(a)-(b) (2010).

99. 11 U.S.C. § 1527(1)-(5) (2010).

100. 11 U.S.C. § 1529 (2010).

101. *See infra* notes 102-112 and accompanying text.

102. § 1529(1)(A).

103. *See supra* note 91 and accompanying text.

104. 11 U.S.C. § 1529(1)(B) (2010).

105. § 1529(2)(A).

Further, if the foreign proceeding is a foreign main proceeding, the stay and suspension referred to in 11 U.S.C. § 1520(a) must be modified or terminated if it is inconsistent with the relief granted in the U.S. case.[106] However, in granting, extending, or modifying relief to the foreign representative in a foreign non-main proceeding, the court must be satisfied that the relief relates to assets that, under U.S. law, should be administered or concern information required in the U.S. case.[107]

Finally, in achieving cooperation and coordination required under Chapter 15, the court may, after proper notice and hearing, dismiss the U.S. case or suspend all U.S. proceedings if the interests of creditors and the debtor or the purposes of Chapter 15 would be better served by dismissal or suspension.[108]

IV. CROSS-BORDER BANKRUPTCY UNDER CHINA'S CORPORATE BANKRUPTCY LAW

A. Overview of China's Corporate Bankruptcy Law[109]

On August 27, 2006, the Standing Committee of the National People's Congress adopted the Corporate Bankruptcy Law of the People's Republic of China.[110] The new law, effective June 1, 2007, replaced the existing enterprise bankruptcy law enacted in 1986.[111] China's new bankruptcy law is "formulated in order to regulate the procedure of corporate bankruptcy, to wind up debts and indebtedness fairly, to protect the legitimate rights and interests of creditors and debtors, and to maintain the order of the socialist market economy."[112] Modeled after western bankruptcy laws and standards,[113] the new Corporate Bankruptcy Law

106. § 1529(2)(B).

107. § 1529(3).

108. 11 U.S.C. § 1529(4) (2010) (referencing the relief available under 11 U.S.C. § 305(a)(1)-(2)(2010)).

109. This overview is largely drawn from the author's previous work in this area. *See* Steven J. Arsenault, *The Westernization of Chinese Bankruptcy: An Examination of China's New Corporate Bankruptcy Law through the Lens of the UNCITRAL Legislative Guide to Insolvency Law*, 27 PENN ST. INT'L L. REV. 45 (2008) (providing a detailed examination of China's Corporate Bankruptcy Law and a comparison to U.S. bankruptcy law).

110. [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007) art. 1.

111. *See* Adam Li, *China: Bankruptcy and Insolvency Law and Policy*, *in* THE LAW OF INTERNATIONAL INSOLVENCIES AND DEBT RESTRUCTURINGS 127-141 (James R. Silkenat & Charles D. Schmerler, eds., 2006) (discussing the prior Chinese bankruptcy law).

112. *Id.*

113. Ann vom Eigen, *China's New Bankruptcy Law Encourages Investment*, 25-OCT. AM. BANKR. INST. J. 8 (2006); Mary Swanton, *Bankruptcy: China Passes Its First Unified Bankruptcy Law*, INSIDE COUNS., Nov. 2006, at 68. Western bankruptcy law has been used as the basis for other countries' bankruptcy laws. For example, Chapter 11 of the U.S.

represents a significant step forward in Chinese bankruptcy law.

The new bankruptcy law applies broadly to all types of business enterprises in China including most state-owned[114] and non-state-owned enterprises.[115] The new law provides for either a voluntary bankruptcy filing by the debtor or an involuntary bankruptcy filing by a creditor through an application to the People's Court[116] in the debtor's place of residence.[117] Under the new law, in order to voluntarily file for bankruptcy, the business entity must either: 1) be unable to repay debts that fall due and have insufficient assets to repay debts in full, or 2) must be clearly insolvent.[118] A debtor meeting these basic filing criteria may submit a bankruptcy application to the People's Court.[119] However, an involuntary filing by a creditor is held to a lower filing standard; a creditor need merely show that the debtor is unable to repay the debt due.[120] The new law provides three different types of bankruptcy proceedings: reorganization, settlement, and liquidation.[121] All three types are available to a debtor filing for voluntary bankruptcy protection, but only reorganization and liquidation are available in an involuntary proceeding.[122]

Once an application is filed with the People's Court in China, the court has fifteen days to review the application and determine whether to accept or reject the filing.[123] If the People's Court accepts the

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Bankruptcy Code served as the basis for amendments to the bankruptcy law in France, Japan and Korea in recent years. *See* Sandor E. Schick, *Globalization, Bankruptcy and the Myth of the Broken Bench*, 80 AM. BANKR. L.J. 219 (2006).

114. Approximately 2000 state-owned enterprises are excluded from the scope of the new bankruptcy law designated by the State Council. These are primarily business entities engaged in military or mining operations. *See* James H.M. Sprayregent & Jonathan P. Friedland, *The Middle Kingdom's Chapter 11? China's New Bankruptcy Law Comes into Sight*, 23-JAN AM. BANKR. INST. J. 34 (2005).

115. The new law applies to all "[c]orporate legal persons." [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007) art. 2.

116. *Id.* art. 7.

117. *Id.* art. 3.

118. *Id.* art. 2. However, the new law does not explicitly define the term "insolvent." *See* Arsenault, *supra* note 109, at 84-85 (discussing the issues raised this lack of definition).

119. [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007) art. 7.

120. *Id.*

121. *Id.* The addition of provisions allowing for reorganization is a significant feature of the new Chinese bankruptcy law and is consistent with prevailing international practice. *See* Weijing Wu, *Commencement of Bankruptcy Proceedings in China Key Issues in the Proposed New Enterprise Bankruptcy and Reorganization Law*, 35 VICT. U. WELLINGTON L. REV. 239, 249 (2004).

122. [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007) art. 7.

123. The law refers to this decision as "taking cognizance of a bankruptcy application." *Id.* arts. 10-11.

application,[124] all property belonging to the debtor and any property later obtained becomes property of the bankruptcy estate, subject to the jurisdiction of the court.[125] Additionally, any repayment by the debtor to an individual creditor is invalid.[126]

Under the Corporate Bankruptcy Law, the court must appoint a professional and independent administrator. This receiver has broad powers to manage the debtor's property and business affairs.[127] The receiver has the right not only to decide day-to-day expenses and other necessary expenses of the debtor, but also to manage, distribute, and dispose of the debtor's property and estate.[128] The receiver may also recover improperly transferred property.[129] Specifically, the receiver may ask the court to nullify transactions committed up to one year prior to the bankruptcy filing if the transactions involved transfers of property without compensation, transactions at a clearly unreasonable price, provisions of guarantees for debt without property, repayment of debts not yet due, or abandonment of debt.[130] The receiver may also petition the court to nullify any repayment to an individual creditor made within six months prior to filing if the debtor was insolvent. However, a receiver may not petition to nullify transactions or repayments that benefited the debtor's property and the bankruptcy estate.[131] Finally, any action to conceal and transfer the debtor's property for purpose of evasion, including fabrication of indebtedness or admitting false indebtedness, shall be declared invalid.[132]

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124. It is the acceptance of the bankruptcy application by the court, rather than its initial filing, that has legal effect under the Chinese law. Unlike U.S. law, which provides for an automatic stay of proceedings and other actions by creditors against the debtor upon filing of the bankruptcy petition, *see* 11 U.S.C. § 362 (2010), under the Chinese law, it is the court's acceptance of the bankruptcy application that triggers an automatic stay of creditor's actions against the debtor and a stay of execution proceedings against the debtor's assets. [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007) art. 19-20. Even then, the automatic stay only applies until a receiver is appointed to manage the debtor's property. New civil suits can be commenced against the debtor after the bankruptcy is commenced by filing suit in the People's Court that has jurisdiction over the debtor's bankruptcy proceeding. [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007) art. 20.

125. [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007) art. 30.

126. *Id.* art. 16.

127. *Id.* arts. 22, 25. The receiver is required to take over the property, books and records of the debtor; investigate and report on the debtor's property; manage the affairs and day-to-day expenses of the debtor; manage, distribute and dispose of the debtor's property; and represent the debtor in legal proceedings. *Id.* art. 25.

128. *Id.* art. 25(4), (6).

129. *Id.* art. 34.

130. *Id.* art. 31.

131. *Id.* art. 32.

132. *Id.* art. 33.

In each of the above cases, the receiver has the power to recover the debtor's property obtained by improper acts.[133]

Once the court cognizes the bankruptcy, it must determine a time limit for creditors to declare their debts. The time limit must be between thirty days and three months,[134] and creditors are required to declare their debts within the time limit specified.[135] Creditors must specify in writing the amount of their debts, any relevant evidence of the debts, and whether the debts are secured by property.[136] If a creditor fails to declare his or her debt within the specified time limit, he or she may make a late declaration before the final distribution of the bankruptcy estate.[137] However, the creditor will not be given any supplementary distribution for distributions already made. The costs and expenses of examining and confirming the late filing will be the responsibility of the creditor.[138] Moreover, a creditor who has not declared his or her debt will not be allowed to exercise creditor rights under the Corporate Bankruptcy Law.[139]

Once the declaration of debts is received, the receiver must keep records of the declarations, scrutinize the debts declared, and prepare a statement of debts[140] to be presented for examination and verification at the first creditors' meeting.[141] Either the debtor or creditors may bring suit in the People's Court if they disagree with the statement of debts prepared by the receiver.[142] Under the new law, claims of creditors holding the equivalent of a security interest in a specific property generally receive first priority against that specific property.[143] Priority is then given to bankruptcy costs and expenses. These consist of expenses for litigation of the bankruptcy estate, expenses for managing and disposing of the debtor's property, and fees and expenses of the receiver.[144] Secondary priority is given to debts for the common benefit. These debts include contracts into which the receiver has entered, debts incurred by management without cause, debts incurred as a result of unjust benefit to the debtor, and costs for personal injury caused by the receiver or the property and estate of the

133. *Id.* art. 34.
134. *Id.* art. 45.
135. *Id.* art. 48.
136. *Id.* art. 49.
137. *Id.* art. 56.
138. *Id.*
139. *Id.*
140. *Id.* art. 57.
141. *Id.* art. 58.
142. *Id.*
143. *Id.* art. 109; Dexter Roberts, *China's New Mantra: Creditors First*, BUS. WK. (Aug. 31, 2006), http://www.businessweek.com/globalbiz/content/aug2006/gb20060830_421789.htm?campaign_id=rss_topStories.
144. [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007) art. 41.

debtor.[145] Wages and other funds owed to staff and employees receive next priority[146] followed by social insurance expenses owed by the debtor and, finally, ordinary unsecured debts.[147] When assets are insufficient to repay the claims in full within each preference category, they are paid pro rata.[148]

B. The Corporate Bankruptcy Law and Cross-Border Bankruptcies

The Corporate Bankruptcy Law includes two provisions dealing with international or cross-border bankruptcies, addressing both the application of China's bankruptcy law outside of China and the recognition of the judgments of foreign bankruptcy courts in China. Outside China, the Corporate Bankruptcy Law makes clear that bankruptcy proceedings initiated in China are binding on the debtor's property and estate situated outside of China.[149] Thus, the new law specifically provides for extraterritorial application of its provisions.

Regarding the recognition of foreign bankruptcy court judgments in China, the new law provides that judgments and decisions in foreign courts involving the debtor's property or estate may be recognized by the People's Court.[150] However, in order to do so, the People's Court must scrutinize the judgment in accordance with applicable international treaties. It may recognize and enforce such judgments when the court determines that it does not "impair the security and sovereignty of the country and social and public interests or the legitimate rights and interests of the debtors within the People's Republic of China."[151]

While much of the Corporate Bankruptcy Law is written in terms of requirements, including the provision that bankruptcy proceedings in China *are* binding on the debtor's property outside of China,[152] the language involving recognition of foreign judgments is permissive – providing that the foreign judgment *can* be recognized and that after scrutiny the People's Court *may* recognize the judgment.[153] This language is extremely vague and imprecise, and it may lead to a concern regarding the enforceability of

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145. *Id.* arts. 42, 113.

146. Prioritization of claims is a significant change from China's prior bankruptcy law, particularly with regard to claims by employees. Under China's former law, employee claims took priority over the claims of secured creditors. *See* John Rapisardi & Deryck Palmer, *Precedent Needed*, 26 INT'L FIN L. REV. 4 (2007); vom Eigen, *supra* note 113. *See* Arsenault, *supra* note 109, at 57-58 (discussing in more detail the political compromises necessary to implement this change).

147. [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007) art. 113.

148. *Id.*

149. *Id.* art. 5.

150. *Id.*

151. *Id.*

152. *Id.* art. 5.

153. *Id.*

foreign bankruptcy judgments in China. This concern regarding recognizing foreign judgments is precisely the kind of issue that cross-border insolvency proceedings face in general, considering that "international insolvency is an administrative nightmare when no country holds complete jurisdiction over . . . the debtor, its assets, or its creditors."[154]

While the language is imprecise, China's Corporate Bankruptcy Law contains elements of both universalism and modified universalism.[155] For cases filed in China involving Chinese business entities, China takes jurisdiction over the debtor's worldwide assets and their distribution.[156] For cases involving foreign companies with assets in China, the new law seems to assume that the main insolvency case will be maintained in the debtor's home country. It also assumes China will maintain an ancillary or secondary case subject to the requirement that enforcement not offend Chinese law, Chinese security, sovereignty and public interests, or the interests of the debtor in China.[157] Thus, the arguments of supporters and critics of the universalism and modified universalism approaches discussed above[158] would also apply to the cross-border insolvency provisions of China's Corporate Bankruptcy Law.

V. PROPOSAL FOR ADJUSTMENTS TO CHINA'S LAW

China's Corporate Bankruptcy Law incorporates theories of universalism and modified universalism in its approach to cross-border insolvency cases. The Corporate Bankruptcy Law largely follows the guidance offered by the UNCITRAL Model Law. Having examined the new law in this area, two proposed adjustments are appropriate for China's Corporate Bankruptcy Law: clarify the language of Article 5 and add cooperation language.

A. Clarify the Language of Article 5 of the Corporate Bankruptcy Law

The Corporate Bankruptcy Law's permissive language concerning the recognition of foreign bankruptcy judgments in China is extremely vague and imprecise.[159] Foreign parties, already uneasy about the application of

154. Biery, Bolund & Cornwell, *supra* note 2, at 48 (citing Gilreath, *supra* note 2, at 401).

155. *See supra* notes 30-35 and accompanying text.

156. *See* [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007) art. 5.

157. *Id.*

158. *See supra* notes 36-41 and accompanying text.

159. *See supra* notes 149-150 and accompanying text.

China's laws to foreign entities,[160] are likely to view this language with concern. This concern has the potential to undermine both the goals of cooperation under the UNCITRAL Model Law and the foreign economic investment activity that China seeks. As one commentator indicated, effective and predictable rules of insolvency create a better environment for foreign direct investment, allowing lenders and international investors to more accurately analyze and assess risks associated with specific transactions.[161]

China should revise the Corporate Bankruptcy Law to provide the court with more specific guidance about the exercise of its discretion in enforcing foreign bankruptcy judgments. The language most likely to concern foreign investors is the reference to the "security and sovereignty of the country and social and public interests."[162] This type of language is directed at protecting the state rather than the economic interests of the debtors and creditors involved in the insolvency proceedings. Modified universalism preserves the ability of local courts to evaluate the fairness of the main case proceeding, to protect the interests of local creditors, and, in some cases, even assess whether compliance offends the country's public policy.[163] However, modified universalism's focus on the state interest outside the insolvency proceeding is too broad. This type of language has historically caused foreign investors to question the applicability of the rule of law to foreigners in China.[164]

Of course, eliminating such a provision from China's law would forfeit some degree of sovereignty and control that, at least at the time the Corporate Bankruptcy Law was adopted, was important to Chinese legislators. Additionally, China would likely argue that the insolvency laws of other countries that are based on the UNCITRAL Model Law include similar policy-based discretion. Indeed, Chapter 15 of the U.S. Bankruptcy Code includes a provision allowing the Bankruptcy Court to refuse to hear an action that "would be manifestly contrary to the public policy of the

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160. *See, e.g.*, Aaron Back, *U.S. Firms Criticize Chinese Policy - Business Group's Survey Shows Growing Concern About Protectionism, but Optimism Over Economy*, WALL ST. J., April 27, 2010, at A13. *See also* Stanley Lubman, *Looking for Law in China*, 20 COLUM. J. ASIAN L. 1, 30-32 (2006) (describing local protectionism exhibited by China's judiciary).

161. Fernando Locatelli, *International Trade and Insolvency Law: Is the UNCITRAL Model Law on Cross-Border Insolvency an Answer for Brazil? (An Economic Analysis of its Benefits on International Trade)*, 14 LAW & BUS. REV. AM. 313, 323 (2008); *see id.* at 320-323 (examining in detail the economic basis for insolvency law in general and specifically cross border insolvency provisions).

162. [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007) art. 5.

163. *See supra* notes 32-35 and accompanying text.

164. *See* Back, *supra* note 160, at A13; Lubman, *supra* note160, at 30-32.

United States."[165] China should revisit this issue and balance its public policy concerns against the effects of the Corporate Bankruptcy Law's vague provisions on foreign investment.

B. Add Cooperation Language to the Corporate Bankruptcy Law Similar to 11 U.S.C. § 1501-1532

China should consider adding cooperation instructions for Chinese courts hearing in cross-border insolvency cases. This instruction could be modeled after the cooperation and concurrent administration provisions contained in Chapter 15 of the U.S. Bankruptcy Code.[166] Such a change would be less controversial than the elimination of the public interests language discussed above.[167] Although it would not provide significantly more substantive protection, potential economic investors could see it as indicating a more open and cooperative approach to foreign proceedings.

This type of cooperative language is suggested by the UNCITRAL Model Law[168] and was included in Chapter 15 of the U.S. Bankruptcy Code. Chapter 15 directs U.S. courts to cooperate with foreign insolvency courts and foreign representatives "to the maximum extent possible."[169] While this standard is imprecise, it demonstrates the United States' cooperative rather than obstructive intent. Such intent is a positive approach to cross-border insolvency issues.[170] A demonstration of similar intent is likely to be welcome in China as well.

VI. CONCLUSION

A lack of binding multinational rules has made cross-border insolvencies inefficient and uncoordinated. A number of countries, including the United States, have adopted insolvency provisions based on the UNCITRAL Model Law to address these concerns. The recently enacted Corporate Bankruptcy Law in China, while not specifically based on the UNCITRAL Model Law, does incorporate modern concepts of modified universalism. Clarifying the language of Article 5 and adding

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165. 11 U.S.C. § 1506 (2010).

166. *See* 11 U.S.C. §§ 1525-1532 (2010); *see also supra* notes 95-108 and accompanying text.

167. *See supra* notes 162-165 and accompanying text.

168. Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law, G.A. Res. 52/158, Annex, ch. IV, U.N. Doc. A/RES/52/158/Annex (Jan. 30, 1998).

169. 11 U.S.C. §§ 1525(a), 1526(a) (2010).

170. The Legislative Guide to Enactment indicates a similar sentiment, stating that "even in jurisdictions in which there is a tradition of wider judicial latitude, enactment of a legislative framework for cooperation has proved to be useful." GUIDE TO ENACTMENT, *supra* note 58, para. 173; *see also* Clift, *supra* note 48, at 327.

cooperation language to the Chinese law would encourage foreign direct investment in China.

PROPERTY RIGHTS, HOUSING, AND THE AMERICAN CONSTITUTION: THE SOCIAL BENEFITS OF PROPERTY RIGHTS PROTECTION, GOVERNMENT INTERVENTIONS, AND THE EUROPEAN COURT ON HUMAN RIGHTS' *HUTTEN-CZAPSKA* DECISION*

Edward H. Ziegler** and Jan G. Laitos***

ABSTRACT

Nations around the world utilize government interventions to promote the availability and affordability of housing. This Article focuses on various types of government regulatory interventions, such as rent controls, building dedications and exactions, and density and growth controls on housing. These interventions are common in the United States and in other countries and may contribute to inefficient resource allocation and poor housing outcomes. This Article examines whether these types of government interventions may require, in particular cases in the United States, judicially required compensatory damages for affected property owners. The social costs of these forms of government intervention are examined from the perspective of the benefits accruing from a regime of property rights protection. This Article further explains that there is some existing precedent under international human rights norms, as illustrated by the *Hutten-Czapska v. Poland*[1] decision, for the standards used in the United States for protecting the property rights of owners and developers of housing from excessive and unwise government regulation.

I. INTRODUCTION

The U.S. Constitution provides protection for private property owners when the government intervenes through official regulations restricting an owner's rights in land or housing.[2] When the government acts through regulatory intervention that restricts the private use of land and housing, the

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1. Hutten-Czapska v. Poland, 45 Eur. Ct. H.R. 4 (2007).

2. *See* 1 EDWARD H. ZIEGLER, JR., RATHKOPF'S THE LAW OF ZONING AND PLANNING § 6:2-3 (4th ed. 2010) [hereinafter ZIEGLER, RATHKOPF'S].

property rights of affected owners are protected under the Fourteenth Amendment and the Takings Clause of the Fifth Amendment of the U.S. Constitution.[3] These provisions apply regardless of the personal status or income of the affected private owner.[4]

Government intervention by police power regulation of land and housing in the United States is constrained by judicial interpretation of the constitutional protection afforded private owners of property. The Fifth Amendment of the U.S. Constitution provides that "[n]o person shall be . . . deprived of life, liberty or property without due process of law; nor shall private property be taken for public use, without just compensation."[5] The next section of this Article discusses the legal protection afforded private housing and landowners by the U.S. Constitution's Takings Clause and the court decisions interpreting this provision.

To a significant degree, the constitutional protection of property rights for owners of real property in the United States is reflected in the European Court on Human Rights' *Hutten-Czapska* decision, which involved rent controls imposed on apartment housing in Poland.[6] The European Court ruled that rent controls violated the right to property in the European Convention on Human Rights. Over time, rent controls denied a housing owner any economically viable use of his property, which amounted to a disproportionate and impermissible benefit extraction of the owner's interest in the property.[7] The rationale of the Court's decision closely parallels the U.S. Supreme Court's analysis of the protection of private property under the U.S. Constitution.[8]

The constitutional protection of private property rights in the United States is thought to promote economic prosperity and efficiency, as well as basic fairness and individual liberty.[9] In this sense, private property rights are institutionally considered important human and civil rights that operate to protect a disfavored minority from favoritism and unfairness caused by majority legislative action.[10] In the United States, while a right to housing is not codified, there is no shortage of quality housing space available at

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3. *Id.*

4. *Id.* § 6:2.

5. The Fifth Amendment is held applicable to state and local regulation by its incorporation into the Due Process Clause of the Fourteenth Amendment. State constitutions also contain similar due process and takings clauses. Some state constitutions grant greater protections than the guarantees provided under the Fifth and Fourteenth Amendments. *Id.*

6. Hutten-Czapska v. Poland, 45 Eur. Ct. H.R. 4 (2007).

7. *See id.*

8. *See infra* notes 65-67 and accompanying text.

9. *See generally* JAN G. LAITOS, LAW OF PROPERTY RIGHTS PROTECTION: LIMITATIONS ON GOVERNMENTAL POWER (2005).

10. Edward H. Ziegler, *Fundamental Fairness and Regulatory Takings: Judicial Standards of Fairness Shaping the Limits of Categorical and Partial Taking Claims*, 1996 INST. ON PLAN. ZONING & EMINENT DOMAIN 11-1 [hereinafter *Fundamental Fairness*].

market prices. Also, on a comparative and absolute basis, the United States provides substantial public and private financial support for housing the very poor and homeless.[11] The U.S. housing market is highly influential across the globe,[12] likely due, at least in part, to the constitutional protection of the property rights of private owners and renters of housing.

II. TAKING PRIVATE PROPERTY AND THE RIGHT TO COMPENSATION

The U.S. Constitution's Takings Clause requires that an owner be paid just compensation when the government takes private property for a public use.[13] Compensation must be paid to an owner when the government directly takes title to private property to establish a new public use, like a public park.[14] However, courts have also ruled that a taking occurs, and compensation must be paid, when the government interferes in certain ways with an owner's possessory interests, while acting in an enterprise capacity or by a police power regulation of private property rights.[15] These situations are known as cases of inverse condemnation, in which there is no direct taking of title. The government often contests in court whether compensation is required.[16] These cases are controlled by the general jurisprudential taking principle that police power regulation of

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11. *See, e.g.*, NAT'L ALLIANCE TO END HOMELESSNESS, ANNUAL REPORT 2008 (2008), *available at* http://www.endhomelessness.org/content/article/detail/2547; U.S. INTERAGENCY COUNCIL ON HOMELESSNESS, http://www.ich.gov/ (last visited Nov. 26, 2010).

12. *World Housing Market*, ECONOMY WATCH, http://www.economywatch.com/market/housing-market/world.html (last visited Jan. 31, 2011).

13. Edward H. Ziegler, *Partial Taking Claims, Ownership Rights in Land and Urban Planning Practice: The Emerging Dichotomy Between Uncompensated Regulation and Compensable Benefit Extraction under the Fifth Amendment Takings Clause*, 22 J. LAND RESOURCES & ENVTL. L. 1 (2002) [hereinafter Ziegler, *Partial Taking*].

14. *See* Allison Duham, *A Legal and Economic Basis for City Planning*, 58 Colum. L. Rev. 650, 666-67 (1958); *see also* ZIEGLER, RATHKOPF'S, *supra* note 2,§ 6:34; Ziegler, *Partial Taking*, *supra* note 13, at 9.

15. *See* ZIEGLER, RATHKOPF'S, *supra* note 2, § 6:3; *see generally* LAITOS, *supra* note 9; Ziegler, *Partial Taking, supra* note 13.

16. *See, e.g.*, United States v. Causby, 328 U.S. 256 (1946) (direct overflights destroyed present use of land as a chicken farm); United States v. Cress, 243 U.S. 316 (1917) (repeated flooding of land caused by water project); *see also* Moden v. United States, 60 Fed. Cl. 275, 282 (Fed. Cl. 2004) (test for distinguishing a taking from a tort in inverse condemnation cases involves a two-part inquiry: (1) "a property loss compensable as a taking only results when the government intends to invade a protected property interest *or* the asserted invasion is the 'direct, natural, or probable result of an authorized activity and not the incidental or consequential injury by the action,'" and (2) "'the nature and magnitude of the government action must be considered. Even where the effects of the government action are predictable, to constitute a taking, an invasion must appropriate a benefit to the government at the expense of the property owner, or at least preempt the owner['s right to enjoy his property for an extended period of time, rather than merely inflict an injury that reduces its value'") (quoting Ridge Line, Inc. v. United States, 346 F.3d 1346, 1355-56 (Fed.Cir.2003), *aff'd*, 404 F.3d 1335 (Fed. Cir. 2005)).

private property may not be used simply as a mechanism for extracting public benefits from private landowners that, in all fairness and justice, should be paid for by the public as a whole.[17]

Courts have recognized that land value consists not only in title ownership and possession, but also in the rights of an owner to use, enjoy and develop the land.[18] Since all property is subject to the exercise of government regulation in protection of the public welfare, government regulation of land will not be held a taking simply because it partially reduces or destroys the use or development value of the land.[19] Justice Holmes argued that "government hardly could go on if to some extent values incident to property could not be diminished without paying for every change in the general law."[20] However, Holmes also recognized, in view of the policies underlying the due process and takings provisions in the U.S. constitutional system, that "if regulation goes too far it will be

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17. *See* Armstrong v. United States, 364 U.S. 40 (1960). Recent U.S. Supreme Court taking decisions continue to embrace this ultimate taking standard. *See* Agins v. City of Tiburon, 447 U.S. 255, 260 (1980) ("The determination that governmental action constitutes a taking is, in essence, a determination that the public at large, rather than a single owner, must bear the burden of an exercise of state power in the public interest."); *see also* First English Evangelical Lutheran Church v. Los Angeles Cnty., 482 U.S. 304, 318-19 (1987) ("It is axiomatic that the Fifth Amendment's just compensation provision is 'designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole'") (quoting *Armstrong*, 364 U.S. at 49)). The following cases contain the same quote from *Armstrong*: Dolan v. City of Tigard, 512 U.S. 374, 384 (1994); Concrete Pipe & Prods. of Cal., Inc. v. Constr. Laborers Pension Trust for S. Cal., 508 U.S. 602, 646-47 (1993); Nollan v. Cal. Coastal Comm'n, 483 U.S. 825, 835 n.4 (1987); and Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104, 123 (1978).

18. The U.S. Supreme Court and all state courts recognize that, short of taking title to property, a police power restriction on land use may "go too far" and constitute an unconstitutional taking of property for public use, due to government's failure to pay compensation for the use or development interests thereby destroyed. As Justice Brennan stated in *San Diego Gas & Electric Co. v. City of San Diego*, "Police power regulations such as zoning ordinances and other land-use restrictions can destroy the use and enjoyment of property in order to promote the public good just as effectively as formal condemnation or physical invasion of property. From the property owner's point of view, it may matter little whether his land is condemned or flooded, or whether it is restricted by regulation to use in its natural state, if the effect in both cases is to deprive him of all beneficial use of it. From the government's point of view, the benefits flowing to the public from preservation of open space through regulation may be equally great as creating a wildlife refuge through formal condemnation or increasing electricity production through a dam project that floods private property." 450 U.S. 621, 652 (1981). *See also* Phillips v. Wash. Legal Found., 524 U.S. 156 (1998) (for purposes of taking analysis, property consists of a group of rights including the owner's right to possess, use, and dispose of it); *Nollan*, 483 U.S. at 833, n.2 ("[T]he right to build on one's own property - even though its exercise can be subjected to legitimate permitting requirements—cannot remotely be described as a 'governmental benefit.'").

19. *See* ZIEGLER, RATHKOPF'S, *supra* note 2, § 6:3; *see generally* LAITOS, *supra* note 9; *Fundamental Fairness*, *supra* note 10, at 11-19.

20. Pa. Coal Co. v. Mahon, 260 U.S. 393, 413 (1922).

recognized as a taking."[21] The police power "must have its limits" and "when it reaches a certain magnitude, in most if not all cases, there must be an exercise of eminent domain and compensation to sustain the act."[22]

The Takings Clause in the U.S. Constitution plays a significant role in shaping the limits and forms of government regulation that are sought for housing or new housing development.[23] All three types of the constitutional taking claims discussed below – physical invasion analysis, economically viable use analysis, and partial benefit-extraction analysis – significantly restrict the methods of government intervention that may address perceived social problems related to housing in the United States.[24]

A. Physical Invasion Takings Analysis

A regulation adopted by a governing authority that allows someone to enter another person's property will likely be considered a physical invasion taking of the private right to exclusive possession for which

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21. *Id.* at 415.

22. *Id.* at 413.

23. The Fifth Amendment Takings Clause presupposes the fundamental unfairness of the uncompensated taking of private property for public use or benefit. In the regulatory takings context, analysis of fundamental fairness in allocation of the burdens imposed, in view of the policy of horizontal equity (the approximation of equal sharing of costs or of sharing according to capacity to pay that exists when property is taken by the expenditure of public funds) underlying the Takings Clause, secures and implements its original meaning and purpose. Thus, the Supreme Court noted "the oft-cited maxim that 'while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking.'" Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1014-15 (1992) (quoting *Pa. Coal Co.*, 260 U.S. at 415).

24. *See* RICHARD EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN 138 (1985); Frank I. Michelman, *Possession vs. Distribution in the Constitutional Idea of Property,* 72 IOWA L. REV. 1319, 1329 (1987); Antonin Scalia, *Economic Affairs as Human Affairs,* 4 CATO J. 703, 703-04 (1985); *see also* Jan Laitos, *The Strange Career of Private Property and the Police Power*, 40A ROCKY MTN. MIN. L. INST. 2, 2-35 (1995) ("This protection is occurring in three general ways. First, courts are beginning to strike laws whose primary defect is that they have unfairly affected private property interests. The main theories used by courts to defend property against police power exercises that are fundamentally unfair are (1) presumptions against retroactivity; (2) vested rights; and (3) equitable estoppel. Second, certain property-protective clauses in the Constitution are being activated by courts (particularly the United States Supreme Court and the United States Federal Circuit Court of Appeals) to resist government regulations of land and property. These clauses are (1) the Takings Clause; (2) the Contracts Clause; and (3) the Due Process Clause. Third, the United States Congress has proposed legislation that would require agencies to pay compensation to landowners whose property value has been diminished by police power exercises. In a perfect reflection of the nation's newly discovered interest in the role of private property, many of these bills are entitled 'The Private Property Owners Bill of Rights.'").

compensation must be paid.[25] The U.S. Supreme Court has adopted a *per se* confiscation taking rule that applies when government interferes, through regulation, with an owner's possessory interest in excluding others from his property.[26] Under this analysis, a taking occurs when regulation results in a permanent physical invasion of private property or an interference with an owner's right to exclude others from his property, which disturbs his reasonable investment-backed expectations.[27] For example, in *Loretto v. Teleprompter Manhattan CATV Corp*, the Supreme Court held that a New York law requiring a landlord to permit installation of cable television on his property constituted a taking.[28] Similarly, a taking would be found if the government was to require owners of private apartments to provide free housing for the poor or homeless.[29] In such cases, the government would have to compensate the private owner for the fair market rental value for the possession of the apartments. However, extensive government regulation of all aspects of the landlord-tenant relationship is generally allowed within the constitutional parameters discussed below.[30]

B. Economically Viable Use Analysis

Zoning, urban planning, public design controls, and other forms of government intervention by regulation will not be held confiscatory simply because regulation prohibits the owner from making the most profitable use of the property or results in a substantial diminution in market value of the land.[31] Generally, a regulation will be held confiscatory only where it deprives an owner of every use to which the property is reasonably adapted.[32] Recently, the U.S. Supreme Court and most state courts have

25. *See* Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470, 516 (1987); Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 430 (1982).

26. *See Loretto*, 485 U.S. at 426-435; *see also* Penn Central Transp. Co. v. City of New York, 438 U.S. 104, 124-25 (1978).

27. *See Loretto*, 485 U.S. at 426-435; *see also Penn Central Transp. Co.*, 438 U.S. at 124-25 (1978).

28. *Loretto*, 485 U.S. at 438.

29. *See* Ziegler, *Partial Taking*, *supra* note 13, at 13-14.

30. *See, e.g.*, Aspen-Tarpon Springs Ltd. P'ship v. Stuart, 635 So. 2d 61 (Fla. Dist. Ct. App. 1994) (statute requiring mobile park owners to either buy tenants' homes or pay relocation costs held a regulatory taking); Manocherian v. Lenox Hill Hosp., 643 N.E.2d 479 (N.Y. 1994) (holding statute that required owners to provide renewal leases to non-private hospitals based on primary residency status of hospital's employee-subtenant affected partial regulatory taking); Seawall Assocs. v. City of New York, 542 N.E.2d 1059 (N.Y. 1989) (ordinance preventing destruction or conversion of single-room occupancy buildings is facially invalid as a regulatory taking).

31. *See* ZIEGLER, RATHKOPF'S, *supra* note 2, § 6:11; *see generally* LAITOS, *supra* note 9.

32. ZIEGLER, RATHKOPF'S, *supra* note 2, §§ 6:14, 6:22.

adopted the economically viable use test.[33] Under this test, a regulation generally will not be held confiscatory unless it denies an owner all reasonably beneficial and economically viable use of the land considered as a whole.[34] A regulation may be held confiscatory even if an owner is afforded a beneficial or economically viable use of the property under either of the alternative takings tests.[35]

Applying the economically viable use analysis, the purchase price paid by a present owner and the decline in market value as a result of regulation are unlikely to be determinative in whether a taking has occurred and compensation must be paid.[36] However, the testimony of an appraiser or real estate expert regarding the market value of land developed for allowed uses may constitute an important part of a landowner's confiscation claim.[37] Market value and demand for permitted land uses, taken together, may demonstrate that such potential uses are not reasonably beneficial and economically viable uses for the land in question, rendering the regulation confiscatory.[38] For example, where a landowner's proof demonstrated that, upon completion of a residence on a lot, the market value of the house and lot would be less than the cost of constructing the residence, the regulation was confiscatory because the lot was held to be unsuitable and valueless for residential use.[39] Similarly, denial of a variance to operate a gasoline station in an area zoned for retail business was confiscatory based on a finding that the area was so undeveloped, residentially and otherwise, that

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33. ZIEGLER, RATHKOPF'S, *supra* note 2, § 6:15; *see also, e.g.*, Fla. Rock Indus., Inc. v. United States, 18 F.3d 1560, 1567-68 (Fed. Cir. 1994) (reduction in fair market value of almost ninety-five percent, from $10,500 to $500 per acre, would clearly constitute a total taking).

34. *See* ZIEGLER, RATHKOPF'S, *supra* note 2, § 6:15; *see generally* LAITOS, *supra* note 9.

35. *See discussion infra* Part II.A; *see* discussion *supra* Part II.C.

36. ZIEGLER, RATHKOPF'S, *supra* note 2, § 6:30.

37. *Id.*

38. The U.S. Supreme Court's decision in *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992) clarifies that a categorical taking occurs not only when an owner is denied all beneficial use of the land but also when the uses allowed deny an owner all economically viable use of the land.

39. *See, e.g.*, Helms v. City of Charlotte, 122 S.E.2d 817 (N.C. 1961); *see also* Palazzolo v. Rhode Island, 533 U.S. 606 (2001) (owner retained an economically viable use of his land where regulation allowed a residence to be built on the land, which had a market value of $200,000—a decrease in market value of about ninety-four percent from the market value of $3,150,000 if fully developed); Walcek v. United States, 303 F.3d 1349 (Fed. Cir. 2002) (applying whole parcel analysis to wetland regulation taking claim and ruling that adjustment of base value of owner's land for inflation or deflation was not warranted to determine extent of economic impact of regulation); Am. Nat'l Bank & Trust Co. of Chi. v. Vill. of Winfield, 274 N.E.2d 144 (Ill. App. Ct. 1971); McConnell v. Inc. Vill. of Tuckahoe, 25 A.D.2d 441 (N.Y. App. Div. 1966); *Cf.* Munoz Realty Corp. v. Borough of Verona, 225 A.2d 594 (N.J. Super. Ct. App. Div. 1966) (evidence failed to show that homes could not be built without cellars and sold at a fair profit or that lots could not be sold unimproved for a fair price to seller), *aff'd*, 225 A.2d 569 (N.J. 1966).

there was no market value or demand for commercial use of the land.[40]

Government interventions that regulate housing are generally permissible if they leave the owner with an economically viable use of the land.[41] This general rule is true for most ordinary government planning restrictions on building development, such as construction standards related to building bulk and height, lot size, setbacks, open space, fences, building design, landscaping, and parking.[42] Similarly, regarding rent control, the U.S. Supreme Court has upheld the general constitutionality of rent restrictions in several court cases dating back to World War II.[43] In those cases, the Court focused on the increased war-time power of the government and discussed the takings issue and property rights related to housing. The Court ruled that setting maximum rent prices did not constitute a taking unless the restrictions went so far as to be confiscatory.[44] The Court noted that although rent control "may reduce the value of the property regulated," it was not unconstitutional.[45]

Today, government rent control regulation would likely be considered a taking for which compensation must be paid only if the regulation, as applied to an owner's property, did not provide the private owner with an "economically viable return" on the land and buildings as an operational investment.[46] More broadly, a confiscation claim to a government restriction respecting rent control, tenant eviction protection, or apartment-to-ownership conversion could be successfully asserted where the regulation, as applied, merely denies an owner a fair and reasonable return

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40. *See* People *ex rel.* St. Albans-Springfield Corp. v. Connell, 177 N.E. 313 (N.Y. 1931); *see also* Opgal, Inc. v. Burns, 189 N.Y.S.2d 606 (N.Y. Sup. Ct. 1959) (because there were approximately 1,300 acres of industrially zoned land in use in the town, 800 acres of undeveloped industrially zoned land, and approximately 5,800 acres of vacant land zoned for industrial use in the county and the neighboring county at the time the plaintiff's land was zoned from residential to industrial, there was no present need for further industrial rezoning; rezoning plaintiff's land was restrictive and unconstitutional), *aff'd*, 10 A.D.2d 977 (N.Y. App. Div. 1960), *aff'd*, 173 N.E.2d 50 (N.Y. 1961).

41. ZIEGLER, RATHKOPF'S, *supra* note 2, §§ 6:22, 6:51.

42. *See* Pennell v. City of San Jose, 485 U.S. 1, 20 (1988) (Scalia, J., dissenting) ("Traditional land-use regulation (short of that which totally destroys the economic value of property) does not violate [fairness principles] . . . . Thus, the common zoning regulations requiring subdivisions to observe lot-size and set-back restrictions, and to dedicate certain areas to public streets, are in accord with our constitutional traditions because the proposed property use would otherwise be the cause of excessive congestion.").

43. *See, e.g.*, Woods v. Cloyd W. Miller Co., 333 U.S. 138 (1948); Bowles v. Willingham, 321 U.S. 503 (1944).

44. *Bowles*, 321 U.S. at 516-17.

45. *Id.* at 517.

46. *See, e.g.*, Adamson Cos. v. City of Malibu, 854 F. Supp. 1476, 1502 (C.D. Cal. 1994) (rent control ordinance); Aspen-Tarpon Springs Ltd. P'ship v. Stuart, 635 So. 2d 61 (Fla. Dist. Ct. App. 1994) (conditions on change of use of mobile home park); Manocherian v. Lenox Hill Hosp., 643 N.E.2d 479 (N.Y. 1994) (requirement on landlord relating to renewal leases).

on his investment.[47] Court decisions have utilized different takings analyses in evaluating whether various types of rent control and tenant protection provisions are confiscatory.[48] Typically, the key question in these cases is what constitutes a fair return on investment.[49] While a variety of fair return formulas may be permissible,[50] including a net operating income ratio formula,[51] courts have ruled that landlords are not constitutionally entitled to market value rates of return on their investment.[52]

In determining a fair return, some courts have held that inflation must be taken into account,[53] and every dollar for capital improvement the landlord puts into the property constitutes an investment for which a fair and reasonable return must be allowed.[54] In *Richardson v. City & County of Honolulu*,[55] a federal District Court held a local rent control ordinance confiscatory based on a straightforward fair return formula.[56] The Court ruled that by indiscriminately basing maximum rent allowed on the initial rent paid under a lease and by neglecting to provide a mechanism for

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47. *See* W. Dennis Keating, *Rent Control: Fair Return, Landlord Hardship, and Regulatory takings*, 12 ZONING & PLAN. L. REP. 169 (1989); *see also* Santa Monica Beach, Ltd. V. Superior Court, 968 P.2d 993, 1002 (Cal. 1999) (rejecting a substantive due process claim to rent control law; "[C]ourts have employed the fair return analysis to price regulation cases whether the contested regulation is dominated as a taking or a deprivation of property without due process.").

48. *See generally* Karl Manheim, *Tenant Eviction Protection and the Takings Clause*, 1989 WIS. L. REV. 925.

49. *See* Kenneth K. Baar, *Guidelines for Drafting Rent Control Laws: Lessons of a Decade*, 35 RUTGERS L. REV. 721, 784-816 (1983). The U.S. Supreme Court has generally defined fair return in this context as a "return . . . commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to . . . extract capitol." Fed. Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944). *See also In re* Permian Basin Area Rate Cases, 390 U.S. 747, 792 (1968) ("The court must determine whether the [regulation] may reasonably be expected to maintain financial integrity, attract necessary capitol, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection for the relevant public interests, both existing and foreseeable.").

50. *See* Kavanau v. Santa Monica Rent Control Bd., 941 P.2d 851, 858-59 (Cal. 1997) (summarizing a number of important criteria for evaluating whether regulation as applied provides a "fair return" on investment).

51. Parks v. Rent Control Bd., 526 A.2d 685, 686 (N.J. 1987).

52. *See generally* San Marcos Mobilehome Park Owners Ass'n v. City of San Marcos, 238 Cal. Rptr. 290 (Cal. Ct. App. 1987); *Parks*, 526 A.2d 685.

53. Assistance, Inc. v. Teledyne Indus., Inc., 112 Cal. Rptr. 418 (Cal. Ct. App. 1974).

54. Sierra Lake Reserve v. City of Rocklin, 938 F.2d 951, 958 (9th Cir. 1991), *vacated*, 506 U.S. 802 (1992); *see also* Main Union Assocs. v. Twp. of Little Falls Rent Leveling Bd., 703 A.2d 971 (N.J. Super. Ct. App. Div. 1997) (absence of provision for capital improvement surcharge did not render rent control ordinance unconstitutional on its face since the ordinance allowed rent increases to provide a just and reasonable return).

55. Richardson v. City & Cnty of Honolulu, 759 F. Supp. 1477 (D. Haw. 1991).

56. *Id.*

adjustment or review, the law operated to deprive owners of a just and reasonable rate of return.[57] The Court held that tying rent increases to general increases in prices and incomes would not result in a fair return on investment because there was substantial evidence that the base rate of initial rent paid, which served as a basis for this calculation, would often be far below fair market rental value.[58]

The New York Court of Appeals applied a similar economically viable use analysis in *Seawall Associates v. City of New York.*[59] The Court held a local ordinance enacted to preserve and maintain low rent single-room occupancy (SRO) housing within the City of New York confiscatory.[60] The law, among other requirements, prohibited property owners from altering, demolishing, or converting their buildings to any other use; compelled owners to restore any uninhabitable unit to habitable condition; and required owners to keep all their units occupied as SRO housing.[61] The court analyzed the impact of the law on property owners' basic rights "to possess, use, and dispose" of their buildings and found that the law substantially impaired each of these rights.[62] The court further noted that the mandatory rental provisions, together with the above requirements, denied owners of SRO buildings any right to use their properties and deprived them of an economically viable use of their properties.[63] The court found that the ordinance operatively ignored the legitimate investment-backed expectations of SRO property owners and failed to establish a formula to provide owners a fair return on their investment.[64]

C. Partial Benefit-Extraction Taking Analysis

As the U.S. Supreme Court has often stated, the Fifth Amendment's just compensation provision is "designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole."[65] As reflected in recent U.S.

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57. *Id.* at 1489.

58. *Id.* at 1489-90.

59. Seawall Assocs. v. City of New York, 542 N.E.2d 1059 (N.Y. 1989).

60. *Id.*

61. *Id.* at 1060-61.

62. *Id.* at 1065-68.

63. *Seawall Assocs.*, 542 N.E.2d at 1069.

64. *Id.*; *see also* Aspen-Tarpon Springs Ltd. P'ship v. Stuart, 635 So. 2d 61 (Fla. Dist. Ct. App. 1994) (statute requiring owner, if changing use of mobile home park, to either buy tenants' homes or pay to have homes moved held unconstitutional since not economically feasible).

65. *See, e.g.*, Dolan v. City of Tigard, 512 U.S. 374 (1994); Concrete Pipe & Prods. of Cal., Inc. v. Constr. Laborers Pension Trust for S. Cal., 508 U.S. 602 (1993); Nollan v. Cal. Coastal Comm'n, 483 U.S. 825 (1987); Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104 (1978).

Supreme Court decisions, the partial taking analysis explicitly recognizes that a regulation may affect an unconstitutional taking of private property without amounting to a categorical or *per se* taking, either by denying an owner all economically viable use or by resulting in the physical occupation of the owner's land.[66]

Under the benefit-extraction taking analysis, confiscation occurs when the burden imposed on a private owner, in view of the nature of the government action involved, is one that the public fairly and justly should pay for as a whole through taxing and spending.[67] Justice and fairness require that economic injuries caused by regulation be compensated by the government rather than remain disproportionately concentrated on regulated and burdened private owners.[68] Courts in these cases find that the regulation in question is designed primarily to secure the acquisition of public resources and extract from the affected owners a public benefit that is not substantially attributable to some problem related to the owners' conduct.[69] This takings analysis is reflected in a very long line of state court decisions and in a number of recent U.S. Supreme Court decisions dealing with "development exactions."[70] The benefit-extraction taking

66. *See* ZIEGLER, RATHKOPF'S, *supra* note 2, § 6:51; *see also Dolan*, 512 U.S. at 374; *Nollan*, 483 U.S. at 825.

67. ZIEGLER, RATHKOPF'S, *supra* note 2, §§ 6:51-52.

68. *See* ZIEGLER, RATHKOPF'S, *supra* note 2, § 6:51; *see also* Fla. Rock Indus., Inc. v. United States, 18 F.3d 1560, 1571 (Fed. Cir. 1994); *see generally Fundamental Fairness*, *supra* note 10.

69. *See, e.g.*, E. Enters. v. Apfel, 524 U.S. 498, 528-29, 537 (1998) (the Takings Clause requires fair assessment of burdens imposed related to causation and proportionality); Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1018-26 (1992) (while regulation often may be interpreted as either "harm-preventing" or "benefit-conferring," there must be heightened judicial review of the nexus between the conduct restricted and the social problem addressed by regulation in situations where there is a "heightened risk that private property is being pressed into some form of public service"); United States v. Armstrong, 364 U.S. 40, 49 (1960) (the Takings Clause "was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole."); Pa. Coal Co. v. Mahon, 260 U.S. 393, 416 (1922) ("[A] strong public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying for the change . . . . [T]he question at bottom is upon whom the loss of the [regulatory] changes desired should fall."); Monongahela Navigation Co. v. United States, 148 U.S. 312, 325 (1893) (the Takings Clause "prevents the public from loading upon one individual more than his just share of the burdens of government, and says that when he surrenders to the public something more and different from that which is exacted from other members of the public, a full and just equivalent shall be returned to him.").

70. *Dolan*, 512 U.S. 374 (holding that there must be rough proportionality between amount of development exaction and extent of specific problem related to or need generated by particular development proposal); *Nollan*, 483 U.S. 825 (holding that there must be a substantial relationship between nature of development exaction and some specific problem related to or need generated by particular development proposal); *see also Fundamental Fairness*, *supra* note 10, at 11-23.

principle at work here is that development exactions must be reasonably related in nature to some problem caused by development and reasonably related in amount to the magnitude of that problem.[71]

For example, a regulatory condition imposed on the development of food markets mandating that they give free food to persons with an official "low income" card would be a taking requiring compensation. The stores would simply be convenient targets of a regulation providing free food to persons with a low income, though the stores were not a significant cause of the poverty that the regulation addresses. Under this analysis, the public benefit secured by such a regulation - feeding the poor - is considered constitutionally appropriate, but that burden must be publicly shared through taxing and spending powers.[72] This benefit-extraction taking analysis would also apply to regulations imposed on private owners to house the poor or shelter the homeless.[73]

This taking analysis has been applied in cases involving impact fees for public housing and other similar regulatory schemes.[74] For example,

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71. *Dolan*, 512 U.S. 374 (holding that there must be rough proportionality between amount of development exaction and extent of specific problem related to or need generated by particular development proposal); *Nollan*, 483 U.S. 825 (holding there must be a substantial relationship between nature of development exaction and some specific problem related to or need generated by particular development proposal); *see also* ZIEGLER, RATHKOPF'S , *supra* note 2, § 6:10; *Fundamental Fairness*, *supra* note 10, at 11-23; *see generally* LAITOS, *supra* note 9.

72. This type of partial taking analysis is reflected, in another context, in California Chief Justice Rose Bird's dissenting opinion in *Yarborough v. Superior Court*, 702 P.2d 583, 432 (Cal. 1985) (quoting Yarbrough v. Superior Court, 197 Cal.Rptr. 737, 744-45 (Cal. Ct. App. 1983) (King, J., concurring):

> No one would dare suggest courts have the authority to order a doctor, dentist or any other professional to provide free services, while at the same time telling them they must personally pay their own overhead charges for that time. No crystal ball is necessary to foresee the public outrage which would erupt if we ordered grocery store owners to give indigents two months of free groceries or automobile dealers to give them two months of free cars. Lawyers in our society are entitled to no greater privileges than the butcher, the baker and the candlestick maker; but they certainly are entitled to no less.

73. *But cf.* Commercial Builders of N. Cal. v. City of Sacramento, 941 F.2d 872, 873 (9th Cir. 1991) (upholding low-income housing fee on commercial building permits); Holmdel Builders Ass'n v. Twp. of Holmdel, 583 A.2d 277, 295 (N.J. 1990) (upholding low-income housing fee on commercial building permits); Seawall Assocs. v. City of New York, 542 N.E.2d 1059, 1069 (N.Y. 1989) (affirming buyout and other burdens imposed on single-room only housing to address problems of homeless).

74. *See, e.g.*, Commercial Builders of N. California v. City of Sacramento, 941 F.2d 872 (9th Cir. 1991) (upholding city ordinance that conditioned nonresidential building permits on payment of fee to offset burdens associated with influx of low-income workers to work on such developments); S. Shell Inv. v. Town of Wrightsville Beach, 703 F. Supp. 1192, 1206 (E.D.N.C. 1988) (rejecting a claim that a three-fold increase in utility system and tap water impact fees was arbitrary even though the fees bore no relationship to the stated purposes and were intermixed with government funds), *aff'd*, 900 F.2d 255 (4th Cir. 1990); Bldg.

the California Court of Appeals recently ruled in favor of the housing developer when it struck down an affordable housing impact fee imposed on a new housing development.[75] The court held that the increase in the affordable housing fee was not "reasonably justified" under existing law because there was no reasonable relationship between the amount of increase in the fee and some demonstrated "deleterious public impact of development."[76] The court relied on the lack of evidence of any relationship between the extent of the city's affordable housing need and the development of housing units by the developer.[77] Other decisions have held regulatory conditions on housing confiscatory under benefit-extraction taking analysis.[78] It has also been applied to public rent control schemes where the burden is arbitrarily placed on a disfavored group of tenants.[79]

III. THE *HUTTEN-CZAPSKA* CASE: PROPERTY, HUMAN RIGHTS, AND CONFISCATION CLAIMS

In 2006, the European Court of Human Rights (ECHR) heard a housing case involving the government's imposition of long-term rent controls on private owners of housing in Poland.[80] The suit originated in the Polish courts by Maria Hutten-Czapska, a French national with property in Poland. Restrictive landlord provisions had been passed in response to the housing shortage in Poland – the most severe shortage in Eastern Europe after World War II.[81] The laws imposed a number of rent

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Indus. Ass'n of Cent. Cal. v. City of Patterson, 90 Cal. Rptr.3d 63 (Cal. Ct. App.), *cert. denied*, 130 S.Ct. 660 (2009).

75. *Bldg. Indus. Ass'n*, 90 Cal.Rptr.3d at 73-74.

76. *Id.*

77. *Id.* at 74.

78. *See, e.g.*, Garneau v. City of Seattle, 897 F. Supp. 1318 (W.D. Wash. 1995) (exaction of cash relocation assistance for low-income tenants); Gagne v. City of Hartford, 10 Conn. L. Rptr. 630 (Conn. Super. Ct. 1994) (requiring replacement of, or "in lieu" fees for, low income housing); Aspen-Tarpon Springs Ltd. P'ship v. Stuart, 635 So. 2d 61 (Fla. Dist. Ct. App. 1994) (requirement that mobile home park owners buy tenants' homes or pay relocation costs); Prop. Owners Ass'n v. Twp. of N. Bergen, 378 A.2d 25 (N.J. 1977) (ordinance requiring landlords and other tenants to subsidize senior citizens' rents); Manocherian v. Lenox Hill Hosp., 643 N.E.2d 479 (N.Y. 1994) (requirement that owners provide renewal leases to non-private hospitals based on primary residency status of hospital's employee-subtenant); *Seawall Assocs.*, 542 N.E.2d at 1069 (buyout and other burdens imposed on single-room-only housing to address homelessness problem); Guimont v. Clarke, 854 P.2d 1 (Wash 1993) (relocation assistance for low-income tenants); Robinson v. City of Seattle, 830 P.2d 318 (Wash. 1992) (fees required for destruction of low-income housing).

79. *Prop. Owners Ass'n*, 378 A.2d at 33 ("[T]he initial burden falls exclusively upon the shoulders of the non-Senior Tenants, who in a given case may be financially less capable of bearing the increase than the Senior Tenants.").

80. Hutten-Czapska v. Poland, 45 Eur. Ct. H.R. 4 (2007).

81. Maureen Markham, Poland: Housing Challenge In a Time of Transition (2003)

restrictions on landlords, including a low ceiling on rent levels such that landlords could not recover maintenance costs, much less make a profit and a return on investment.[82] In 2001, the Polish Constitutional Court (PCC) held the laws unconstitutional for placing a disproportionate and excessive burden on landlords.[83] In February 2005, the PCC again found the legislation unconstitutional because it made it impossible for landlords to receive rent reasonably commensurate with the costs of property maintenance.[84] The PCC directed Poland to find a way to provide Hutten-Czapska and the other 100,000 similarly situated landlords a reasonable level of rent or to provide them with a way to mitigate the consequences of the state-controlled rent increases.[85]

The Polish government requested referral of the case to the Grand Chamber of the ECHR. The Grand Chamber relied on the European Convention on Human Rights [86] and the Charter of Fundamental Rights of the European Union, which states that the right to property is a fundamental right.[87] The Grand Chamber agreed that Poland, which inherited an abominable housing situation from the communist regime, was in the difficult position of balancing conflicting interests of landlords and tenants.[88] However, the Polish government failed to distribute the social and financial burden fairly. The ECHR essentially applied the benefit-extraction confiscation analysis, as used by U.S. courts, and found that Poland had placed the burden on one particular social group.[89] By failing to establish a "reasonable relation of proportionality" between the legitimate goal of the Polish government and the restrictions utilized to achieve that goal, the ECHR ruled that the government violated Article 1 of Protocol No. 1 of the Convention.[90]

Had this case arisen in the United States, the outcome would have likely been the same. Under both the economically viable use and the

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(unpublished HUT-236M paper, Harvard University), http://www.jchs.harvard.edu/education/ oustanding_student_papers/markham_poland_03.pdf.

82. *Hutten-Czapska*, 45 Eur. Ct. H.R. at ¶ 237.

83. *Id.*

84. *Id.* at ¶¶ 136-41.

85. *Hutten-Czapska*, 45 Eur. Ct. H.R. at ¶ 237.

86. Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms of 20 March 1952, as amended by Protocol No. 11, May 11, 1994, ETS No. 155 (entered into force Nov. 1, 1998), *available at* http://www.ena.lu/protocol_convention_protection_human_rights_fundamental_freedoms_paris_march_1952_amended_version-2-13069.

87. Charter of Fundamental Rights of the European Union, art. 17, ¶ 1, 2000 O.J. (C 364) 1, 12.

88. *Hutten-Czapska*, 45 Eur. Ct. H.R. at ¶ 225.

89. *Id.*

90. *Id.* at ¶ 167; *see also* Spadea & Scalabrino v. Italy, 21 Eur. Ct. H.R. 482 (1996) (discussing the impossibility for a landlord to obtain the enforcement of a decision evicting a tenant).

benefit-extraction analyses utilized in U.S. court decisions, the long-term rent controls in *Hutten-Czapska* would have been held an unconstitutional taking of the landlord's property.[91] Future ECHR decisions may continue to reflect, at least in part, the analysis utilized in U.S. court decisions interpreting the taking of private property rights by government regulatory interventions. The three lines of constitutional regulatory takings analysis utilized by U.S. courts may be consulted for possible lines of argument and analysis in future property rights cases arising under the Charter of Fundamental Rights of the European Union and the European Convention on Human Rights.[92]

IV. OWNERSHIP OF PRIVATE PROPERTY, OVERREGULATION, AND JUDICIAL RESTRAINTS

The *Hutten-Czapscka* decision is a classic example of how a well-meaning housing rule can create negative consequences such that private entrepreneurial choices become frustrated and defeated. In Poland, long-term rent controls designed to address an acute housing shortage made it impossible for owners of rental housing to enjoy any economic gains or viable ownership benefits. The only solution was first a judicial override of the rent control law by the Polish courts then by the ECHR Grand Chamber. The United States has also experienced this sequence of good-faith government interference with private property markets resulting in economic marketplace chaos requiring judicial intervention to restore fairness and economic growth.[93] Such a pattern is not uncommon when a government decides to assert its authority over decisions involving rights to privately owned property.

Conversely, several positive market consequences result when private parties contract for the use and development of property free from unreasonable government interference. Property ownership permits private economic ordering and helps secure the investment capital necessary for financial growth. Moreover, property provides a benefit to non-owners, who are better off because an owner decided to develop, transfer, or make active use of the property. When the private exercise of a property right benefits third parties, like parties other than the owner or a party to whom the property is conveyed, the property is generating a positive externality.

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91. *See supra* notes 65-71 and accompanying text.

92. *See* Charter of Fundamental Rights of the European Union, art. 17, ¶ 1, 2000 O.J. (C 364) 1, 12; Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms of 20 March 1952, as amended by Protocol No. 11, May 11, 1994, ETS No. 155 (entered into force Nov. 1, 1998), *available at* http://www.ena.lu/protocol_convention_protection_human_rights_fundamental_freedoms_paris_march_1952_amended_version-2-13069.

93. *See* discussion *supra* Part II.

When the private property is actively used and not passively held, it becomes a "public good."[94] A public good is an economist's term for a resource whose use by a private party benefits not only the owner but also third parties.[95]

Private property, when transformed by the owner into a valuable commodity, becomes a public good because the owner's behavior has a positive effect on parties that are external to both the owner and the party to whom the property is transferred. For example, property development for residential purposes has repercussions beyond the owner when the use makes the property economically productive. For instance, if an owner subdivides land and builds homes, second parties directly benefit from this use. These include workers employed during the construction of the homes, agents who sell the homes, and future homeowners. Third parties benefit indirectly, like government agencies whose property tax base is expanded. Employers of those who live in the new homes benefit because otherwise they might have had to provide housing for their employees. Also, the overall local economy benefits from the purchasing power of new consumers now living in the area.

Despite unregulated private property creating a public good, especially when that property becomes housing, the government may choose to regulate the uses of that property and restrict the choices of the owners. Controls over land use, housing, and property have been common in Western civilization ever since the Roman Empire introduced regulations for setback lines for buildings and trees in as early as 450 B.C.[96] In the United States, although land use regulations existed since the colonial era, it wasn't until the twentieth century that the demand for regulations of real estate development became significant.[97] First, as the United States moved toward a more urban society, "city governments sought to gain control over the location of industry, commerce, and housing" through zoning.[98] New York City, for example, adopted its first comprehensive zoning ordinance in 1916.[99] By the 1930s, most urban areas had adopted some kind of zoning law.[100] After World War II, increasing suburbanization in the United States led to municipal regulations, controlling the size and type of such housing developments.[101] Beginning in the 1970s, once again growing urban population necessitated regional planning and even more

94. *See* Thomas W. Merrill, Dolan v. City of Tigard*: Constitutional Rights as Public Goods*, 72 DENV. U. L. REV. 859 (1995).

95. *See generally id.*

96. 6 West's Encyclopedia of American Law 185 (Jeffrey Lehman & Shirelle Phelps eds., 2nd ed. 2005).

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.*

restrictive housing and property policies.[102]

One such restrictive policy is exclusionary zoning. "Exclusionary zoning is using zoning to further the parochial interests of a particular municipality, at the expense of surrounding regions."[103] It takes various forms, such as setting a minimum lot or house size or prohibiting multifamily housing or mobile homes.[104] This type of zoning "fences out" low-income housing and decreases the overall supply of housing.[105] Exclusionary zoning thus advances economic, social, and often racial segregation.[106] It takes advantage of regional development to create and maintain homogenous communities and building affluent municipalities.[107] The practice certainly goes against the idea that municipal zoning aims to advance general welfare.

Such government interference with private housing decisions produces several negative consequences.[108] Generally, excessive regulation smothers the creativity of marketplace actors whose decisions fuel economic growth.[109] Additionally, regulation fails to enhance personal liberty since the government's exercise of police power inhibits it.[110] Government regulation limits a person's ability to make fundamental choices about how best to deploy resources productively, and it entails high

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102. *Id.*

103. West's Encyclopedia of American Law, *supra* note 96, at 187.

104. *Id.*

105. *Id.*

106. *Id.*

107. *Id.*

108. One such intervention is rent control, where government artificially restricts rent increases or limits the landlord's ability to charge a service fee to tenants and thus interferes with the market supply, demand and price, rendering the market's self-corrective features inoperative. *See, e.g.*, Guggenheim v. City of Goleta, 2010 WL 5174984 (9th Cir. December 22, 2010) (en banc) (holding that a mobile home park rent control ordinance constituted a regulatory taking. The ordinance was a wealth transfer mechanism, which placed a high burden on private owners to accomplish city goals that could have been accomplished by other means and went "too far." The 9th Circuit, sitting en banc, reversed, holding that the ordinance furthered legitimate government purpose, as required by due process, and thus did not constitute taking).

Different tax rates among localities, concentrating higher tax rates in the centrally located urban developments encourage suburbanization and aggravate the troubles of central-city business properties. Through various policies, such as tax incentives, low interest loans, easy credit, secondary mortgage market and capital gains protection, the government creates over-stimulation of demand. These policies led to the near collapse of the American housing market in 2008-2009.

109. *See generally* STEPHEN G. BREYER, REGULATION AND ITS REFORM (1982); PHILIP K. HOWARD, THE DEATH OF COMMON SENSE: HOW LAW IS SUFFOCATING AMERICA (1994); SUSAN ROSE-ACKERMAN, RETHINKING THE PROGRESSIVE AGENDA: THE REFORM OF THE AMERICAN REGULATORY STATE (1992).

110. *See* ROSE-ACKERMAN, *supra* note 109, at 133-34.

administrative costs.[111]

Three other negative consequences that flow from unchecked regulation have a particular impact on third parties. The first occurs when the government, not properly monitored through meaningful judicial review, disproportionately burdens one or a very small number of individuals, while not subjecting similarly situated persons to equivalent burdens.[112] If this kind of regulation paralyzes the courts, third parties benefit by not having to share the cost of regulation, and they become free riders.[113]

Another third party consequence is the creation of what Professor Frank Michelman calls "demoralization costs."[114] These costs "accrue to [property owners] and their sympathizers specifically from the realization that [no judicial relief] is offered" when government over-regulates.[115] These costs are the effect that excessive property regulation has on other property owners who witness but do not directly experience the regulatory impact.[116] These third parties may be less inclined to develop their property when they see a neighbor saddled with unrelieved, burdensome regulation. Furthermore, unrestricted regulation can change the preexisting distribution of wealth by forcing or authorizing exchanges of property between property owners without compensating them for their loss.[117] Such forced exchanges occur with rent-control laws that burden landlords and benefit tenants[118] and with certain environmental laws that deprive property owners of environmentally sensitive land for the benefit of the public.[119]

Another harm resulting from government interference with private property autonomy is that the disadvantaged often bear the brunt of any attendant harm.[120] Typically, when regulation creates costs or conditions of

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111. Norman Kailin, *Substantive Due Process: A Doctrine for Regulatory Control*, 13 SW. U. L. REV. 479, 480 (1983).

112. *See* LAITOS, *supra* note 9, § 1.04(C)(1).

113. *See* Dolan v. City of Tigard, 512 U.S. 374, 385-86 (1994); Armstrong v. United States, 364 U.S. 40, 49 (1960); *see also* LAITOS, *supra* note 9, § 1.04(C)(1).

114. Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165, 1214 (1967) [hereinafter Michelman, *Property*].

115. *Id.*

116. LAITOS, *supra* note 9, § 1.04(C)(1).

117. EPSTEIN, *supra* note 24, at 95-200.

118. Pennell v. City of San Jose, 485 U.S. 1, 19-23 (1988) (Scalia, J., concurring in part and dissenting in part).

119. *Dolan*, 512 U.S. at 386-87, 391-93 (1994).

120. *See* Philip P. Houle, *Eminent Domain, Police Power and Business Regulation: Economic Liberty and the Constitution*, 92 W. Va. L. Rev. 51, 61 (1989); Anthony S. McCaskey, Comment, *Thesis and Antithesis of Liberty of Contract: Excess in* Lochner *and* Johnson Controls, 3 SETON HALL CONST. L.J. 409, 459 (1993); James L. Oakes, *"Property Rights" in Constitutional Analysis Today*, 56 WASH. L. REV. 583, 624 (1981); Note,

scarcity, the poor suffer the most.[121] These distributional consequences are worsened because the poor are the least able to alter legislative decisions that produce over-regulation.[122] Moreover, legislators enacting police power regulation are often influenced by interest-group politics. The economically disadvantaged have neither the funds nor the expertise to access lobbyists who have the most influence over legislators. Therefore, the interests of the disadvantaged are not frequently reflected in police power legislation.[123]

For private property to have the potential to maximize the welfare of not only owners and those with whom they engage in transactions regarding the property but also third parties who benefit from property's public goods component, courts should protect property uses from over-zealous exercises of the police power. Courts could then preserve external benefits for third parties that result from reducing regulation of private property. The judiciary can protect both individual choices and the public good of property use by applying the legal doctrines established in constitutions that allow courts to halt excessive regulations. In the United States, the U.S. Constitution's Takings Clause provides this protection.[124]

V. SOCIAL AND POLICY BENEFITS OF THE TAKINGS CLAUSE

The Takings Clause of the U.S. Constitution is a limit on the ability of government actions to take or otherwise unreasonably burden private rights

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Resurrecting Economic Rights: The Doctrine of Due Process Reconsidered, 103 HARV. L. REV. 1363, 1371 (1990).

121. LAITOS, *supra* note 9, § 1.04(C)(1).

122. Houle, *supra* note 120, at 59, 98.

123. *See* MANCUR M. OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THEORY OF GROUPS 165-67 (2d ed. 1971); *see also* Glynn S. Lunney, Jr., *A Critical Reexamination of the Takings Jurisprudence*, 90 MICH. L. REV. 1892, 1950-51 (1992) (concentrated groups are likely to have disproportionately greater resources available than a dispersed group of poor individuals and are more likely to use the available resources more effectively to influence the legislature).

124. Legal Scholars have increasingly argued that property rights should be accorded constitutional protection equal to those enjoyed by other individual rights. *See, e.g.*, EPSTEIN, *supra* note 24; 3 FRIEDRICK A. HAYAK, LAW, LEGISLATION, AND LIBERTY: THE POLITICAL ORDER OF A FREE PEOPLE (1979); ROSE-ACKERMAN, *supra* note 109; BERNARD H. SIEGAN, ECONOMIC LIBERTIES AND THE CONSTITUTION (1980); CASS R. SUNSTEIN, AFTER THE RIGHTS REVOLUTION: RECONCEIVING THE REGULATORY STATE (1990); Ronald J. Krotoszynski, Jr., *Fundamental Property Rights*, 85 GEO. L.J. 555 (1997); Douglas W. Kmiec, *Property and Economic Liberty as Civil Rights: The Magisterial History of James W. Ely, Jr.*, 52 VAND. L. REV. 737 (1999) (reviewing PROPERTY RIGHTS IN AMERICAN HISTORY (James W. Ely, Jr. ed. 1997)). *But see* C. Edwin Baker, *Property and its Relation to Constitutionally Protected Liberty*, 134 U. PA. L. REV. 741 (1986); Alan E. Brownstein, *Constitutional Wish Granting and the Property Rights Genie*, 13 CONST. COMMENT. 7 (1996).

in land, property, or housing. [125] It serves an important check on government decisions that interfere with private choices about property interests. There are many social and policy benefits that follow from this kind of constitutional limit on governmental meddling in the economic market.

A. The Takings Clause prevents government from denying owners any use of their property

When the government denies all economically beneficial or productive use of property, it affects a *per se* taking.[126] Some courts have even decided that a *per se* taking can occur when the government substantially deprives a property owner of the use and enjoyment of property.[127] A compensable temporary taking occurs when an owner is prevented from doing anything with his or her property for a limited period of time.[128] In *Lucas v. South Carolina Coastal Council*, the Supreme Court clarified why the Takings Clause is proper by invoking Lockean-liberal assumptions about private property: "[O]ur prior takings cases evince an abiding concern for the productive use of, and economic investment in, land."[129]

B. The Takings Clause promotes economic prosperity

One of the assumptions behind the Takings Clause is that if private property rights are secure, ownership in real property is protected. The free market is allowed to operate without extensive government interference, and individuals in these communities are economically better off. Prosperity follows. The Takings Clause is designed to curb aggressive government decisions that are inconsistent with these three premises.

Moreover, if legislatures are able to change private property into public property, there has been a transfer of resources from private hands to the general community. Commentators have warned that when private owners have too many of their assets and earnings redistributed by the force of law, they will become discouraged and may stop developing their

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126. Lucas v. S. C. Coastal Council, 505 U.S. 1003, 1015 (1992).

127. Van Wyk v. Public Serv. Co., 996 P.2d 193 (Colo. App. 1999), *rev'd in part*, 27 P.3d 377 (Colo. 2001).

128. Ali v. City of Los Angeles, 91 Cal. Rptr.2d 458 (Cal. Ct. App. 1999) (two-year temporary taking).

129. *Lucas*, 505 U.S. at 1019 n.8; *see also* Shelden v. United States, 7 F.3d 1022 (Fed. Cir. 1993) (taking when government action totally destroyed value of a mortgage owned by the plaintiff).

property.[130] Property owners incur these demoralization costs when the law interferes with their expectations of keeping and controlling the properties in which they have invested. One important purpose of the Constitution's Takings Clause is to prevent this.

C. The Takings Clause encourages efficient decision making

The mere presence of the Takings Clause in the U.S. Constitution deters excessive or unreasonable government action because government actors are aware that private parties may challenge such action in court. For example, exclusionary zoning is a public and collective decision that stands in stark contrast to a system of private property decision-making, in which individual owners make choices about how to use their property. The Takings Clause might permit owners to make choices about efficient land use instead of a more distant and collective government choice.[131]

D. The Takings Clause requires the government to act fairly

One of the central tenets of the Takings Clause is that government should not extract a public benefit from private land and property owners.[132] Indeed, in *Armstrong v. United States*,[133] a seminal case in 1960, the Supreme Court explained that the principal purpose of the Takings Clause was "to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole."[134] Other courts have since decided that the essence of a takings claim, particularly a partial takings claim, is the extent to which a police power regulation has singled out one or a few property owners to bear burdens disproportionately, while the community shares the benefits.[135] When property owners have not contributed more to a problem, then it is a taking if a regulation makes them remedy the problem.[136] Even though the police power regulation may be well-intentioned, the law cannot

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130. *See* Michelman, *Property, supra* note 114, at 1211-14; *see also* JEREMY BENTHAM, PRINCIPLES OF THE CIVIL CODE, IN THEORY OF LEGISLATION 109-14, 121 (C.K. Ogden ed. 1987).

131. EPSTEIN, *supra* note 24, at 265.

132. ZIEGLER, RATHKOPF'S, *supra* note 2, § 6:16.

133. Armstrong v. United States, 364 U.S. 40 (1960).

134. *Id.* at 44.

135. *See, e.g.*, Christopher Lake Dev. Co. v. St. Louis Cnty., 35 F.3d 1269, 1275 (8th Cir. 1994); Creppel v. United States, 41 F.3d 627, 631 (Fed. Cir. 1994); Cardan Oil Co. v. City of Phoenix, 593 P.2d 656, 659 (Ariz. 1979); Manocherian v. Lenox Hill Hosp., 643 N.E.2d 479, 484 (N.Y. 1994).

136. *See, e.g.*, Bonnie Briar Syndicate, Inc. v. Town of Mamaroneck, 699 N.Y.S.2d 721 (N.Y. 1999) (discussing whether plaintiffs had been singled out or involuntarily conscripted to provide open space to the public).

force some people to confer benefits on other similarly-situated property owners.[137]

E. The Takings Clause contributes to individual liberty

In a free market system, each person's welfare is maximized if autonomous decision-making is allowed. When the government prevents such autonomy by making public and collective choices (such as a zoning or rent control law), the market is frustrated, and individual benefits may be frustrated. The Takings Clause unleashes individual liberty by limiting government actions that interfere with individualized choice about land, property, and ownership rights. Such liberty of choice in turn yields economic prosperity.[138]

VI. CONCLUSION

Although government housing policies are often said to be designed to benefit the general welfare, sometimes those same policies can result in damaging burdens to private property owners, including prospective buyers as consumers of housing. Such burdens, in turn, not only harm these existing and prospective housing owners, but also they can produce social costs that adversely affect the public as a whole. A higher law, such as the U.S. Constitution or the European Convention on Human Rights, can sometimes utilize constitutional norms to override the government policies that create these types of negative consequences for property owners and the public. Landlords and developers are not the only beneficiaries of the application of this higher law. The market for higher quality and affordable housing is often assisted when excessive or unreasonable restrictions on private housing decisions are removed.

137. *See* Robert C. Ellickson, *Suburban Growth Controls: An Economic and Legal Analysis*, 86 YALE L.J. 420 (1977); A. Dan Tarlock, Zoning and Land Use Symposium: *Regulatory Takings*, 60 CHI.-KENT L. REV. 23, 31 (1984).

138. EPSTEIN, *supra* note 24, at viii.

BEYOND TRAFFICKING AND SEXUAL EXPLOITATION: PROTECTING INDIA'S CHILDREN FROM INTER AND INTRA-FAMILIAL SEXUAL ABUSE

Jennifer Bays Beinart*

I. INTRODUCTION

Child sexual abuse (CSA) has been documented throughout history.[1] However, the willingness to recognize CSA as a problem has varied considerably.[2] It was not until the 1960s and 1970s that the United States recognized CSA as a serious problem affecting its youth.[3] As time passed, other nations began to acknowledge CSA as a significant social issue.[4] Then, in 1989, the United Nations General Assembly adopted the Convention on the Rights of the Child (CRC) which called for the protection of children from all forms of sexual exploitation and abuse.[5] Although the CRC has been ratified by every nation except Somalia and the United States,[6] most countries continue to struggle to address CSA, whether

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1. SANDY K. WURTELE & CINDY L. MILLER-PERRIN, PREVENTING CHILD SEXUAL ABUSE 1 (1992).

2. *Id.*

3. *Id.* at 3.

4. *Id.*

5. Convention on the Rights of the Child, G.A. Res. 44/25, U.N. Doc A/RES/44/25 (Nov. 20, 1989).

6. The United States signed the CRC on February 16, 1995, but has yet to ratify the agreement. Convention on the Rights of the Child, *opened for signature* Nov. 20, 1989, 1557 U.N.T.S. 3, *available at* http://treaties.un.org/doc/Publication/MTDSG/Volume%20I/Chapter%20IV/IV-11.en.pdf. When ratifying a treaty the United States evaluates the treaty's compliance with existing state and federal law and practice. *Frequently Asked Questions - Convention on the Rights of the Child,* U.N.I.C.E.F., http://www.unicef.org/crc/index_30229.html (last updated Feb. 10, 2006). This process often takes several years or longer if the treaty is politicized or controversial. *Id.* Additionally, the United States generally only reviews one human rights treaty at a time. *Id.* Currently, the United States is reviewing the Convention on the Elimination of All Forms of Discrimination against Women. *Id.* The Convention on the Elimination of All Forms of Discrimination against Women was signed by the United States on July 17, 1980, and has yet to be ratified by Congress. Convention on the Elimination of All Forms of Discrimination against Women, *opened for signature* Mar. 1, 1980, 1249 U.N.T.S. 13, *available at* http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=IV-8&chapter=4& lang=en.

culturally or through their legislatures.[7] India is no exception.

As of 2007, India was home to the world's largest number of sexually abused children: every 155 minutes, a child between the ages of ten and sixteen is raped, and every thirteen hours, a child younger than ten is raped.[8] India is the largest democracy in the world with over 1.17 billion inhabitants, of which approximately thirty percent are fourteen years of age or younger.[9] In India, fifty-three percent of all children, or 248 million children, have reported being sexually abused.[10] The number of CSA victims in India is more than three times the number of children living in the United States.[11]

With over half of India's children suffering from the emotional, physical, and mental effects of CSA, India's ability to thrive as a healthy and strong democracy is severely impaired.[12] According to a 2007 study by the Indian Ministry of Women and Child Development, fifty percent of CSA is perpetrated by persons known to the child or in a position of trust and responsibility.[13] India can no longer argue that CSA is a "Western

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7. While it is hard to compare various prevalence studies due to differing methodology, CSA rates tend to be above ten percent in many western nations. *See Table 1: Prevalence studies of child sexual abuse in different countries,* NATIONAL SOCIETY FOR THE PREVENTION OF CRUELTY TO CHILDREN, http://www.nspcc.org.uk/Inform/research/briefings/prevalencetable1_wdf49715.pdf (last visited Jan. 22, 2011); WURTELE & MILLER-PERRIN, *supra* note 1, at 6-10.

8. LOVELEEN KACKER, SRINIVAS VARADAN, & PRAVESH KUMAR, MINISTRY OF WOMEN AND CHILD DEV., STUDY ON CHILD ABUSE: INDIA 2007 7 (2007), *available at* http://wcd.nic.in/ childabuse.pdf.

9. *The World Factbook: India,* CIA, https://www.cia.gov/library/publications/the-world-factbook/geos/in.html (last visited Dec. 22, 2010).

10. *Child Protection Issues,* CHILDLINE INDIA FOUND., http://www.childlineindia.org.in/cr_CPI_abuse_6.htm (last visited Dec. 22, 2010).

11. As of 2006, there were an estimated 73.7 million children under the age of 18 in the United States. *Number of Children,* CHILD TRENDS DATABANK, http://www.childtrendsdatabank.org/pdf/53_PDF.pdf (last visited Dec. 22, 2010).

12. KACKER ET AL., *supra* note 8, at ii.

13. *See id.* at vii. This study was the first comprehensive CSA study in India and was ordered by the newly created Ministry of Women and Child Development in order to understand the "extent and magnitude of [CSA] in India." *Id.* at i. The Ministry began the study in 2005, which covered thirteen Indian States with a sample size of 12,447 children (5 to 18 years of age), 2324 young adults (18 to 24 years of age), and 2449 stakeholders. *Id.* at iii, 15. Stakeholders were persons who held positions in government departments, private service, urban and rural local bodies, and individuals from the community. *Id.* at 16. Stakeholders were included in order to survey the possible agencies to deal with child abuse. *Id.* The study examined four different types of abuse: physical, sexual, emotional, and girl child neglect. *Id.* at 14. The study divided up participants into five different evidence groups: (1) children in a family environment, (2) children in school, (3) children at work, (4) children on the street, and (5) children in institutions. *Id.* at 15. The study attempted to maintain an equal number of boys and girls in each evidence group. *Id.* The data collection process took approximately six months. *Id.* at 17. Data entry was done by a professional agency hired by the Ministry. *Id.* at 18. The analysis of the data and writing of the report

problem."[14] Statistics prove that India's children are being abused, not only by Western tourists or the sex trade, but also by family members and family friends.[15] CSA is India's problem.

II. ISSUE: INDIA'S CHILDREN LACK LEGAL PROTECTION AGAINST CHILD SEXUAL ABUSE

Since the 1990s, several theories have attempted to explain India's high CSA rates. For example, many theorists point to India's outdated laws and unresponsive judiciary.[16] Unlike the United States and most developed nations, India does not have explicit laws addressing inter-familial and intra-familial CSA, nor does India's penal code recognize incest as a crime.[17] India's sexual offense laws penalize only rape, sodomy, unnatural offenses,[18] and outrage against the modesty of a woman.[19] The Indian Penal Code (IPC) has been criticized for its lack of punishment for crimes associated with a CSA case.[20] Most of the applicable sections of the IPC impose a maximum prison sentence of two years and/or a fine.[21]

India's lack of explicit prohibitions against incest and CSA also

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was completed by the Ministry. *Id.* at 19. For the purpose of this study, sexual abuse was defined as "severe" and "other." *Id.* at 73. Severe forms of abuse included assault (including rape and sodomy), touching or fondling a child, exhibitionism (forcing a child to exhibit his/her body parts), and photographing a child in the nude. *Id.* Other forms included forcible kissing, sexual advances toward a child during travel, sexual advances toward a child during marriage situations, exhibitionism (exhibiting before a child), and exposing a child to pornography. *Id.* at 73. Out of the total child respondents, 53.22% reported having encountered either a severe or other form of abuse. *Id.* at 74. *See* KACKER, ET AL., *supra* note 8, at 13-20 (additional information regarding the study methodology). In contrast, according to the 2010 Fourth National Incidence Study of Child Abuse and Neglect, twenty-two percent of children in the United States are sexually abused each year. ANDREA J. SEDLAK ET AL, U.S. DEPT. OF HEALTH & HUMAN SERVS., FOURTH NATIONAL INCIDENCE STUDY OF CHILD ABUSE AND NEGLECT (NIS-4) 6, 6-7 (2010).

14. KACKER ET AL., *supra* note 8, at 73.

15. *See id.* at 81 (stating that only twenty-one percent of children reported being abused by strangers or those they faintly knew).

16. *E.g.*, ASHA BAJPAI, CHILD RIGHTS IN INDIA: LAW, POLICY, AND PRACTICE 14 (2d ed.2006).

17. Shoma Chatterji, *Incest and the Conspiracy of Silence*, INDIA TOGETHER (Apr. 30, 2009), http://www.indiatogether.org/2009/apr/chi-incest.htm.

18. Section 377 of the Indian Penal Code states that "[w]hoever voluntarily has carnal intercourse against the order of nature with any man, woman or animal" commits an unnatural offense. PEN. CODE § 377 (2010) (India). The explanation to this section requires that the penetration be "sufficient to constitute carnal intercourse." *Id.*

19. Chatterji, *supra* note 17.

20. *Moily for Tough Law Against Child Sexual Abuse*, ECON. TIMES (India) (Jan. 14, 2010, 04:04 AM IST), http://economictimes.indiatimes.com/news/politics/nation/Moily-for-tough-law-against-sexual-abuse/articleshow/5442354.cms.

21. Neeta Lal, *Hidden Darkness: Child Sexual Abuse in India*, ASIA SENTINEL (May 2, 2007), http://www.asiasentinel.com/index.php?option=com_content&task= view&id=476& Itemid=34.

affects India's compliance with the multinational CRC.[22] The United Nations Committee on the Rights of the Child continues to express concern with India's outdated CSA laws.[23] While India has addressed other issues concerning children such as child education, health and development,[24] its CSA actions have been woefully inadequate. In order to comply with the CRC, India must make changes to its antiquated laws and judicial procedures.

The first part of this Note provides a short introduction to CSA, discusses possible definitions of CSA, and discusses the recognition of CSA as a societal problem. The second part of this Note examines current CSA laws and the case of *Sakshi v. Union of India*.[25] In addition, this part focuses on the United Nations Convention on the Rights of the Child, Indian Constitution, Indian Penal Code of 1860, Goa Children's Act and its Amendments, and the Commissions for the Protection of Child Rights Act. Finally, this Note discusses recommendations for India's Parliament and Executive to better tackle the problem of CSA in India while improving compliance with the CRC.

III. BACKGROUND

A. What is CSA?

There is little agreement on the appropriate definition of CSA.[26] There are medical, psychological, legal, sociological, feminist, and moral definitions of CSA.[27] Cultural differences may account for the varied CSA definitions.[28] "Perceptions of what constitutes sexual abuse are culturally and socially determined, with the result that acts which are considered offensive in one cultural context may be quite normal in another."[29] Separate countries and/or cultures have different definitions of "child" and "sexual," which also highlight varying perceptions about the duration of childhood and a child's proper development.[30]

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22. Comm. on the Rights of the Child, *Consideration of Reports Submitted by States Parties Under Article 44 of the Convention,* 35 U.N. DOC. CRC/C/15/Add.228 (Feb. 26, 2004).

23. *Id.*

24. Deepa Jain Singh, *Foreword* to LOVELEEN KACKER, SRINIVAS VARADAN, & PRAVESH KUMAR, MINISTRY OF WOMEN AND CHILD DEV., STUDY ON CHILD ABUSE: INDIA 2007 iii (2007), *available at* http://wcd.nic.in/childabuse.pdf.

25. Sakshi v. Union of India & Ors, A.I.R. 2004 S.C. 3566 (India).

26. INT'L CHILD DEV. INITIATIVES, CHILD SEXUAL ABUSE: WHAT CAN GOVERNMENTS DO? 3 (Rekha Wazir & Nico van Oudenhoven eds., 1998).

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.*

For example, "Age limits are a legal manifestation of a community's beliefs regarding the development of a child's capacities and responsibilities. . . . But age limits vary from activity to activity and country to country."[31] In the United States, "[r]esearchers concerned with establishing the prevalence of CSA have defined the term child using chronological age thresholds of sixteen, seventeen, or eighteen years."[32] These thresholds correspond with other increased privileges in the United States such as driving, voting, having the option to drop out of school, and getting married. Across the world, legal definitions of childhood vary substantially; the legal age of consent for sexual activity spans from twelve in some parts of Mexico and the Philippines to twenty-one in Madagascar.[33] Additionally, some countries, including Ecuador, North Korea, Oman, and Pakistan, do not have a legal age of consent for sexual activity.[34]

India, like the United States, has several different legal thresholds marking the end of childhood. The Census of India defines a child as a person below the age of fourteen.[35] Passed during British rule, the Indian Majority Act[36] defined a child as anyone under the age of eighteen, unless a particular personal law[37] stated otherwise.[38] The Child Marriage Restraint Act, the passage of which was due to British pressure to reduce the number of child marriages, defined the age of sexual consent for a female as sixteen if unmarried and fifteen if married.[39] Later, the IPC was amended to mirror the legal definition of childhood from the Child Marriage Restraint Act and established the age of sexual consent for both males and females as sixteen, unless the child is married, in which case the age of sexual consent is fifteen.[40]

Defining the term "sexual" has also been plagued by a lack of uniformity. Most scholars and cultures agree that certain behaviors such as

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31. BAJPAI, *supra* note 16, at 2.

32. STEPHEN SMALLBONE ET AL., PREVENTING CHILD SEXUAL ABUSE: EVIDENCE, POLICY, AND PRACTICE 2-3 (2008).

33. *Id.*

34. *Id.*

35. BAJPAI, *supra* note 16, at 2.

36. Indian Majority Act, No.9 of 1875, INDIA CODE (2010).

37. Instead of a uniform civil code, India adopted four personal law systems: Hindu, Muslim, Christian, and Parsis. These personal laws cover subjects such as marriage, divorce, inheritance, adoption, and custody of children. Those who do not fall within one of the four religions specified may appeal either to general civil law, where such laws could be identified, or to Hindu personal law. Purushottam Bilimoria, *Muslim Personal Law in India: Colonial Legacy and Current Debates*, http://www.law.emory.edu/ifl/index2.html (last visited Dec. 22, 2010). *See also* Asha Bajpai, *Custody and Guardianship of Children in India*, 39 FAM. L.Q. 441 (2005) (discussing India's many religions and legal custody of children).

38. Indian Majority Act, No. 9 of 1875.

39. Child Marriage Restraint Act, No. 19 of 1929, INDIA CODE (2010).

40. PEN. CODE § 375 (2010) (India).

genital stimulation or sexual intercourse qualify as sexual.[41] However, there is less agreement as to whether the term sexual could extend to behaviors such as bathing or sleeping with a child, kissing a child, or massaging a child.[42]

The lack of uniformity in the definition of sexual has led to many generalized CSA definitions that attempt cross-cultural application. One widely-used definition describes CSA "as any kind of physical or mental violation of a child with sexual intent usually by a person who is in a position of trust or power vis-à-vis the child."[43] Another source defines CSA as "any sexual behavior directed at a person under sixteen, without informed consent."[44]

B. Acknowledgement of CSA as a recognized problem

In the late nineteenth century, both charity and social workers in the United States were familiar with CSA and knew that the most common form was intra-familial CSA; however, the view of these workers, as well as the view of the general public, changed drastically in the early twentieth century.[45]

> By the 1920's [sic] a three part transformation in attitude had occurred: [CSA] was perceived to be in the streets, rather than in the home, the perpetrator was perceived as a perverted stranger rather than a male family member, and the victim was perceived as a temptress rather than an innocent child.[46]

As a result of this change in perception, social workers de-emphasized incest and academics dismissed incest as being extremely rare, claiming that it occurred in only one in a million cases.[47] Even though Indiana University professor and revolutionary sex researcher Alfred Kinsey's studies in the middle of the twentieth century established that incest and CSA were far from rare, Kinsey did not view CSA as problematic.[48] Thus, while professionals acknowledged CSA was occurring, its consequences were minimized.[49]

The sexual revolution of the 1960s and 1970s led to a public

41. SMALLBONE ET AL., *supra* note 32, at 3.
42. *Id.*
43. BAJPAI, *supra* note 16, at 207.
44. *Id.*
45. WURTELE & MILLER-PERRIN, *supra* note 1, at 2.
46. *Id.*
47. *Id.*
48. *Id.*
49. *Id.*

awareness of the problems of CSA. The sexual revolution created an atmosphere in which *adults* who had been victims were encouraged to discuss their experiences.[50] As official reports of CSA increased and CSA began to receive unprecedented media coverage, the United States finally recognized that CSA was a serious problem.[51]

Conversely, CSA is still a taboo subject in India that is shrouded in a conspiracy of silence.[52] Most Indians believe that CSA is largely a Western problem and that CSA does not occur in India.[53] This disbelief can be partially explained by India's conservative family and community structure that does not allow discussion of sex and/or sexuality.[54] Additionally, India has developed a culture that prizes virginity in female children.[55] Many different cultural and social practices have been developed to protect a female child's purity prior to marriage.[56] These practices include child marriage, segregating the sexes except in situations that can be observed by elders, and disfavoring marriage with a non-virgin female.

Most Indians believe that families and communities, as opposed to the government, are responsible for the care and protection of children.[57] A strong patriarchal family rarely recognizes that children are individuals with their own rights.[58] Rather, children are the responsibility of the male figurehead, who has the right to make decisions regarding his child's care and welfare.

In 1985, in order to address the needs of women and children, the Government of India created the Department of Women and Child Development in the Ministry of Human Resource Development.[59] The Department of Women and Child Development pushed for a rights-based approach to bolster development and protection for women and children.[60] In 2006, India made a firm commitment to a right-based approach to the development and advancement of India's women and children and upgraded the Department of Women and Children to a Ministry.[61] Initial Ministry investigations revealed that India suffered serious gaps in child protection.[62] Furthermore, the Ministry discovered that India had enormous

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50. *Id.* at 3.
51. *Id.*
52. KACKER ET AL., *supra* note 8, at 73.
53. *Id.*
54. *Id.*
55. *Id.*
56. *Id.*
57. KACKER ET AL., *supra* note 8, at v.
58. *Id.*
59. *About Us*, MINISTRY OF WOMEN AND CHILD DEV., http://wcd.nic.in/ (last visited Dec. 22, 2010).
60. *See* KACKER ET AL., *supra* note 8, at v.
61. *About Us*, *supra* note 59.
62. KACKER ET AL., *supra* note 8, at v.

numbers of children who needed care and protection.[63]

However, the Ministry has continually suffered from insufficient budgetary allocations and a lack of programs to protect children in need of services.[64] In the course of researching the needs of India's children, the Ministry observed that India's child protection scheme needed an enabling environment, constructed through legislation, to address issues of child abuse.[65] In addition, the Ministry recognized the need for a national policy on child protection that included procedures for interventions and outreach service.[66] In order to address these needs, the Ministry, in conjunction with Parliament, created the National Commission for the Protection of the Rights of the Child.[67] The Ministry and Parliament also began to draft a bill to prevent offenses against children and construct a comprehensive national child protection scheme.[68] During this process, a lack of data on offenses against children held back the Ministry's work.[69] In order to understand the gravity of the problem, the Ministry initiated a national study on child abuse.[70] This study, as well as the increasing number of grown CSA victims speaking about their experiences, led India to realize that CSA is not just a western problem, but a global problem.[71]

IV. UNITED NATIONS CONVENTION ON THE RIGHTS OF THE CHILD (CRC)

The CRC has three articles that address a government's responsibility to prevent CSA and other forms of child abuse. Article 19 requires governments to take all "appropriate legislative, administrative, social and educational measures" to protect children from CSA and incest.[72] Protective measures, according to the CRC, should include "effective procedures for the establishment of social [programs] to provide necessary support for the child and for those who have the care of the child, as well as for other forms of prevention and for identification, reporting, referral, investigation, treatment, and follow-up."[73] Article 34 requires governments

63. *Id.*
64. *Id.*
65. *Id.*
66. *Id.*
67. *Id.*
68. *Id.*
69. *Id.*
70. *Id.* Prior to this study, the only information available annually was the crime database managed by the National Crime Records Bureau. However, this information only included reported crimes under the India Penal Code (IPC). *Id.* at 8. This information is unreliable as most CSA goes unreported and incidents which are reported often do not qualify as crimes under the IPC. *Id.* at 9. *See infra* Part V.B.
71. KACKER ET AL., *supra* note 8, at 73.
72. Convention on the Rights of the Child, *supra* note 5, art.19.
73. *Id.*

to protect children from all forms of sexual exploitation and abuse (CSA).[74] Finally, Article 39 requires states to "take all appropriate measures to promote physical and psychological recovery and social reintegration of a child victim."[75] Recovery measures are intended to foster respect for the "health, self-respect and dignity" of the child victim.[76]

Article 253 of the Indian Constitution allows Parliament to implement and ratify treaties.[77] On November 12, 1992, India ratified the CRC.[78] Additionally, the Supreme Court of India has held that "once signed, any international treaty will be treated as part of the law unless otherwise stated."[79] Thus, once India signs a convention or treaty, India is bound to its obligation to implement that convention or treaty unless dictated otherwise.[80] This enables all citizens to bring actions to enforce provisions of a signed agreement and to use the agreement's provisions to support legal arguments.[81]

V. INDIA'S CURRENT CSA PROTECTIONS

A. Constitution

India's Constitution "recognizes the vulnerable position of children and their right to protection."[82] Following the doctrine of protective discrimination,[83] Article 15 of the Indian Constitution provides for special attention to children through laws and policies designed to safeguard their rights.[84] Article 39 grants further protection, requiring the state to "direct its policy towards securing . . . that children are given opportunities and facilities to develop in a healthy manner and in conditions of freedom and dignity and that childhood and youth are protected against exploitation and against moral and material abandonment."[85]

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74. *Id.* art. 34.
75. *Id.* art. 39.
76. *Id.*
77. INDIA CONST. art. 253.
78. BAJPAI, *supra* note 16, at 23.
79. *Id.* at 14-15.
80. *Id.* at 15
81. *Id.*
82. KACKER ET AL., *supra* note 8, at 23.
83. The doctrine of protective discrimination, also known as positive discrimination, provides special privileges to a particular group to offset societal discrimination. This doctrine is most often invoked for women and the scheduled castes of India. *See* TAMESHNIE DEANE, AFFIRMATIVE ACTION: A COMPARATIVE STUDY 264-70 (2005) (J.D. Thesis, University of South Africa), *available at* http://uir.unisa.ac.za/dspace/bitstream/10500/2012/2/09chapter8.pdf.
84. Article 15(c) states that "[n]othing in this article shall prevent the State from making any special provision for women and children." INDIA CONST. art. 15(c).
85. INDIA CONST. art. 39(f).

B. Laws and Statutes

1. Indian Penal Code of 1860

The Indian Penal Code (IPC) is the primary code for all criminal offenses and punishment in India. The code has been described by some as archaic and sexist.[86] However, the IPC does not directly address or recognize CSA.[87] Furthermore, Indian laws fail to provide a clear legal definition of CSA.[88] The majority of CSA cases brought in India are tried under Section 375, which many argue is adequate to deal with CSA.[89] Under Section 375, rape is defined as penile penetration in a vagina, which is sufficient to constitute sexual intercourse.[90] Section 375 states:

> A man is said to commit "rape" who . . . has sexual intercourse with a woman under circumstances falling under any of the six following descriptions:
>
> First. - Against her will.
> Secondly. - Without her consent.
>
> Thirdly. - With her consent, when her consent has been obtained by putting her or any person in whom she is interested in fear of death or of hurt.
>
> Fourthly. - With her consent, when the man knows that he is not her husband, and that her consent is given because she believes that he is another man to whom she is or believes herself to be lawfully married.
>
> Fifthly. - With her consent, when, at the time of giving such consent, by reason of unsoundness of mind or intoxication or the administration by him personally or through another of any stupefying or unwholesome substance, she is unable to understand the nature and consequences of that to which she gives consent.

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86. *See* PINKI VIRANI, BITTER CHOCOLATE: CHILD SEXUAL ABUSE IN INDIA (2000).

87. PEN. CODE (2010) (India).

88. BAJPAI, *supra* note 16, at 14.

89. *See id.* at 217-20.

90. The IPC explanation states that "[p]enetration is sufficient to constitute the sexual intercourse necessary to the offence of rape." PEN. CODE § 375 (2010) (India). However, this has been interpreted to require penetration of a sufficient force or depth to qualify as sexual intercourse. *See* Lal, *supra* note 21.

> Sixthly. - With or without her consent, when she is under sixteen years of age.[91]

The IPC does not recognize digital, oral, or object penetration, nor does it recognize the rape of a man by another man or woman.[92] In addition, the IPC's definition of rape is highly dependent on medical evidence to support the allegation of penetration.[93] Prior to 2000, most courts stated that evidence of non-injury signified consent of the victim or the falsity of the claim.[94] However, in 2000, the Supreme Court of India set aside a lower court ruling that acquitted an accused rapist on the grounds that the lack of injury to the victim was a material fact.[95] As such, the high court held that it was probable that the victim had consented.[96] Thus, with the Supreme Court's ruling, evidence of non-injury to the victim is no longer considered prima facie evidence of consent or falsity.[97]

Section 377 – unnatural offenses – is often invoked as a supplementary cause of action for CSA when penile penetration is not present.[98] Under Section 377, "[w]hoever voluntarily has carnal intercourse against the order of nature with any man, woman, or animal, shall be punished with imprisonment for life, or with imprisonment of either description for a term which may extend to ten years and shall also be liable to fine."[99] Section 377 is most often used when male children are sexually abused.[100] Specifically, this section was designed to prevent sodomy and only applies to cases of penile penetration.[101] Thus, this section does not cover acts such as sexual molestation, or digital and/or object penetration.[102] Similar to Section 375, the degree of penetration must be sufficient to constitute intercourse.[103]

Section 354 is the last resort for CSA victims when an offense cannot be prosecuted under Sections 375 or 377. Section 354 criminalizes acts that outrage a person's modesty.[104] Under Section 354, "[w]hoever assaults or uses criminal force to any woman, intending to outrage or knowing it to be

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91. PEN.CODE § 375 (2010) (India).
92. *See* PEN. CODE (2010) (India).
93. LAL, *supra* note 21. *See* LAW COMM. OF INDIA, ONE HUNDRED FIFTY-SIXTH REPORT ON THE INDIAN PENAL CODE 184 (1997), *available at* http://lawcommissionofindia.nic.in/101-169/Report156Vol1.pdf [hereinafter 156TH REPORT].
94. VIRANI, *supra* note 86, at 147.
95. *Id.*
96. *Id.*
97. *Id.*
98. *Id.* at 137.
99. PEN. CODE § 377 (2010) (India).
100. BAJPAI, *supra* note 16, at 219-20.
101. *See Child Protection Issues, supra* note 10.
102. *See id.*
103. PEN. CODE § 377 (2010) (India).
104. PEN. CODE § 354 (2010) (India).

likely that he will thereby outrage her modesty, shall be punished with imprisonment of either description for a term which may extend to two years, or with fine, or with both."[105] Section 354 is alternatively referred to as molestation.[106] Under Section 354, only a female's modesty can be outraged; thus, no section of the IPC deals with the sexual molestation of males.[107]

The IPC imposes varying penalties depending on the severity of the crime. However, much like the United States, India rarely imposes the maximum sentence.[108] For example, in cases of rape, some victims are later married to the abuser, which subsequently results in the charges being dropped.[109] Even though the maximum prison sentence under Section 377 is ten years, imprisonment terms are most often five years.[110] Under Section 354, sentences are generally less than the two year maximum term.[111]

The most stringent sexual offense penalties in the IPC are reserved for the crime of rape. Under Section 376, imprisonment ranges from seven years to life. Note that if the victim is a woman, the perpetrator is her husband, and she is 12 years of age or older, the convicted only faces a prison term of up to two years.[112] In addition to the statutorily-based prison terms, Section 376 allows for significant judicial discretion: the court may, "for adequate and special reasons to be mentioned in the judgment, impose a sentence of imprisonment for a term of less than seven years."[113] In one example of such latitude, a court reduced a jail term to six months when the rapist agreed to pay the victim's father "four lakh rupees" (Rs. 400,000) following negotiations between the father and the rapist.[114] The court agreed to the reduction and stated that "the compensation is necessary for a woman who will never get married."[115]

2. Goa Children's Act of 2003

In 2003, Goa, an Indian state, took a major step forward in the fight to reduce CSA with the passage of the Goa Children's Act (GCA).[116] Many

105. *Id.*
106. VIRANI, *supra* note 88, at 137.
107. *See Child Protection Issues, supra* note 10.
108. See VIRANI, *supra* note 86, at 137.
109. *Id.*
110. *See Child Protection Issues, supra* note 10; VIRANI, *supra* note 86, at 137.
111. PEN. CODE § 354 (2010) (India).
112. PEN. CODE § 376 (2010) (India).
113. *Id.*
114. VIRANI, *supra* note 86, at 137.
115. *Id.*
116. Goa Children's Act, 2003, No. 18, Act of Leg. Assembly of Goa, 2003 (India), *available at* http://www.goagovt.nic.in/documents/goachildact2003.pdf.

child advocates have recommended that this legislation be used as a model to draft a national bill criminalizing incest and CSA in India.[117] The GCA explicitly criminalized a variety of sexual offenses against children[118] and set up Children's Courts to try CSA cases.[119] Under the GCA, CSA is divided into three categories: (1) Grave Sexual Assault, (2) Sexual Assault, and (3) Incest.[120]

According to the GCA, "Grave Sexual Assault . . . covers different types of intercourse: vaginal, oral, anal, use of objects, forcing minors to have sex with each other, deliberately causing injury to the sexual organs, [and] making children pose for pornographic photos or films."[121] Sexual assault covers "sexual touching with the use of any body part or object, voyeurism, exhibitionism, showing pornographic pictures or films to minors, making children watch others engaged in sexual activity, issuing of threats to sexually abuse a minor, [and] verbally abusing a minor using vulgar and obscene language."[122] The GCA is the first Indian statute to explicitly criminalize incest and impose criminal penalties for incest.[123] Under the GCA, incest is "the commission of a sexual offense by an adult on a child who is a relative or is related by ties of adoption."[124] In addition to the three categories of CSA, the GCA provides a slightly expanded definition of child, which includes all persons under the age of eighteen unless otherwise specified by law.[125]

Depending on the nature and severity of the crime, the GCA provides for both imprisonment and fines. If a person is convicted of grave sexual assault, he or she faces a sentence between seven and ten years, as well as a fine of Rs. 200,000.[126] A person convicted of sexual assault under the GCA faces a prison sentence of up to three years and a fine of Rs. 100,000.[127] If

117. *See SC Sets Norms to Curb Child Trafficking*, HINDUSTAN TIMES (India), Jan. 16, 2010; Sairam Bhat, *Too Little for the Little Ones*, INDIA TOGETHER (Dec. 2004), http://www.indiatogether.org/2004/dec/chi-abuse.htm.

118. The GCA does not include CSA in its terminology; instead, the crimes are referred to as sexual offenses. Under the GCA a sexual offense is a sexual act listed in one of the three categories above committed against or with a child. However, for purposes of uniformity in this Note, the term sexual offense (as utilized in the GCA) is analogous to CSA.

119. Goa Children's Act, 2003, § 27. The GCA went into effect in July 2003, and the Children's Court started hearing cases on December 10, 2004. DIRECTORATE OF WOMEN AND CHILD DEVELOPMENT (GOVERNMENT OF GOA), CITIZEN'S CHARTER § B (3.4) (2005), *available at* http://www.goagovt.nic.in/charter/files/women_child/charter.pdf.

120. Goa Children's Act, 2003, §§ 2(y)(i)-(iii).

121. *Id.* § 2(y)(i).

122. *Id.* § 2(y)(ii).

123. *Id.* § 8(2).

124. *Id.* § 2(y)(iii).

125. *Id.* § 2(d).

126. *Id.* § 8(2).

127. *Id.*

a person commits incest, he or she faces a maximum imprisonment of one year and a fine of Rs. 100,000.[128]

In addition to creating criminal sanctions for CSA, the GCA created the Children's Court of Goa.[129] The goal of the Children's Court is to maintain a child-friendly environment that is tailored to the needs of young victims and their parents.[130] The Children's Court has jurisdiction over all offenses against children, whether specified in the GCA or some other law.[131] Other than appeals to the Bombay High Court or Indian Supreme Court, no other court has jurisdiction over offenses against children.[132] All Children's Court proceedings qualify as judicial proceedings.[133] The Court has the powers of both a civil court and a Court of Sessions under the Code of Criminal Procedure.[134] This enables the court to issue summons, enforce attendance of witnesses, compel discovery, administer oaths, record evidence, and impose criminal penalties.[135]

The GCA sets out specific procedural safeguards to protect children in Children's Court proceedings.[136] The Act calls for the use of non-stigmatizing language and explicitly prohibits the use of "adversarial or accusatory words, such as, arrest, remand, accused, charge sheet, trial, prosecution, warrant, summons, conviction, inmate, delinquent, neglected, custody, etc."[137] Furthermore, only a judge may aggressively question a child victim.[138] In the Children's Court, the *accused* carries the burden of proof when the victim of the alleged offense is a child.[139] When a child victim testifies before any authority, including the Court, the child victim may not testify in the presence of the accused.[140] Instead, provisions provide for testimony by child victims via closed circuit television.[141] All questions to child victims are to be short, clear, and concise.[142] Leading questions may be used by social workers when taking the testimony of children under eight years of age.[143] The GCA also calls for procedures to

128. *Id.*
129. *Id.* §§ 27-32.
130. *See id.* § 27(2).
131. *Id.* § 30(1).
132. *Id.* § 34.
133. *Id.* §§ 31(1)-(2).
134. *Id.*
135. *See id.* §§ 31(1)-(2), 33; CODE CRIM. PROC. (2010) (India), *available at* http://indiacode.nic.in/fullact1.asp?tfnm=197402; PEN. CODE §§ 195, 228 (2010) (India).
136. *See* Goa Children's Act, 2003, No. 18, Act of Leg. Assembly of Goa, 2003, § 32 (India), *available at* http://www.goagovt.nic.in/documents/goachildact2003.pdf.
137. *Id.* § 32(1)(e).
138. *Id.* § 31(2)(e).
139. *Id.* § 31(1)(*l*).
140. *Id.* § 31(1)(m).
141. *Id.* § 31(2)(f).
142. *Id.* § 31(2)(n)(v).
143. *Id.* § 31(2)(n)(vi).

increase the child-friendly nature of the Court. Instead of a court proceeding with old English formality, such as robes and wigs, the Court incorporates child friendly apparel, explanations of the roles of court members to young witnesses, informing child witnesses/victims of their role in the proceedings, and enabling children to familiarize themselves with the court surroundings.[144]

The GCA requires the creation of victim assistance units.[145] These units are designed to assist children in comprehending and healing from CSA.[146] The victim assistance units also provide support and education to children appearing as witnesses in cases before the Children's Court.[147] Provisions within the GCA provide for sensitization training for professionals involved in the investigation and litigation of CSA cases.[148] This training is to combat the lack of experience exhibited by the majority of police, psychologists, doctors, nurses, and other health professionals in India in identifying CSA and helping rehabilitate children from CSA.[149] Thus, sensitization training is needed to ensure that healthcare and other professionals understand the special needs of child victims in both cases of CSA and child abuse.[150]

Sensitization training should help police and others in law enforcement become familiar with the appropriate laws and rights of children. In order to prosecute and convict CSA offenders, police must be aware of the necessary elements of the crime, the proper procedures, and how to interact with children. Increased convictions are not possible until those involved in the investigative and prosecutorial processes understand both the proper legal basis for prosecution and the needs of the children involved.

However, the GCA has been scrutinized for poor drafting, lack of legal insight, and for placing the responsibility of coping with CSA upon different members of society, such as hotel owners and cyber café operators.[151] For example, the GCA holds both the owner and the manager of a hotel or similar establishment solely liable for any violations of the GCA.[152] A hotel owner is required to ensure "that children are safe and not at risk of child abuse within [the hotel's] premises including all adjoining beaches, parks, etc."[153] Violations include allowing a child to enter a guest

144. *Id.* §§ 32(o)(2)(a), 32(2)(n)(i)-(ii), 32(2)(n)(iv), 27(2).
145. *Id.* § 8(19).
146. *Id.*
147. *Id.*
148. *Id.* §§ 8(20), (21).
149. *See* VIRANI, *supra* note 86, at 174-75, 185-88.
150. *Id.* at 185-86.
151. Bhat, *supra* note 117.
152. Goa Children's Act, 2003, No. 18, Act of Leg. Assembly of Goa, 2003, § 8(10)(d) (India), *available at* http://www.goagovt.nic.in/documents/goachildact2003.pdf.
153. *Id.* § 8(10)(a).

room where he or she is not a registered guest staying with a person related by blood and allowing children access to unfiltered internet facilities.[154]

The constitutionality of the GCA has also been questioned. Lawyers have filed several petitions in the Bombay High Court that question the burden of proof and the access of the accused to cross-examine the child victim aspects of the GCA.[155] However, none of these petitions have been heard due to the Bombay High Court's case backlog.[156] Conflicts between the GCA and other laws have also raised concerns. Some argue that provisions of the Indian Constitution and the IPC already protect children from sexual exploitation.[157] Others argue that the Indian Parliament, which was considering a similar bill when the GCA was passed, should implement this type of legislation.[158] Critics of the GCA question which act will prevail in the event Parliament does pass similar legislation.[159]

The Children's Court has not been immune from criticism, either. Questions have been raised regarding whether the Children's Court is actually any more child friendly than the other courts in India.[160] For example, it is unclear whether children must wait for proceedings in the same waiting room as their abusers.[161] Efforts to observe the court in session have been thwarted.[162] Furthermore, critics have raised concerns over the speed at which cases are disposed since the court meets only one day a week and requests for additional court days have been ignored.[163]

To deal with criticisms over the GCA, Goa amended the Act in both 2004 and 2005.[164] The 2005 amendment lowered the age limit for adulthood in cases of rape; currently, a victim of rape is a child if he or she is below the age of sixteen.[165] Rape is now defined by cross-reference to IPC Section 375 and is classified as a grave sexual assault.[166] The 2005

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154. *Id.* §§ 8(10)(b)-(c).

155. *See* Preetu Nair, *Goa Children's Act - A Case Analysis,* SULEKHA.COM (Jan. 2, 2007), http://goadourado.sulekha.com/blog/post/2007/01/goa-childrens-act-a-case-analysis.htm.

156. *Id.*

157. *Id.*

158. *Id.*

159. *Id.*

160. *Id.*

161. *Id.*

162. *Id.*

163. *Id.*

164. Goa Children's (Amendment) Act, 2004, No. 12, Act of Leg. Assembly of Goa, 2004 (India), *available at* http://www.nls.ac.in/ccl/Acts%20to%20be%20loaded/The%20Goa%20 Childrens%20Act%20and%20Rules.pdf; Goa Children's (Amendment) Act, 2005, No. 20, Act of Leg. Assembly of Goa, 2005, § 2(d) (India), *available at* http://www.nls.ac.in/ccl/Acts%20to%20be%20loaded/The%20Goa%20Childrens%20Act%20and%20Rules.pdf.

165. Goa Children's (Amendment) Act, 2005, § 2(d).

166. *Id.* §§ 2(uv), 2(y)(i).

amendment also increased fines and prison sentences for both grave sexual assault and incest.[167] Punishment for grave sexual assault now ranges from ten years to life imprisonment, as opposed to a sentence between seven and ten years.[168] Punishment for incest convictions was amended to a minimum sentence of ten years and a maximum sentence of life imprisonment.[169] Incest also carries an increased maximum fine of Rs. 200,000.[170]

The 2005 amendments modified several provisions in order to better protect children involved in cases of CSA. Section 8 now requires a medical examination of the child victim when there are allegations of a grave sexual assault.[171] In contrast, the 2003 GCA permitted, but did not require, medical examination when grave sexual assault was alleged.[172] Additionally, several changes were made to Children's Court procedural safeguards. The 2005 amendment altered the burden of proof in cases of offenses against children.[173] Under the 2003 GCA, the burden of proof was placed on the accused if the alleged crime involved a child victim.[174] The 2005 amendment narrowed the application of this provision so that it applies only to situations where the child victim was in the custody of the accused (1) at the time of his or her arrest, (2) at the time when the offense was committed, or (3) at the time when the child was rescued or removed.[175] The amendment also modified the procedure for questioning and cross-examining child victims and witnesses.[176] With the 2005 amendment, child witnesses were entitled to the same procedural safeguards of the GCA as child victims.[177] Prior to the 2005 amendment, only child victims received special procedural safeguards in order to help reduce psychological distress.[178] While children are not to testify in the presence of the accused or perpetrators of the alleged crime, the 2005 amendment made an explicit allowance for the presence of the accused's advocate.[179]

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167. *Id.* § 8(2).

168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.* § 8(3).

172. Goa Children's Act, 2003, No. 18, Act of Leg. Assembly of Goa, 2003, § 8(3) (India), *available at* http://www.goagovt.nic.in/documents/goachildact2003.pdf.

173. Goa Children's (Amendment) Act, 2005, No. 20, Act of Leg. Assembly of Goa, 2005, § 32(1)(*l*) (India), *available at* http://www.nls.ac.in/ccl/Acts%20to%20be%20loaded/The%20Goa%20Childrens%20Act%20and%20Rules.pdf.

174. Goa Children's Act, 2003, § 32(1)(*l*).

175. Goa Children's (Amendment) Act, 2005, § 32(1)(*l*).

176. *Id.* § 32(l)(m).

177. *Id.*

178. Goa Children's Act, 2003, § 32(1)(m).

179. Goa Children's (Amendment) Act, 2005, § 32(1)(m).

3. The Commissions for the Protection of Child Rights Act and Amendments

The Commissions for the Protection of Child Rights Act created national, state, and union territory commissions to protect child rights in every state and union territory in 2005.[180] The Commissions are directed to examine and review the safeguards provided by law for the protection of child rights.[181] The Commissions provide recommendations on measures to implement laws effectively in order to best serve the interests of children.[182] The Commissions study international instruments and treaties to undertake periodic review of all policies, programs, and other activities related to child rights.[183] In addition, the Commissions make recommendations regarding the effective implementation of international instruments and treaties.[184] The Commissions' Rules give special focus to assessing India's compliance with the CRC as well as reviewing and commenting on proposed legislation from a child protection perspective.[185]

The Commissions also have the power to investigate violations of child rights and recommend the initiation of judicial proceedings when necessary.[186] When either a child or a person concerned on the child's behalf makes a complaint, the Commission may initiate a formal investigation.[187] A Commission, when undertaking a formal investigation, has the same powers as a civil court trying a suit under the 1908 Code of Civil Procedure.[188] This enables the Commissions to summon and enforce the attendance of any person and require discovery and/or document production.[189]

The Commissions for Protection of Child Rights Act also created

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180. Commissions for Protection of Child Rights Act, No. 4 of 2006, § 3, INDIA CODE (2010), *available at* http://www.ncpcr.gov.in/Acts/National_Commission_for_Protection_of_Child_Rights_Act_2005.pdf.

181. *Id.* §§ 13(1)(a), 17(1).

182. *Id.* §§ 13(1)(a), 13(f), 24(a)–(b).

183. *Id.* §§ 13(1)(c), 24(a)–(b).

184. *Id.* §§ 13(1)(f), 24(a)–(b).

185. Commissions for Protection of Child Rights Rules, 2006, § 17(a), Gazette of India, part II, section 3(i), (July 31, 2006), *available at* http://www.ncpcr.gov.in/Acts/National_Commission_for_Protection_of_Child_Rights_NCPCR_Rules.pdf.

186. Commissions for Protection of Child Rights Act, No. 4 of 2006, §§ 13(1)(c), 24(a)–(b), INDIA CODE (2010), *available at* http://www.ncpcr.gov.in/Acts/National_Commission_for_Protection_of_Child_Rights_Act_2005.pdf.

187. Commissions for Protection of Child Rights Rules, 2006, § 17(c), Gazette of India, part II, section 3(i), (July 31, 2006), *available at* http://www.ncpcr.gov.in/Acts/National_Commission_for_Protection_of_Child_Rights_NCPCR_Rules.pdf.

188. Commissions for Protection of Child Rights Act, No. 4 of 2006, §§ 14(1), 24(a)–(b), INDIA CODE (2010), *available at* http://www.ncpcr.gov.in/Acts/National_Commission_for_Protection_of_Child_Rights_Act_2005.pdf.

189. *Id.* § 14(1)(a)–(e), 24(a)–(b).

children's courts for the speedy trial of offenses against children and violations of children's rights.[190] The state or union territory government may appoint a special prosecutor or advocate for the purpose of conducting cases in the Children's Court.[191]

While the Commissions were an important step toward protecting the rights of children, the Commissions have not addressed CSA, electing to focus instead on corporal punishment, juvenile justice, child labor, and education.[192] Moreover, the National Commission neither has a CSA working group nor specifically addresses CSA concerns.[193] The National Commission does not concern itself with CSA because the Commissions for the Protection of Child Rights Act focus on children affected by terrorism, natural disaster, domestic violence, HIV/AIDS, trafficking, children in conflict with the law, and increasing child literacy.[194]

4. Other Acts

Several other acts strive to protect children from CSA. These acts include the Juvenile Justice Act,[195] the Juvenile Justice (Care and Protection of Children) Act,[196] the Juvenile Justice (Care and Protection of Children) Amendment Act,[197] the Prevention of Immoral Traffic Act,[198] and the Prohibition of Child Marriages Act.[199] The 1986 Juvenile Justice Act does not directly deal with CSA; instead, it primarily deals with the care, protection, treatment, development, and rehabilitation of delinquent and neglected children.[200] Specifically, the Act created Juvenile Justice Boards

190. *Id.* § 25.

191. *Id.* § 26.

192. *See Issues*, NAT'L COMM. FOR THE PROTECTION OF CHILD RIGHTS, http://www.ncpcr.gov.in/issues.htm (last visited Dec. 22, 2010).

193. The current working groups include: Child Labor and Education; Juvenile Justice; Corporal Punishment; Child Health and Nutrition; Female Foeticide; Children without Parental Care; Child Participation in TV/Reality Shows; Safeguards for Children on Railway Platforms; International Displaced Children; and Child Rights and Panchayats. *See NCPCR Working Groups*, NAT'L COMM. FOR THE PROTECTION OF CHILD RIGHTS, http://www.ncpcr.gov.in/ working_groups.htm (last visited Dec. 22, 2010).

194. Commissions for Protection of Child Rights Act, §§ 13(1)(d)–(e), 24(a)–(b).

195. Juvenile Justice Act, 1986, No. 53 of 1986, *repealed by* Juvenile Justice (Care and Protection of Children) Act, 2000, No. 56 of 2000, INDIA CODE (2010).

196. Juvenile Justice (Care and Protection of Children) Act, 2000.

197. Juvenile Justice (Care and Protection of Children) Amendment Act, 2006, No. 33 of 2006, INDIA CODE (2010), *available at* http://wcd.nic.in/childprot/jjactamedment.pdf.

198. Prevention of Immoral Traffic Act, 1986, No. 44 of 1986, INDIA CODE 2010 (amending Suppression of Immoral Traffic in Women and Girls Act, 1954, No. 58 of 1954).

199. Prohibition of Child Marriage Act, 2007, No. 6 of 2007, INDIA CODE (2010), *available at* http://wcd.nic.in/cma2006.pdf.

200. Juvenile Justice Act, 1986, pmbl., No. 53 of 1986, *repealed by* Juvenile Justice (Care and Protection of Children) Act, 2000, No. 56 of 2000, INDIA CODE (2010).

to deal with accusations of neglect and delinquency.[201] These boards were not created to deal with CSA victims, and no specialized care or treatment was provided for CSA victims.[202]

The 1986 Juvenile Justice Act was the primary legal framework for juvenile justice in India until the passage of the Juvenile Justice (Care and Protection of Children) Act in 2000, which replaced the Juvenile Justice Act.[203] The Juvenile Justice (Care and Protection of Children) Act contained substantial modifications and changes in terminology, including the replacement of Juvenile Welfare Boards with Child Welfare Committees.[204] Section 23 of the Juvenile Justice (Care and Protection of Children) Act addressed cruelty to a child, stating that when a person who has control of or otherwise is in charge of a child assaults the child, or procures a child to be assaulted in a manner likely to cause unnecessary mental or physical suffering, that controlling person may be punished with imprisonment up to six months and/or a fine.[205] However, this Act does not directly address CSA or the special needs of CSA victims.[206]

The Juvenile Justice (Care and Protection) Act was amended in 2006.[207] The 2006 Amendments ordered each state to create a Child Protection Unit to address the needs of children who have had prior unlawful encounters and to address the needs of children in group homes.[208] These units are not trained to deal with CSA or sexual offenses.[209]

The 2006 Amendments also attempted to reduce the length of time that it takes the Boards to resolve cases.[210] According to the Juvenile Justice (Care and Protection) Act, cases in front of the Welfare Boards were to be resolved within four months.[211] However, that portion of the statute lacked proper implementation.[212] So, in 2006 Parliament instructed the Chief Magistrate to review the pendency of cases every six months. The Chief Magistrate has the ability to order additional sittings of the Welfare Boards or to create additional Boards, depending on the backlog.[213]

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201. *Id.* § 4.

202. BAJPAI, *supra* note 16, at 217.

203. Juvenile Justice (Care and Protection of Children) Act, 2000, § 69.

204. *Id.* § 29.

205. *Id.* § 23.

206. *See* BAJPAI, *supra* note 16, at 217.

207. Juvenile Justice (Care and Protection of Children) Amendment Act, 2006, No. 33 of 2006, INDIA CODE (2010), *available at* http://wcd.nic.in/cma2006.pdf.

208. *Id.* § 24.

209. *See* BAJPAI, *supra* note 16, at 217.

210. Juvenile Justice (Care and Protection of Children) Act, No. 56 of 2000, § 14; INDIA CODE (2010), *available at* http://nicp.nisd.gov.in/pdf/jjact.pdf.

211. *Id.*

212. KACKER ET AL., *supra* note 8, at 27.

213. Juvenile Justice (Care and Protection of Children) Amendment Act, No. 33 of 2006, § 11(2); INDIA CODE (2010), *available at* http://wcd.nic.in/childprot/jjactamedment.pdf.

The 1986 Immoral Trafficking Prevention Act primarily punishes the acts of third parties that facilitate prostitution and sex trafficking, such as brothel keepers and pimps.[214] However, punishing brothel keepers and pimps neither provides comprehensive protection for children nor specifically addresses CSA. Finally, the government enacted the Prohibition of Child Marriages Act 2006 in order to prevent the solemnization of child marriages, but this Act also fails to address CSA.[215]

C. Case Law - Sakshi v. Union of India & Ors

In 1997, Sakshi, a well-respected non-governmental organization (NGO) interested in issues concerning women and children,[216] brought CSA to the attention of the Supreme Court of India.[217] Sakshi petitioned the court to declare that rape under IPC Section 375 included *all* forms of forcible penetration, instead of being limited to penile penetration.[218] Sakshi argued that the definition of rape under Section 375 violated both the Indian Constitution and India's commitments under international agreements such as the CRC and the United Nations Convention on the Elimination of all Forms of Discrimination Against Women.[219] On January 13, 1998, the Supreme Court of India directed the Law Commission of India to address the issues raised in Sakshi's writ petition regarding the reach of penetration under Section 375.[220]

On July 28, 1998, the Law Commission filed an affidavit setting out portions which dealt with the issues raised by Sakshi[221] in its 156th Report on the Indian Penal Code.[222] The 156th Report did not agree with Sakshi's position.[223] Sakshi submitted a response to the Court arguing that the 156th Report did not deal with the precise issues raised in its writ petition.[224] The Court directed Sakshi to write a note concerning the precise issues involved in the petition.[225] Following Sakshi's note submission, on August 9, 1999, the Court ordered the Law Commission of India to examine the precise

214. Prevention of Immoral Traffic Act, 1986, No. 44 of 1986, INDIA CODE 2010 (amending Suppression of Immoral Traffic in Women and Girls Act, 1954, No. 58 of 1954).

215. Prohibition of Child Marriage Act, 2007, pmbl., No. 6 of 2007, INDIA CODE (2010).

216. Sakshi v. Union of India & Ors, (1999) 6 S.C.C. 591 (India).

217. *Id.*

218. Shri Ram Jethmalani, *Introduction* to LAW COMM. OF INDIA, ONE HUNDRED AND SEVENTY SECOND REPORT ON REVIEW OF RAPE LAWS (2000), *available at* http://www.lawcommissionofindia.nic.in/rapelaws.htm.

219. *Id.*

220. *Id.*

221. *See id.*

222. 156TH REPORT, *supra* note 93.

223. *Id.*

224. *Id.*

225. *Id.*

issues submitted by Sakshi.[226] The Court specifically requested that the Law Commission "examine the issues submitted by [Sakshi] and examine the feasibility of making recommendations for amendment of the [IPC] or deal with the same in any other manner so as to plug the loopholes."[227]

Pursuant to the Court's order, the Law Commission of India reviewed the IPC rape laws and recommended amending certain sections, including Sections 375, 376, and 377.[228] The Law Commission also made recommendations for amendments to the Code of Criminal Procedure[229] and the Indian Evidence Act.[230] The Law Commission found that, in light of increased reports of custodial rape and CSA, the IPC needs to be amended to adopt a modern understanding of sexual offenses and include more stringent penalties.[231]

VI. RECOMMENDATIONS

A. Gaps in the Current System

Most existing child protection mechanisms under Indian laws cater to post-harm situations.[232] Preventative measures are wholly lacking in India's approach to child protection.[233] In fact, preventative child protection has never been a part of India's child protection plan.[234] Additionally, glaring gaps exist in India's infrastructure and outreach services for children. These gaps include: (1) poor planning and coordination, (2) lack of sufficient coverage for India's children, and (3) poor infrastructure.[235] A poor understanding of child rights and a lack of a child-friendly approach has affected both planning and service delivery and has resulted in these gaps.[236]

Currently, child protection schemes are spread throughout various ministries and departments. For example, the Labor Ministry is responsible for child labor elimination; the Ministry of Women and Child Development is responsible for juvenile justice, child trafficking, and adoption-related

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226. *Id.*

227. LAW COMM. OF INDIA, ONE HUNDRED AND SEVENTY SECOND REPORT ON REVIEW OF RAPE LAWS (2000), *available at* http://www.lawcommissionofindia.nic.in/rapelaws.htm [hereinafter 172ND REPORT].

228. *Id.*

229. CODE CRIM. PROC. (2010) (India), *available at* http://indiacode.nic.in/fullact1.asp?tfnm=197402; PEN. CODE §§ 195, 228 (2010) (India).

230. Indian Evidence Act, No. 1 of 1872, INDIA CODE (2010); 172ND REPORT, *supra* note 233.

231. 172ND REPORT, *supra* note 227.

232. KACKER ET AL., *supra* note 8, at 31.

233. *Id.*

234. *Id.*

235. *Id.*

236. *See id.* at 6.

matters; and the Ministry of Health and Family Welfare is responsible for the implementation of the Pre-Conception and Pre-Natal Diagnostic Techniques (Prohibition of Sex Selection) Act.[237] Therefore, India's ability to undertake preventative measures for child violence, child abuse, and other harms to children is limited by a severe lack of communication and cooperation among various National and State Ministries and Departments.[238]

India has inadequate child protection resources.[239] The 1974 National Policy for Children declared children to be a "supreme national asset."[240] To this end, the Policy pledged to secure and safeguard children's needs by making wise use of available national resources.[241] Unfortunately, ten successive Five Year Plans have failed to allocate adequate resources to meet the needs of children.[242] A study by the Ministry of Women and Child Development revealed that combined *total* expenditures on children in 2005–2006 for health, education, development, and protection amounted to a mere 3.86 percent of India's total expenditures.[243] This figure rose to 4.91 percent in 2006–2007.[244] However, the share of resources allocated for expenditures on children used specifically for child protection was abysmally low at 0.034 percent in 2005–2006 and remained unchanged in 2006–2007.[245] Available resources have not been utilized effectively protecting the innocence of India's children.[246]

India's current infrastructure also lacks sufficient coverage of India's children.[247] The number of children with no support or services is ever-increasing.[248] Further compounding this issue is the lack of systematic and comprehensive mapping (1) of children in need of services or (2) of the services available for children on a local and national scale.[249] Additionally, India's minimal infrastructure is rigid, and a significant amount of resources are spent maintaining the structure rather than focusing on outcomes.[250] Furthermore, a great deal of the infrastructure required by various acts has not been implemented, including Juvenile Justice Boards

237. *Id.* at 31.
238. *Id.*
239. *Id.* at 6.
240. *Id.*
241. *Id.*
242. *Id.*
243. *Id.*
244. *Id.*
245. *Id.*
246. *Id.*
247. *Id.* at 31.
248. *Id.*
249. *Id.*
250. *Id.*

and Child Welfare Committees.[251] Finally, shelters and institutional care facilities for children in need of services are highly inadequate.[252]

Therefore, based on India's poor planning and coordination of child services, lack of sufficient coverage for India's children, and poor child service infrastructure, serious gaps exist in services for India's children. Due to the fragmented structure of India's child protection plan, no services deal with all categories of child protection. Thus, monitoring of the existing fragmented programs is fairly poor, which further reflects that child protection is not a priority in the Indian States and Union Territories.[253]

The lack of funding and service gaps must be addressed in conjunction with any legislative or executive changes. Proper funding of India's child protection programs will allow the government to effectively address problem areas that currently jeopardize India's compliance with the CRC. India has a responsibility to its children to provide adequate funding for both its existing and any new CSA programs.

B. Legislative Changes

In order to explicitly denounce CSA and decrease the number of CSA incidents, Parliament should: (1) adopt a national law criminalizing CSA and incest, (2) revise the IPC to reflect the current understanding of sexual offenses such as rape, and (3) encourage States to pass laws criminalizing CSA and incest.

India must adopt a national law that explicitly criminalizes CSA and incest. The GCA can serve as a model to develop the new law. By explicitly stating that CSA is not acceptable, India will perform both a signaling and channeling function regarding acceptable behavior toward children. While all countries struggle to address CSA, India is one of the few nations that does not explicitly criminalize CSA.[254] Under the CRC, India is required to take "appropriate legislative, administrative, social and educational measures" to protect children from CSA and incest.[255] However, India's high rate of CSA shows that India's current laws do not appropriately address CSA.[256] Furthermore, the nature of the current IPC makes CSA prosecution and conviction difficult.[257] Because most abusers believe that they will likely not be caught, and even if they are caught, the case may not be tried for years, it is unlikely that an explicit law

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251. *Id.*

252. *Id.*

253. *See id.*

254. *See* Sara Shapouri, *Ending Child Sexual Abuse and Exploitation: A Guide for Child Protection in Iran*, 7 WHITTIER J. CHILD & FAM. ADVOC. 63, 92 (2007).

255. Convention on the Rights of the Child, *supra* note 5, art. 19.

256. *See supra* Part I.

257. *See* VIRANI, *supra* note 86, at 90-91, 141, 181-82.

criminalizing CSA will deter such abusive behavior.[258] While an explicit law on its own will not be a complete deterrent from criminal activity for most abusers, this law will provide both police and social workers with tools to develop and try cases against abusers. An explicit CSA law will also enable India to better comply with the child protection requirements of the CRC.

A national law criminalizing CSA and incest should include the following provisions to protect child victims and increase the number of successful CSA prosecutions: (1) remove the presumption of innocence for child guardian(s),[259] (2) incorporate procedures to protect child witnesses,[260] (3) incorporate procedures and rules to make courts child-friendly,[261] (4) incorporate procedures to reduce the length of litigation, (5) create a child protective services agency to investigate allegations of CSA and incest,[262] and (6) create a reporting system mandating the reporting mechanisms and persons responsible for reporting CSA.[263]

First, under the current system, there is a presumption that a child's guardian(s) are innocent.[264] Therefore, a prosecuting lawyer must overcome this presumption in trying cases against parents, uncles, and others who live with the child. This takes incredible commitment on the part of the lawyer since courts do not generally side with the prosecution.[265] To protect Indian children against CSA, the presumption of guardian innocence must be overturned.

Second, procedures need to be implemented in order to ensure the protection of child witnesses in CSA cases. In *Sakshi*, the Supreme Court of India approved the use of a screen while in court to shield a victim from view of or by the accuser.[266] In addition to screen usage, other procedures could be implemented, including the using closed circuit television examinations, questioning of child witnesses by a judge, and using a child's deposition in lieu of live testimony.[267]

The GCA also provides many specific examples of measures other than screens to protect child witnesses. Like the GCA, any new CSA law should require the use of non-stigmatizing language and prohibit the use of "adversarial or accusatory words, such as, arrest, remand, accused, charge sheet, trial, prosecution, warrant, summons, conviction, inmate, delinquent,

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258. *See* Shapouri, *supra* note 254, at 88. *But see* SMALLBONE ET AL., *supra* note 32, at 94, 97-104.

259. BAJPAI, *supra* note 16, at 262.

260. *Id.* at 242-44.

261. VIRANI, *supra* note 86, at 156-57.

262. *Id.* at 180-88. BAJPAI, *supra* note 16, at 241.

263. KACKER ET AL., *supra* note 8, at 121.

264. BAJPAI, *supra* note 16, at 262.

265. *See id.*

266. Sakshi v. Union of India & Ors, A.I.R. 2004 S.C. 3566 (India).

267. BAJPAI, *supra* note 16, at 243-44. *See* 18 U.S.C. § 3509(b).

neglected, custody, etc."[268] Aggressive questioning of a child victim should be permitted only if done by the judge.[269] All questions should be asked in child-friendly language, which is short, clear, and concise.[270] Ideally, when a child victim testifies before any authority, including the court, the child victim should not testify in the presence of the accused or the alleged perpetrators.[271] "In camera proceedings" are provided for under Section 327(2) of the Code of Criminal Procedure for trials of rape under IPC Section 376.[272] *Sakshi* expanded this section to apply to trials under IPC Sections 354 and 377.[273] However, in camera proceedings should be extended to apply in all cases of child abuse under the new national law.

Additionally, in the United States and United Kingdom, a child witness can be accompanied by an adult of the child's choosing at a judicial proceeding.[274] In CSA cases, this person could be someone the child feels comfortable with, such as the non-abusing parent and/or a close family friend.[275] Therefore, because of the child's comfort with the adult, this adult could be extremely effective in helping a child cope with trial. Furthermore, a child should be allowed to bring a comfort object to the stand such as a blanket, toy, or doll.[276] In order to make the courts child-friendly, India should follow the lead of the United States and United Kingdom and allow children to have a trusted adult and a familiar object with them at trial.

Third, similar to protecting child witnesses, any new CSA law should require courts to adopt child-friendly procedures in CSA cases. Under the 2005 Commissions for the Rights of the Child, Children's Courts were established.[277] These courts are likely the best venue to hear CSA cases due to their focus on children's cases; however, in order to be the best venue, the judges and staff must be provided with specialized training in how to avoid secondary victimization of CSA victims. Since not all Indians are fluent in English,[278] interpreters should be provided, when necessary, to

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268. Goa Children's Act, 2003, No. 18, Act of Leg. Assembly of Goa, 2003, § 32(1)(e) (India), *available at* http://www.goagovt.nic.in/documents/goachildact2003.pdf.

269. *Id.* § 32(2)(e).

270. *Id.* § 32(2)(n)(v).

271. *Id.* § 32(1)(m).

272. CODE CRIM. PROC. § 327(2) (2010) (India), *available at* http://indiacode.nic.in/fullact1.asp?tfnm=197402.

273. Sakshi v. Union of India & Ors, A.I.R. 2004 S.C. 3566 (India).

274. 18 U.S.C. § 3509(i).

275. BAJPAI, *supra* note 16, at 246.

276. *Id.*

277. Commissions for Protection of Child Rights Act, No. 4 of 2006, § 3, INDIA CODE (2010), *available at* http://www.ncpcr.gov.in/Acts/National_Commission_for_Protection_of_Child_Rights_Act_2005.pdf.

278. *India: People*, CENT. INTELLIGENCE AGENCY – THE WORLD FACTBOOK, https://www.cia.gov/library/publications/the-world-factbook/geos/in.html (last visited Jan. 22, 2011).

allow the child to communicate in a comfortable and effective manner.

Fourth, to be more child-friendly, any new CSA law should reduce the length of litigation by requiring the speedy resolution of CSA cases. Currently, delays at every stage in the process of investigation and prosecution prevent CSA victims from beginning the healing process.[279] In several cases, CSA victims reach adulthood prior to the conclusion of the hearing for their case.[280] Therefore, cases must be tried in a timely manner. In order to speed the trial process, courts must meet more frequently, and additional courts must be established.

Fifth, the core of any CSA law should be a child protection unit that includes specialized CSA investigators. While the GCA called for Victim Assistance Units, the child protection units called for in this Note are more robust and require the establishment of an agency that both investigates and prosecutes CSA and other types of child abuse/neglect cases in order to put India on par with other Western countries' protection of CSA victims, such as the United States and the United Kingdom.[281]

In the United States, each state determines its own CSA scheme, but most utilize an executive agency, such as Child Protective Services in Indiana, that investigates and tries cases of child abuse.[282] England and Wales established inter-agency cooperation systems.[283] Overall responsibility for child protection in England and Wales rests with the Department for Children, Schools, and Families, which issues statutory and non-statutory guidance to local authorities.[284] Reports are made either directly to local authorities or to the National Society for the Prevention of Cruelty to Children, which then passes reports to local authorities.[285] Additionally, social workers trained in meeting the needs of child victims conduct investigations.[286] As in the United States, if a child is in imminent danger, police in England and Wales take immediate action to remove the child.[287] Similar systems are in place in Scotland and Ireland.[288]

In the Netherlands, the Dutch Child Protections Board under the Ministry of Justice conducts investigations.[289] The Child Protection Board

279. BAJPAI, *supra* note 16, at 226. *See* 18 U.S.C. § 3509(j).

280. BAJPAI, *supra* note 16, at 226.

281. *Id.* at 242.

282. *See id.* at 241; *Child Protective Services*, IND. DEPT. CHILD SERVS., http://www.in.gov/dcs/2398.htm (last visited Dec. 22, 2010).

283. HELEN WALTERS, NATL. SOC'Y FOR THE PREVENTION OF CRUELTY TO CHILDREN, CHILD PROTECTION FACTSHEET 3 (2008), *available at* http://www.nspcc.org.uk/Inform/research/ questions/child_protection_system_wdf76008.pdf.

284. *Id.*

285. *Id.* at 13.

286. *Id.*

287. *Id.*

288. *Id.* at 3.

289. BAJPAI, *supra* note 16, at 241.

is a specialized agency that receives reports from schools, agencies, doctors, police, and other interested persons.[290] The Board uses social workers to investigate children's rights violations and takes necessary steps to protect the child from future abuse.[291]

Child protection units in India should be comprised of specialized staff sensitive to the needs of CSA victims that performs investigations, prosecutions, and pre/post-family services. The staff should include both males and females in order to make children as comfortable as possible during the investigation. As far as possible, the staff member originally assigned to the child's case should stay with the case until completion. Additionally, the staff should be attired in plain clothes, rather than a uniform, to increase the child's comfort.[292] The staff should be fluent in the languages spoken in the region that the agency serves. The staff should also be fluent in English, the language of India's court system.[293] The staff should also be educated beyond the tenth standard,[294] so that they can interact with both educated and uneducated members of society.[295] In short, comprehensive child protection units would be a big step forward in providing the necessary infrastructure to address CSA properly in India.

Sixth, India must (1) develop a national CSA reporting system and (2) determine if suspected CSA must be mandatorily reported. Currently, India has no mandatory reporting of any type of suspected child abuse.[296] In contrast, both the United States and United Kingdom have adopted mandatory reporting laws that require mandated reporters to report suspected cases of child abuse.[297] Who qualifies as a mandated reporter varies by jurisdiction.[298] Some jurisdictions require all persons to report suspected CSA cases while others require only doctors to report.[299]

The merits of mandatory CSA reporting are not without question. Some believe that mandatory CSA reporting has caused greater public awareness of the problem of child abuse through professional alertness and

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290. *Id.*

291. *Id.*

292. *See* VIRANI, *supra* note 86, at 156.

293. *Id.* at 185.

294. *Id.* The tenth standard is roughly equivalent to the tenth grade. For more information regarding the structure of India's education system, please see http://www.indianetzone.com/ 39/structure_indian_education.htm for more information regarding the structure of India's education system.

295. *Id.*

296. BAJPAI, *supra* note 16, at 242.

297. VIRANI, *supra* note 86, at 184.

298. Paul S. Appelbaum, *Law & Psychiatry: Child Abuse Reporting Laws: Time for Reform?*, 50 PSYCHIATRIC SERVICES 27, 27-29 (1999), *available at* http://psychservices.psychiatryonline.org/cgi/content/full/50/1/27.

299. *Id.*

intervention.[300] However, others believe that mandated reporting leads to underreporting and inappropriate reporting.[301] Belgium, the Netherlands, and Luxembourg have adopted an alternate form of reporting in which a doctor within the health care system acts as a "confidential doctor."[302] This doctor receives all allegations regarding child maltreatment.[303] Once an allegation is made through a report, the confidential doctor initiates a confidential investigation without threat of immediate coercive intervention.[304]

The implementation of either mandatory CSA reporting system in India would promote the discovery of CSA and provide statistical data about CSA. This data would enable India to track instances of CSA better and eventually create a database of known abusers. In turn, this information would also better enable police and social workers to perform investigations and outreach services to CSA victims.

C. Executive Changes

The Executive branch should implement the following four changes to decrease incidents of CSA: (1) increase training for professionals in the identification of CSA in children, (2) increase community education regarding CSA, (3) increase CSA arrests and prosecutions, and (4) create outreach and support services for CSA victims.

First, most of India's doctors, psychologists, and nurses have never received formal CSA training.[305] As of 2000, India was without any college or university medical or mental health courses on assisting victims of CSA.[306] Those who work with child victims are either self-taught or have received training from other professionals working with CSA victims.[307] Currently, doctors faced with clear physical signs of sexual abuse often refuse to identify it as CSA.[308] Doctor's notations include "'simple injury,' 'patient's promiscuity,' 'congenital problem of absence of hymen,' [and] 'consequence of excessive masturbation.'"[309] In many cases, medical reports are also vague and incomplete, with no mention of the trauma

300. *Id.*

301. Anita Lichma, *Mandatory Reporting for Child Abuse: A Need for Clarification*, ESSORTMENT, http://www.essortment.com/all/mandatoryreport_rcfl.htm (last visited Dec. 22, 2010). *See also* Appelbaum, *supra* note 298, at 27-29.

302. VIRANI, *supra* note 86, at 184.

303. Appelbaum, *supra* note 298, at 27-29.

304. *Id.*

305. *See* BAJPAI, *supra* note 16, at 215.

306. VIRANI, *supra* note 86, at 174-75.

307. *Id.*

308. *Id.* at 44.

309. *Id. See also* BAJPAI, *supra* note 16, at 226.

caused to the victim.[310] Therefore, to identify and treat potential CSA victims effectively, doctors must have the opportunity for specialized CSA training and sensitization.

Police also do not receive training in how to identify and/or interact with CSA victims.[311] To combat problems in identifying and interacting with CSA victims, India should train its existing police force in CSA matters and/or set up specially-trained child protection units. As stated above, the creation of an agency empowered to investigate child abuse has been successful for several countries.[312] A CSA-focused agency in India would allow for the specialized training of investigators, which can also provide training in child sensitization for local police departments and village gram panchayats.[313]

India should work with other countries to start training programs that teach people who deal with CSA how to investigate and identify CSA and other forms of abuse. For example, India could have a team of experts from the United States and United Kingdom train a group of master trainers in India's Ministry of Women and Child Development. These master trainers could then provide training in connection with the State Commissions on Child Rights to create training teams in each State and Union Territory. A single team of master trainers should include at least one physician, one psychologist, and one police officer (active or retired) in order to connect with their trainees by having all CSA-related professions represented and to adapt the training to India's society and culture.

Second, India must increase community education and awareness of CSA and its effects.[314] The United States has utilized a variety of education programs to alert children to CSA including "stranger danger," "good touch/bad touch," and basic sex education.[315] While "stranger danger" programs perpetuate the myth that only strangers perpetrate CSA, the "good touch/bad touch" programs can reach more forms of CSA. These programs could be adapted to an Indian audience and include different languages to help children learn techniques for protecting their bodies. In the United States, most programming is aimed at elementary-aged children (ages five

310. BAJPAI, *supra* note 16, at 215.

311. *Id.*

312. *See id.* at 241-42.

313. Gram panchayats are the local governments at the village level in India.

314. *See* VIRANI, *supra* note 86, at xxvii-xxx.

315. *See* Ernest E. Allen, *Keeping Children Safe: Rhetoric and Reality*, 5 JUVENILE JUSTICE J. (1998) *available at* http://www.ojjdp.gov/jjjournal/jjjournal598/safe.html; *Good Touch, Bad Touch*, CHILDHELP, http://www.goodtouchbadtouch.com/gtbt (last visited Jan. 22, 2011); *Children's Programs at the YMCA*, YMCA OMAHA, http://www.ywcaomaha.org/SchoolBasedPrograms.aspx (last visited Jan. 22, 2011).

to twelve).[316] India could target a similar age range. This would allow India to reach the largest number of students since schooling is provided for all Indians through age fourteen.

Additionally, community outreach programs should target adults. Parents hold the ultimate responsibility for protecting their children. Therefore, parents must not only be provided with the tools to talk to their children about CSA, but also must learn the signs of CSA. State Commissions on Child Rights or local NGOs could provide such programs. Multiple mediums, including television, Internet, billboards, pamphlets, and workshops can raise awareness. Experimentation with multiple forms of outreach and mass media will be necessary to find the methods that work best in each Indian locale.

Third, and perhaps most important to curtail CSA, India must make a concerted effort to increase arrests and prosecutions of child sexual abusers. If the IPC is modernized and other changes recommended in this Note are implemented, police and/or social workers will be better equipped to build cases against abusers. Currently, CSA investigations are low-priority, peripheral crimes for police.[317] This must be rectified. While police can investigate only CSA incidents that are reported to them, police often fail to properly investigate incidents that are reported.[318]

Fourth, India must set up outreach and support services for victims of CSA. NGOs and government agencies could work together to provide counseling, education, and family support services. Child victims of CSA often require specially trained mental health professionals and family support services to enable children to rebound from CSA.[319]

VII. CONCLUSIONS

Children are the most valuable asset of any country. They are the future of any country and of the global community. Over the past two decades, India has realized that CSA is not just a Western phenomenon – it is a human phenomenon.[320] It does not happen only to "those people," but it happens to all people, including rich, poor, educated, and uneducated. Fifty-three percent of India's children have been victims of CSA.[321] While India has traditionally blamed those involved in child prostitution and

316. PREVENT CHILD SEXUAL ABUSE AMERICA, PREVENTING CHILD SEXUAL ABUSE 2 (2005) *available at* http://www.preventchildabuse.org/advocacy/downloads/child_sexual_abuse.pdf.

317. BAJPAI, *supra* note 16, at 215, 263.

318. VIRANI, *supra* note 86, at 155-56.

319. *See Understanding Child Sexual Abuse: Education, Prevention, and Recovery*, AMERICAN PSYCHOLOGICAL ASS'N, http://www.apa.org/pubs/info/brochures/sex-abuse.aspx (last visited Jan. 22, 2011). *See also* VIRANI, *supra* note 86, at 174-76.

320. *See supra* Part I.

321. *Id.*

trafficking for the high instances of CSA, studies have shown that the majority of abuse is perpetrated by those known to the victim.[322] Even though India has made several steps in the right direction to reduce CSA, further action is required. India must signal to its people and the world that CSA is a serious crime against children and will not be tolerated.

First, India must revamp its legal system to deal with a modern understanding of both sexuality and sexual violence. The Indian Penal Code must be modernized to make CSA an explicit crime. A modern and explicit penal structure would channel other changes that are necessary to protect children, such as lifting the veil of secrecy surrounding sensitive issues such as CSA.

The United States underwent a significant transformation of its CSA laws in the 1960s and 70s.[323] Though not perfect, the United States, has made significant progress in protecting children from CSA and other forms of abuse. For example, CSA is investigated by agencies with specialized training, treated by doctors who are trained to identify CSA, and reported under a mandatory CSA reporting system.[324] Additionally, children are educated about CSA through television shows and school-sponsored programs.[325] While programs in the United States and other nations, such as Great Britain, may not be a perfect fit for India, these programs provide a template for India to develop methods of protection from CSA.

Finally, India will not be able to fix CSA overnight. Cultural and social mindsets must change. Changing deeply ingrained social norms will not be a quick or easy process; however, over time, social norms can adapt to modern life. India can foster and guide this process through government channeling. By adopting explicit and strict laws against CSA, India will send a message to its people and the world that CSA is illegal in India. Just one small step can help change the world.

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322. *Id.*

323. *See supra* Part III.B.

324. *E.g.* WASHINGTON STATE, GUIDELINES FOR CHILD SEXUAL ABUSE INVESTIGATIONS (1999) *available at* http://www.wsipp.wa.gov/rptfiles/childabusewrkgrp.pdf; K.C. FALLER, U.S. DEP'T OF HEALTH & HUMAN SERVS., *Investigations of Child Sexual Abuse in* CHILD SEXUAL ABUSE: INTERVENTION & TREATMENT ISSUES (1993) *available at* http://www.childwelfare.gov/ pubs/usermanuals/sexabuse/sexabused.cfm.

325. *See* VIRANI, *supra* note 86.

FAIR TRADE COFFEE PRACTICES: APPROACHES FOR FUTURE SUSTAINABILITY OF THE MOVEMENT

Grant E. Helms*

Actually, this seems to be the basic need of the human heart in nearly every great crisis: a good, hot cup of coffee.
–Alexander King

I. INTRODUCTION

Coffee is one of the most traded commodities in the world.[1] The coffee industry's scope is truly international.[2] The United States alone consumes twenty percent of the world's coffee, followed by developed areas such as Japan and the European Union (EU).[3] However, producing, roasting, and processing the coffee bean involves many other countries, including various developing nations and approximately twenty-five million small coffee growers.[4] Furthermore, some of these developing countries in the global South depend significantly on coffee production as a core of their export earnings, making the coffee market particularly relevant.[5]

Coffee has become a staple of American life. Coffee rose to popularity in the United States throughout the eighteenth century partly as a backlash against the British Empire, a colonial power with a particular preference for tea.[6] Coffee in the United States may have started as a

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1. *See* Mark Pendergrast, *Coffee Second Only to Oil? Is Coffee Really the Second Largest Commodity*, TEA & COFFEE TRADE J. (2009), *available at* http://www.entrepreneur.com/ tradejournals/article/198849799_1.html. Determining what rank coffee holds as a traded commodity is complicated by the fact that there are multiple questions to ask in order to rank commodities. *Id.* Some sources state that coffee is the second most traded commodity in the world behind oil, but Pendergrast indicates that the figures are more nuanced. *Id.*

2. *See* Seth W. Shannon, Note, *Economic Stimulation: The History and Hope of Coffee in Development*, 18 TRANSNAT'L L. & CONTEMP. PROBS. 169, 170 (2009).

3. *Id.*

4. Ezra Fieser, *Fair Trade: What Price for Good Coffee?*, TIME, Oct. 5, 2009, *available at* http://www.time.com/time/magazine/article/0,9171,1926007-1,00.html.

5. *See* INT'L COFFEE ORG., *International Coffee Agreement 2007: Benefits of Membership* 1 (2007), *available at* http://dev.ico.org/documents/benefits07e.pdf [hereinafter *International Coffee*].

6. *See* MARK PENDERGRAST, UNCOMMON GROUNDS: THE HISTORY OF COFFEE AND HOW IT TRANSFORMED OUR WORLD 15 (1999) [hereinafter PENDERGRAST, UNCOMMON GROUNDS].

political protest beverage, but the bitter brew dripped through various stages of popularity, decline, and quality variation throughout U.S. history. Coffee originated as a drink of low quality commonly consumed by members of the American working class for an extended period of U.S. history.[7] However, coffee today is of much greater quality due to the rise of specialty coffees and exotic beans.[8] Coffee is now considered a luxury item by some, a phenomenon due to the high quality of coffee varieties offered as well as the percolation of "café culture" onto the American scene from established, celebrated coffee practices originating in Europe.[9] The modern success of coffee as a beverage consumed in vast quantities by the cultural "crema" has been bolstered in large part from innovations by corporations such as Starbucks, which founded its business on the idea that coffee is a cultural experience.[10]

The modern attitude of coffee-consuming nations, which view coffee and café culture as a relaxing forum for conversation and intellectualism, is in tension with the more negative experience of many coffee-producing nations. These countries, and especially the farmers cultivating coffee crops there, have historically been exploited in order to benefit coffee-consuming nations.[11] Past trade deals between coffee purchasers and coffee producers were fraught with inequitable practices that tended to maintain a system of unequal bargaining power on a macroeconomic, global scale.[12] In response to these unfair practices, the fair trade movement – the system of producer certification, equitable pay, and reinvestment in farming communities – began brewing throughout the coffee industry.

Fair trade coffee has been a particularly fascinating example of an effective and positive fair trade system;[13] however, it also has drawbacks.[14] The sustainability of the fair trade coffee movement has been questioned by some who wonder whether the movement's growth potential has peaked.[15] An examination of the history of fair trade coffee, what current fair trade coffee practices are, and how that system can be sustained into the future is imperative to gauge the continued success of the fair trade coffee movement. The continued viability of the fair trade coffee movement impacts actors on both a global and individual scale, from national economies to small-scale coffee farmers.

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7. *See id.* at 291-94.

8. *See id.* at 293-94.

9. *See* William Roseberry, *The Rise of Yuppie Coffees and the Reimagination of Class in the United States*, *in* FOOD IN THE USA 149, 154-55 (Carole M. Counihan ed., 2002).

10. *See* PENDERGRAST, UNCOMMON GROUNDS, *supra* note 6, at 375.

11. *See infra* Part II.

12. *See* GAVIN FRIDELL, FAIR TRADE COFFEE: THE PROSPECTS AND PITFALLS OF MARKET-DRIVEN SOCIAL JUSTICE 31 (2007).

13. *See infra* Part II.B.

14. *See infra* Parts II.B, III.C.

15. *See infra* Part II.B.

Beginning in Part II, this Note examines the origins of fair trade coffee, the effect of international labeling organizations, and fair trade coffee's impact on those who produce the good. The first step in evaluating fair trade is to define fair trade since it has taken on various meanings throughout its history. Part II also explains some of the rationales for fair trade and why it is or is not effective in meeting its proffered goals.

Parts III and IV of this Note explore how the United States approaches fair trade coffee both in a policy context and in a consumer context and contrasts the U.S. approach with the European Union's approach to fair trade coffee. Parts III and IV examine legislative documents of the United States and European Union: United States House Resolution 349[16] and the European Parliament Resolution on Fair Trade and Development,[17] respectively. Part V details the local government "fair trade town"[18] phenomena seen across Europe, especially in the United Kingdom,[19] and, in a much more limited fashion, the United States.[20]

Recommendations for the sustainability of fair trade based on the above information are offered in Part VI of this Note. First, the United States should, like the EU, show a commitment to the fair trade movement by making this a higher domestic priority and emulating the detailed and comprehensive resolution produced by the European Parliament.[21] A sub-goal in this proposed domestic policy should also be a concentrated effort on the part of the United States to promote a unified labeling approach in the sale of fair trade coffee. Second, local governments should increase consumer awareness of fair trade coffee and encourage the fair trade town initiative.

The conclusion of this Note focuses, perhaps most importantly, on those whose lives are affected positively by fair trade coffee practices. The fundamental reason to encourage and support fair trade coffee is that the practice ultimately benefits those in developing nations who rely on coffee production for their livelihood.[22]

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16. *See* H.R. Res. 349, 108th Cong. (2003).

17. *See* European Parliament Resolution on Fair Trade and Development, EUR. PARL. DOC. P6_TA (320) (2006), *available at* http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P6-TA-2006-0320.

18. *See infra* Part V.

19. *See* Emma Allen, *Turning Towns on to Fairtrade*, GUARDIAN, http://www.guardian.co.uk/starbucks-fairtrade/fairtrade-community-garstang (last visited Dec. 19, 2010).

20. *See* Kara DiCamillo, *America's Only Fair Trade Town: Media, PA*, TREEHUGGER (Jan. 19, 2007), http://www.treehugger.com/files/2007/01/americas_only_f.php.

21. *See infra* Part IV.

22. *See International Coffee*, *supra* note 5, at 1.

II. HISTORY OF FAIR TRADE COFFEE

As a concept, fair trade encompasses a multitude of agricultural goods traded around the world and seeks to put agricultural goods producers on par with agricultural goods purchasers.[23] Fair trade is a response to international market forces that have traditionally disadvantaged workers in the agricultural field, particularly in poorer, developing nations.[24]

> [Fair trade] contributes to sustainable development by offering better trading conditions to, and securing the rights of, marginalized producers and workers – especially in the South. Fair Trade Organizations, backed by consumers, are engaged actively in supporting producers, awareness raising and in campaigning for changes in the rules and practice of conventional international trade.[25]

Shared principles for all areas of fair trade include increased market access for producers, increased equitable trading relationships, increased producer knowledge- and skill-building, and increased consumer awareness.[26]

In the specific context of coffee production, fair trade maintains these universal principles while gearing its initiatives toward the unique challenges faced by coffee growers and coffee producers.[27] For example, fair trade coffee practices strive to ensure that purchasers pay a price equal to or above coffee market prices to producers[28] who were historically exploited by unscrupulous middlemen.[29] Additionally, fair trade coffee organizations encourage increased investment in local coffee production.[30] This is achieved by farmers who reinvest a portion of their earnings into education efforts and other sustainable community-building programs, often through organized and democratically-run cooperatives.[31] Farmers engaging in fair trade are also required to respect the environment by using environmentally sustainable growing practices.[32] In the absence of a fair

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23. *See* WORLD FAIR TRADE ORG. AND FAIRTRADE LABELLING ORGS. INT'L, A CHARTER OF FAIR TRADE PRINCIPLES 5 (2009), *available at* http://www.european-fair-trade-association.org/observatory/images/stories/file/Charter%20of%20Fair%20Trade%20principles%20-en.pdf.

24. *See id.* at 3.

25. *Id.* at 4.

26. *See id.* at 5.

27. *See Fairtrade in General*, FAIRTRADE FOUND., http://www.fairtrade.org.uk/what_is_fairtrade/faqs.aspx (last visited Jan. 9, 2011).

28. *See id.*

29. *See* Jill Draeger, Note, *Perking Up the Coffee Industry Through Fair Trade*, 11 MINN. J. GLOBAL TRADE 337, 356 (2002).

30. *See id.* at 337.

31. *Id.*

32. *See id.* at 351-52.

trade structure, coffee farmers end up selling their goods on international markets at the mercy of market fluctuations and middlemen who exploit less knowledgeable farmers.[33]

Ensuring that purchasers pay producers a price equal to or above coffee market prices is difficult because several factors are used to determine coffee's "fair" price. A coffee farmer harvests beans off the coffee plant first in the form of a "cherry," whose flesh is removed to obtain the actual coffee bean.[34] The process for removing the cherry shell involves drying the shell and bean either naturally or with the help of mechanical dryers.[35] The farmer may choose to sell the coffee bean in its cherry shell, but the market price is given for the beans alone.[36] It is important to specify the point and condition at which the coffee beans are sold because the fair price determination depends on the process that farmer has undertaken to prepare the crop.[37] Further, the fair trade certification applies to "growers;" however, this could refer to the entity owning the land on which the coffee crop is grown or the individual farmer, which may or may not be the same person.[38] Determining the actual fair trade grower is an important inquiry in determining who receives the major share of the price paid and what percentage of that payment the coffee farmer receives.

A. Fair Trade Brewing: Max Havelaar

Fair trade in general began in the mid-twentieth century,[39] but the fair trade coffee movement began with the idea of a labeling scheme in the 1980s.[40] Labeling goods signaled to consumers which commodities met certain quality criteria and, perhaps more importantly, disseminated the fair trade idea to markets.[41] The first fair trade coffee label, Max Havelaar, was launched in 1988, "under the initiative of the Dutch development agency Solidaridad. The first 'Fairtrade' coffee from Mexico was sold in Dutch supermarkets and was branded 'Max Havelaar,' after a fictional Dutch character who opposed the exploitation of coffee pickers in Dutch colonies."[42]

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33. *See Shannon, supra* note 2, at 178-79.

34. *See* Jill Richardson, *Does Fair Trade Coffee Lift Growers Out of Poverty or Simply Ease Our Guilty Conscience?*, ALTERNET (Feb. 11, 2010), http://www.alternet.org/story/145555/.

35. *See id.*

36. *Id.*

37. *Id.*

38. *Id.*

39. *See Fairtrade - History*, FAIRTRADE FOUND., http://www.fairtrade.org.uk/what_is_fairtrade/history.aspx (last visited Jan. 9, 2011).

40. *See id.*

41. *Id.*

42. *Id.*

The Max Havelaar idea spawned similar initiatives in many other countries, many of which developed their own separate labeling schemes. Throughout the late 1980s and the early 1990s, the Max Havelaar label expanded to Belgium, Switzerland, Denmark, Norway, and France.[43] The label "TransFair" was developed for Germany, Austria, Luxemburg, Italy, the United States, Canada, and Japan, while the "Fairtrade Mark" was developed for the UK and Ireland.[44]

B. Modern Fair Trade Labeling Organizations

The primary objective of the various modern labeling organizations is certification of the commodities they oversee.[45] The regime currently in place to enforce the established international standards for fair trade coffee certification is a network of non-governmental organizations (NGOs) working in concert under a central coordinating organization.[46] This umbrella network is called the Fairtrade Labelling Organizations International (FLO), which was established in 1997 as a way to unify fair trade practices.[47] FLO uses the trademarked term "Fairtrade" to refer to itself and its standards for certification; however, this is distinct from the concept of "fair trade," which refers to the fair trade movement and economic concept generally.[48]

FLO works to meet three objectives.[49] First, it certifies fair trade licensees, a process that includes certification training and developing materials for inspection.[50] Second, FLO "facilitates business contacts between licensed fair trade producers and traders."[51] Third, the organization promotes business and technical support for associated workers and producers.[52] FLO has seen success since its inception, as sales of its certified goods have risen thirty-five percent from 1997 to 2000.[53]

The global labeling scheme is complicated by the fact that labeling exists not only for certified fair trade practices, but also for other sustainable initiatives along the same lines as fair trade, such as organic

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43. *See id.*

44. *Id.*

45. *See* Scott B. Weese, Note, *International Coffee Regulation: A Comparison of the International Coffee Organization and the Fair Trade Coffee Regimes*, 7 CARDOZO PUB. L. POL'Y & ETHICS J. 275, 294 (2008).

46. *See id.* at 295.

47. *See Fairtrade - History, supra* note 39.

48. *See Frequently Asked Questions*, FAIRTRADE LABELLING ORGS. INT'L, http://www.fairtrade.net/faqs.html (last visited Jan. 9, 2011).

49. *See* FRIDELL, *supra* note 12, at 55.

50. *See id.*

51. *Id.*

52. *See id.*

53. *Id.* at 58.

coffees, shade-grown coffees, etc.[54] The global unified labeling scheme is further frustrated by the fact that while FLO is the international face of modern fair trade coffee certification, each country has its own domestic initiative that works in conjunction with FLO and is responsible for disseminating the licensed label for fair trade certified coffees sold in its own country.[55] For example, TransFair USA is the organization responsible for fair trade coffee certified by FLO in the United States.[56] TransFair USA, FLO, and other associated labeling organizations work together to label commodities consistently,[57] but despite efforts to create unified labels, organizations sometimes use distinct labels.[58]

Statistically, the work undertaken by FLO and its associated labeling organizations is significant. For example, the value of the amount of Fairtrade certified coffee sold in the United Kingdom in 2008 was £137.3 million ($224.5 million USD).[59] In contrast, the value of the amount of Fairtrade certified coffee sold in the United Kingdom in 1998 was only £13.7 million ($23 million USD).[60] In 2008 TransFair USA imported 87,772,966 pounds of fair trade certified coffee into the United States, compared to only 76,059 pounds in 1998.[61] FLO estimates that sales of its products have grown an average of forty percent in the last five years.[62] In 2009 worldwide sales of Fairtrade products were approximately €2.9 billion ($4.34 billion USD), a twenty-two percent year-to-year increase.[63] Interestingly, Switzerland has consumed the largest amount of FLO-labeled goods from 1997 to 2000, while the United States only represents 0.2 percent of total FLO-labeled goods over the same period.[64]

Although growth of the fair trade market has boomed in recent decades, there are indications that fair trade coffee practices have limitations in the market and, moreover, that expansion of fair trade coffee practices may be slowing. Some estimate that coffee cooperatives in the global South can only sell twenty percent of their coffee beans certified by

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54. *See* Grace H. Brown, Note, *Making Coffee Good to the Last Drop: Laying the Foundation for Sustainability in the International Coffee Trade*, 16 GEO. INT'L ENVTL. L. REV. 247, 262 (2004).

55. *See* Weese, *supra* note 45, at 295.

56. *See* Fieser, *supra* note 4.

57. *See Fairtrade in General*, *supra* note 27.

58. *Id.*

59. *Fairtrade - Facts and Figures*, FAIRTRADE FOUND., http://www.fairtrade.org.uk/what_is_fairtrade/facts_and_figures.aspx (last visited Dec. 19, 2010).

60. *Id.*

61. TRANSFAIR USA, ALMANAC: 2008 1 (2008), *available at* http://transfairusa.org/pdfs/almanac_2008.pdf.

62. *Facts and Figures*, FAIRTRADE LABELLING ORGS. INT'L , http://www.fairtrade.net/facts_and_figures.html (last visited Dec. 19, 2010).

63. *Id.*

64. *See* FRIDELL, *supra* note 12, at 59.

FLO on fair trade markets, with the rest sold on traditional markets.[65] Furthermore, there are signs that a glass ceiling has been reached in some consumer countries where fair trade commodities have been on sale for decades.[66] For instance, while fair trade sales growth in countries like Italy, France, and Belgium was healthy in the mid-1990s, growth in places where fair trade coffee has been long established, like the Netherlands, Switzerland, Germany, and the UK, was sluggish or nonexistent.[67]

III. CURRENT U.S. FAIR TRADE COFFEE POLICY

A. International Coffee Agreements and the "Coffee Crisis"

The United States policy pertaining to fair trade coffee is both domestic and international. In the context of international economic involvement, U.S. coffee policy has spanned the political spectrum, from active governmental engagement to free market principles.

The starting point for the United States' involvement in the global coffee trade is the International Coffee Agreement (ICA), a trade agreement formed in the 1960s as a response to the unstable financial environment from which coffee commodities suffered.[68] The ICA was one of the earliest reactions to the economic hardships resulting from market price fluctuations faced by many coffee-producing farmers.[69] The original ICA contemplated several economic goals, most of which were focused on price stability, amelioration of coffee farmer hardships, and increased coffee consumption.[70] Although initially hesitant to join the ICA for fear that it would unduly interfere with international free trade, the United States joined in 1962.[71] A likely reason for U.S. participation in the agreement was the desire to protect economic interests in areas where coffee was produced: for example, Latin American countries thought to be susceptible to a political shift toward communism in the event of economic collapse.[72] Later International Coffee Agreements were subsequently signed in 1968, 1976, and 1983.[73]

During its implementation on the world economic stage, the ICA seemed to have been successful in preventing severe poverty in coffee-producing nations, as it was able to prohibit a dangerously low fall in

65. *See id.* at 64.
66. *See id.*
67. *See id.* at 64-65.
68. *See* Brown, *supra* note 54, at 250-51.
69. *See* Shannon, *supra* note 2, at 174.
70. *See id.*
71. *See* Brown, *supra* note 54, at 250-51.
72. *See id.* at 251.
73. *See* Draeger, *supra* note 29, at 344.

prices.[74] Ultimately, however, one of the major drawbacks of the ICA was its inability to realize its long-term goal of coffee price stabilization despite the use of quota restrictions on exporting countries intended to regulate supply and price.[75] The strong regulatory ICA that existed at its inception and throughout the 1970s and 1980s ultimately expired in 1989.[76]

Reasons for the ICA's demise are two-fold.[77] First, the United States withdrew its support because the threat of communism in Latin America diminished[78] and because the United States shifted its economic ideology toward free trade policies.[79] Second, the ICA's regulations no longer fit the global economic climate as coffee-producing countries outgrew the fixed quota system while penalties for noncompliance were lessened.[80] The significance of the ICA was greatly diminished with the withdrawal of the United States as a signatory and a nation with great economic weight.[81]

After the ICA's demise, the coffee market saw a period of harmful coffee crop surplus, which was eventually followed by the "coffee crisis."[82] The international coffee crisis, still present in the global market today, is a severe disequilibrium between the demand for coffee beans and its supply.[83] The oversupply of coffee, along with a decrease in the overall price for the commodity, has resulted in both harmful economic implications for coffee producers and environmental and health concerns, such as using children to work in fields, switching to the cultivation of illicit crops like opium, or using harsh chemicals.[84]

Three overall factors collided to create the global coffee crisis. The central reason for the economic crisis was the breakdown of a strong, regulatory ICA.[85] When the ICA regulated coffee prices for coffee from the 1960s to the late 1980s, coffee producers enjoyed relative price predictability and stability through an enforced price "corset" that held the commodity price within a certain range.[86] Furthermore, participating countries agreed not to oversupply the marketplace, thereby maintaining a

74. *See* Brown, *supra* note 54, at 251.

75. *See id.*

76. *See* Shannon, *supra* note 2, at 176-77.

77. *See id.*; Draeger, *supra* note 29, at 345.

78. *See* Shannon, *supra* note 2, at 177.

79. *See* Draeger, *supra* note 29, at 345.

80. *See id.*

81. The ICA still exists, but its objectives are more focused now on awareness, education, and promotion, which significantly decrease the impact of its regulatory powers. *Id.* at 181.

82. Brown, *supra* note 54, at 252.

83. *See* Seth Petchers & Shayna Harris, *The Roots of the Coffee Crisis*, *in* CONFRONTING THE COFFEE CRISIS: FAIR TRADE, SUSTAINABLE LIVELIHOODS AND ECOSYSTEMS IN MEXICO AND CENTRAL AMERICA 43, 44 (Christopher M. Bacon et al. eds., 2008).

84. *See* Brown, *supra* note 54, at 255-57.

85. *See* Petchers & Harris, *supra* note 83, at 44.

86. *See id.*

stable supply and demand equilibrium.[87] However, in the regulatory vacuum left by the ICA breakdown in 1989, prices for coffee beans became unpredictable and unstable.[88]

The second factor contributing to the coffee crisis was the changing landscape of the major coffee producers.[89] In recent decades, Brazil, currently the world's largest coffee-producing country, improved its crop production and developed new methods of increasing crop yields.[90] This led to increased crop supply and exacerbated the supply/demand imbalance in the world coffee market.[91] Additionally, in the 1990s, Vietnam became the second largest producer of coffee in the world.[92] Its recent coffee exportation flooded the market with surplus beans, including fifteen million pounds of coffee in 2000.[93]

The third factor in the coffee crisis was a decrease in coffee demand in major coffee-consuming countries.[94] While coffee production has remained either stable or rising in many parts of the world, recent drops in demand in major coffee-consuming nations have heightened the effects of the weakened ICA and the oversupply by Brazil and Vietnam.[95] However, the specialty coffee marketplace has not experienced the same drop in demand as more common varieties of coffee.[96] Although specialty coffee is a hopeful prospect in combating the effects of the coffee crisis, it represents only a small percent of the overall coffee production market.[97]

The fair trade movement has attempted to alleviate some of the harmful effects experienced by coffee producers in the wake of the extended market disequilibrium.[98] However, even with some form of market regulation,[99] conditions have never been ideal or equitable for small-scale coffee farmers. If regulatory measures were to come back into play (a helpful policy decision recommended in this Note), the fair trade movement would still have much to contribute to both the maintenance of a more stable economic climate for the coffee market and to the improvement of the living conditions of those involved in the growing, roasting, and exporting of the coffee bean.

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87. *See id.*
88. *See* Brown, *supra* note 54, at 252.
89. *See* Petchers & Harris, *supra* note 83, at 45-46.
90. *See id.*
91. *See id.*
92. *See id.* at 45-46.
93. *See id.*
94. *Id.* at 46.
95. *See id.* at 45-46; Brown, *supra* note 54, at 254.
96. *See* Brown, *supra* note 54, at 254.
97. *See id.*
98. *See supra* Part II.
99. The ICA provided this type of suggested regulation throughout the last few decades of the twentieth century. *See* Shannon, *supra* note 2, at 174.

To a certain extent, the fair trade concept itself has created economic conundrums. For example, when coffee prices are low, the appeal of fair trade participation, in the form of cooperatives, naturally increases.[100] However, if demand for fair trade coffee fails to increase along with the resulting increased fair trade coffee supply, purchasers are forced to dump excess fair trade coffee onto conventional markets.[101] This can potentially drive down the overall price of coffee and perpetuate a cycle that requires farmers to continue participation in a fair trade coffee scheme.[102] Currently, coffee supply surpluses are not serious because of the relatively small amount of fair trade coffee in the economy.[103] This theoretical cycle is affected by a plethora of factors, but it may highlight one reason increased demand for fair trade coffee would be generally positive for fair trade certified farmers when they sell their crops.

B. United States House Resolution 349

While the United States has been quite active in both developing policy for the international coffee market and incorporating coffee in trade agreements,[104] it has yet to pass any domestic legislation that addresses coffee products or regulation of fair trade coffee. For example, the most substantial legislation pertaining to coffee was House Resolution 349 (H.R. 349), which was promulgated by the 108th Congress in 2003.[105] H.R. 349, titled "Encouraging the Consumption of Fair Trade Certified Coffee," was introduced by Representative Pete Stark of California[106] along with seventeen co-sponsors.[107] The first part of the Resolution includes the House's acknowledgement of the economics of the international coffee trade and how it affects both producers and consumers:

> Whereas in the context of the global economy, consumer choices and institutional purchases affect communities and the environment throughout the world; ...
>
> Whereas according to the International Coffee Organization, coffee producing countries are now only earning $5.5 billion in revenue from a $70 billion global

100. *See* James McWilliams, *Fair Trade and the Food Movement*, N.Y. TIMES FREAKONOMICS BLOG (June 30, 2010, 10:30 AM), http://freakonomics.blogs.nytimes.com/2010/06/30/fair-trade-and-the-food-movement/.

101. *See id.*

102. *See id.*

103. *See id.*

104. *See supra* Part III.A.

105. *See* H.R. Res. 349, 108th Cong. (2003).

106. *Id.*

107. *Id.*

> coffee industry, while in 1989, coffee producing countries earned $12 billion in revenue from a $30 billion global coffee industry; ...
>
> Whereas Fair Trade Certification is a solution that ensures a minimum price per pound of coffee at $1.26 for producers and grants them access to credit; ...
>
> Whereas there is an independent market for Fair Trade Certified coffee, but the overall supply of Fair Trade Certified coffee far exceeds current market demand by at least 130 million pounds...[108]

The Resolution concludes by giving three recommendations.[109] First, the government has a responsibility to deliver its food support services in the fairest manner possible by requiring a high standard of ethics.[110] Second, the House would like fair trade coffee at all events and food service locations for the government where possible.[111] Finally, "information should be made available to the public and to State and local governments about the importance of Fair Trade Certified coffee."[112]

Representative Stark, in comments made while introducing the Resolution, indicated that this piece of legislation would promote the sale of fair trade coffee and raise its awareness to the public while not burdening Congress in any significant way.[113] Representative Stark recognized that the force of the Resolution was more in its symbolic nature and less in actual policy change, being a gesture that sent a signal to the country about the government's commitment to fair trade practices.[114] Representative Stark saw no reason why the federal government could not serve fair trade coffee in its buildings and at government functions, especially given that major corporations did the same in their stores.[115] The purpose of the Resolution, for Representative Stark, was both to acknowledge that fair trade coffee can help alleviate the effects of the coffee crisis and to inform the public about the benefits fair trade coffee creates for coffee farmers.[116] Representative Stark hoped that H.R. 349 would reflect the value of fairness by serving as the first step in an effort to curb the abuses suffered by coffee

108. *Id.*
109. *Id.*
110. *Id.*
111. *Id.*
112. *Id.*
113. 149 CONG. REC. 19,878 (2003) (statement of Rep. Stark).
114. *See id.* at 19,879.
115. *See id.*
116. *See id.*

producers at the hands of middlemen.[117] The Resolution, while symbolic in nature, should not be ignored because there is value in voicing support for fair trade coffee practices and raising awareness of the fair trade movement. However, the sponsors of H.R. 349 realize that resolutions promulgated by the U.S. House and Senate do not have the force of law and therefore have an inherently limited impact.[118]

As Representative Stark acknowledged, this Resolution is not a significant burden on the federal government. [119] It is unclear whether actual legislation, as opposed to just another resolution that provided for fair trade coffee in federal food service venues, would be a burden on the government to implement. Further, legislation mandating that the government serve fair trade coffee would likely send an even stronger message to the public in support of fair trade coffee practices. Unfortunately, only H.R. 349 and another resolution generally recognizing the coffee crisis is the only attention the federal legislative branch has given to the possibility of implementing fair trade coffee practices.[120]

C. Starbucks: The Impact of Corporations

Although international political economy and governmental responses are partial aspects to a complicated economic situation created by the international coffee trade, private commercial enterprises are hard to ignore in any meaningful economic analysis. Coffee leviathan Starbucks has led the way in the private sector's involvement in fair trade coffee. In 2005 Starbucks paid an average of twenty-three percent higher than average market price for its coffee, a price that exceeded the fair trade minimum price.[121] Starbucks's purchases of fair trade certified coffee show an impressive upward trend.[122] Starbucks purchased 4.8 million pounds of fair trade coffee in 2004, 11.5 million pounds in 2005,[123] and pledged to purchase 40 million pounds in 2009.[124] Recently, Starbucks announced

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117. *See Fair Trade Coffee Resolution Introduced in the House of Representatives*, JUST-FOOD.COM (July 19, 2002), http://www.just-food.com/article.aspx?id=69746.

118. *See Legislation, Laws, and Acts*, U.S. SENATE, http://www.senate.gov/legislative/common/briefing/leg_laws_acts.htm (last visited Dec. 19, 2010).

119. *See* 149 CONG. REC. 19,878.

120. *See* H.R. Res. 349, 108th Cong. (2003); H.R. Res. 604, 107th Cong. (2002); S. Res. 368, 107th Cong. (2002) (mirroring the House Resolution).

121. Alison Benjamin, *Fair Dunk'em*, GUARDIAN, (Feb. 9, 2006, 15:30 GMT), http://www.guardian.co.uk/environment/2006/feb/09/food.fairtrade.

122. *See id.*

123. *Id.* Also, in 2004 Starbucks created its own farmer equity scheme called Shared Planet because small-holder farms certified by other international groups represented only two percent of the world's coffee supply. *Id.*

124. *Starbucks Says It Will Double Its Buying of 'Fair-Trade' Coffee*, BUS. REV. (Albany), Oct. 29, 2008, *available at* http://albany.bizjournals.com/albany/stories/2008/10/27/daily 28.html.

that, in a partnership with FLO, all of the company's espresso-based drinks, such as lattes and cappuccinos, would be made with Fairtrade-certified espresso by March 2010.[125] Additionally, Starbucks features its fair trade Café Estima blend coffee in over 10,000 of its stores in more than fifty-five countries.[126] At least one positive aspect of Starbucks's involvement in fair trade coffee is its ability to expose consumers to fair trade coffee purchasing options primarily due to the pervasive nature of Starbucks' global brand.

The participation of Starbucks in the fair trade coffee movement potentially changes the focus and direction of the movement. As political scientist Gavin Fridell notes, involvement of major corporations in fair trade transforms the movement from one of concerted efforts by various small advocacy groups to a movement driven by the interests of corporations as they pursue a niche market.[127] Some argue that pursuing fair trade coffee in order to reach out to a niche market may be problematic because it represents an inadequate commitment to fair trade coffee.[128] Another problem Fridell points out is that the increased participation of major corporations like Starbucks in fair trade perpetuates some of the limitations the fair trade network experiences in a market-based model.[129] Further, Fridell argues that corporate-driven expansion of the fair trade coffee movement receives its motivation not from a genuine concern about producers or consumers, but from a desire to protect the corporation's public image and its profitability.[130]

However, from a market-based perspective it is ultimately advantageous to have a major player like Starbucks participating in the fair trade coffee scheme if only because of the sheer volume of resources available to the retailer to boost fair trade coffee purchases and sales. Because Starbucks is the largest purchaser of fair trade certified coffee in the world,[131] the end result of its massive purchasing volume is that more coffee producers benefit from fair trade. Even some working in the fair trade movement recognize that the financial weight of business entities represents a potential source of growth for the movement.[132] In fact,

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125. *See 100% of Starbucks Espresso in Europe to be Starbucks Shared Planet and Fairtrade Certified*, STARBUCKS (Sept. 10, 2009), http://news.starbucks.com/article_display.cfm?article_id=265.

126. Brigid Darragh, *Starbucks Featuring Fair Trade Coffee in 10,000 Stores*, GREEN CHIP STOCKS (Apr. 21, 2010), http://www.greenchipstocks.com/articles/starbucks-new-fair-trade/916.

127. *See* FRIDELL, *supra* note 12, at 6.

128. *See id.* For example, Starbucks has only certified as fair trade six percent of its coffee beans. *Id.*

129. *See id.*

130. *See id.* at 73.

131. *See* Fieser, *supra* note 4.

132. *See* Peter Gaynor, *Aid and Trade in Developing World*, IRISH TIMES, July 26, 2010, *available at* http://www.irishtimes.com/newspaper/letters/2010/0726/1224275466859.html.

businesses might be able to have the largest impact of the volume of fair trade coffee purchased.[133] Part of the overall success of the fair trade movement may come from corporate involvement;[134] therefore, this participation should be encouraged.

IV. CURRENT EU FAIR TRADE COFFEE POLICY: THE SCHMIDT REPORT

The European Parliament, the EU's only directly elected body,[135] passed the Resolution on Fair Trade and Development in 2006.[136] The Parliament's Committee on Development promulgated the Resolution. The Resolution, nicknamed the "Schmidt Report" after its author and committee member Frithjof Schmidt (hereinafter referred to as either the Resolution or the Report), was based on an earlier report on fair trade coffee compiled Mr. Schmidt.[137]

A. Preamble

The Resolution is of considerable length and detail.[138] It begins by recognizing the impact fair trade can have on socially conscious practices: "Fair Trade and other independently monitored trading initiatives contributing to raising social and environmental standards have in common their ambition to market, sell and promote trade in products which comply with certain social, environmental and development criteria."[139]

As the Schmidt Report acknowledges, "Fair Trade pursues two inseparable objectives" by providing "opportunities for development for small-scale producers" as well as prompting "the international trading system ... to operate in a way which is fairer and more conducive to sustainable development."[140] This passage exemplifies the high level of understanding the Resolution's authors have for fair trade and its potential to further policy objectives. In addition to government action, the Resolution also recognizes the role of citizens in the fair trade network

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133. *See id.*

134. *See* FRIDELL, *supra* note 12, at 53. Fridell does not argue that this scheme is ideal; on the contrary, he argues that a market-based approach may not be the most effective route to fair trade policies while recognizing that the fair trade movement has benefitted from neoliberal market policies. *Id.*

135. *See Welcome to the European Parliament*, EUROPEAN PARLIAMENT, http://www.europarl.europa.eu/parliament/public/staticDisplay.do?language=EN&id=146 (last visited Dec. 19, 2010).

136. European Parliament Resolution on Fair Trade and Development, *supra* note 17.

137. *See id.*

138. *See id.*

139. *Id.* ¶ B. The Resolution also acknowledges fair trade's potential for raising social standards and for eradicating poverty, something the EU has sought to do in its Millennium Development Goals. *Id.* ¶ C.

140. *Id.* ¶ G.

through ideas such as public campaigns and other cooperative efforts.[141] The Resolution also specifically mentions the phenomenon of fair trade towns as a way to raise awareness about choosing fair trade products.[142] Connected to the role of consumers in fair trade, the Schmidt Report addresses the importance of retailers in the fair trade system in promoting fair trade practices: "[A]n increasing number of European retailers make significant efforts to support Fair Trade and other independently monitored trading initiatives contributing to raising social and environmental standards by communicating their values and offering their products in their outlets...."[143]

Another important preamble statement focuses on the lack of legal protection for general fair trade practices and the fear that companies may, in light of the success of the fair trade movement, exploit the positive reputation of fair trade products without complying with the required fair trade criteria.[144] This is a wise consideration given that fair trade is growing internationally.[145] This acknowledgement also bolsters an argument for a uniform labeling initiative, which would help eliminate abusive practices of companies using false, misleading, or meaningless labels.[146] The potential for abuse should be especially recognized in areas where fair trade practices are growing today, like the United States, in order to maintain the integrity of fair trade products.[147]

B. Substantive Provisions

The substantive portion of the Schmidt Report contains many relatively specific recommendations that European governments at various levels can heed in order to promote fair trade practices, increase fair trade awareness, and support the success of the fair trade movement generally.

One of the first of the Resolution's thirty-three recommendations combats the problem of potential abuse of the fair trade system by exploitive companies.[148] This recommendation calls for the regulation of overall fair trade practices by using specific criteria that would streamline the fair trade certification process, ensure quality in fair trade products, and,

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141. *See id.* ¶ I.; *infra* Part V.

142. *See* European Parliament Resolution on Fair Trade and Development, *supra* note 17, ¶ I.; *infra* Part V.

143. European Parliament Resolution on Fair Trade and Development, *supra* note 17, ¶ K.

144. *See id.* ¶ S.

145. *See supra* Part II.B.

146. *See infra* Part VI.A.2.

147. *See supra* Part II.B.

148. *See* European Parliament Resolution on Fair Trade and Development, *supra* note 17, ¶ S.

most importantly, guarantee fairness to fair trade producers.[149]

The Report also emphasizes that a central source of strength for the overall fair trade movement has been its labeling initiative, which serves as both a signal to consumers and a quality assurance device.[150] The Report, reinforcing the importance of having a singular and powerful labeling scheme among labeling organizations that indicates fair trade principles and fair trade quality, "[s]tresses that the most significant part of the increase in Fair Trade sales has been achieved with respect to labelled products."[151] The Resolution goes on to make more pointed efforts at initiating action.[152] The Committee adopting the Resolution "[c]alls on the Commission to launch specific calls for proposals in relation to Fair Trade targeted at raising consumer awareness, supporting assurance schemes and labelling and systematic data collection and assessment of effects across the EU...."[153] This admonishment to action demonstrates a certain level of seriousness of the European Parliament both to EU member states and to the international trade community about enacting the recommended proposals and providing for the growth of ideas like consumer awareness and labeling schemes.[154]

The twenty-fourth recommendation in the Resolution encourages the European Parliament to offer fair trade products and further recommends that all EU-related bodies serve fair trade goods.[155] This is essentially the entirety of the substance of the U.S. counterpart to the Schmidt Report, U.S. House Resolution 349.[156]

As with most legislative resolutions, the Schmidt Report does not legally bind the European Parliament.[157] However, it serves as a clear guideline for how various levels of European government can actively promote fair trade practices. The Resolution is impressively detailed and thorough, which places it in stark contrast from other, more superficial

149. *See id.* ¶ 2.

150. *See id.* ¶ N.

151. *Id.* ¶ 3.

152. *Id.* ¶ 13.

153. European Parliament Resolution on Fair Trade and Development, *supra* note 17, ¶ 13. The "Commission" referred to is the European Commission, the executive-type branch of the European Union, which proposes legislation, participates in the decision-making process, carries out various policies, treaties, and etc. *See The European Commission at Work - Basic Facts*, EUROPEAN COMM'N, http://ec.europa.eu/atwork/basicfacts/index_en.htm (last visited Dec. 19, 2010).

154. *See generally* European Parliament Resolution on Fair Trade and Development, *supra* note 17 (displaying a thorough consideration of research about and proposals for fair trade coffee sustainability).

155. *See id.* ¶ 24.

156. *See* H.R. Res. 349, 108th Cong. (2003); *supra* Part III.B.

157. *See* European Parliament Resolution on Fair Trade and Development, *supra* note 17, ¶ 1.

resolutions like H.R. 349.[158] The Schmidt Report raises many important points about how to positively benefit the global fair trade scheme by sustaining fair trade in the future.

C. Report Comments

The Schmidt Report[159] is accompanied by an explanatory statement detailing some of the reasons for the Resolution's adoption. The statement lists five primary reasons to develop a policy for fair trade in the EU which echo many of the sentiments the actual Resolution lists in its Preamble.[160] The first purpose for generating a fair trade policy framework is to promote the EU's goal of encouraging sustainable development and poverty reduction.[161] This goal is squarely aligned with the general principles promoted by the fair trade movement and seemingly represents a recognition on the part of the European Parliament that its social policy goals are in accord with and can, to a certain extent, be implemented through fair trade practices.[162]

The second reason to develop fair trade policy is that the EU has entered into legally binding treaties that advocate support for fair trade, such as the Cotonou Agreement.[163] However, the Report notes that the support given to fair trade practices in the EU and to the various coordinating organizations is "limited and fragmented,"[164] which seems to be an attempt to give recommendations in support of a unified policy on fair trade practices.

The Report states that the third reason for promulgating the Resolution is a desire to harness the growth potential of the fair trade movement in an effort to increase consumer awareness and fair trade demand.[165] The Report recognizes that the EU represents a significant percentage of sales of fair trade goods globally and that its growth in countries where fair trade goods are less established will be significant in the future. Thus, the campaign to increase consumer awareness will have a direct impact on fair trade demand in countries where the fair trade movement is not established.[166]

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158. *See supra* Part III.B.

159. *See* Report on Fair Trade and Development, EUR. PARL. DOC. A6-0207 1 (2006), *available at* http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A6-2006-0207+0+DOC+PDF+V0//EN.

160. *See id.*; European Parliament Resolution on Fair Trade and Development, *supra* note 17.

161. *See* Report on Fair Trade and Development, *supra* note 159, at 11.

162. *See supra* Part II.

163. *See* Cotonou Agreement, 2000 O.J. (L 317) 3; *supra* Part II.

164. Report on Fair Trade and Development, *supra* note 159, at 11.

165. *See id.*

166. *See id.*; *supra* Part II.B.

The fourth reason for promulgating the Resolution is related to the phenomenon of fair trade growth among EU member states.[167] The Report explains that as fair trade practices expand throughout the EU, national legislation regulating the trade will likely be passed.[168] A supranational, EU-based framework of regulation will avoid legislative differences of EU member governments and therefore avoid a hindrance of the "free movement of goods within the European Union."[169]

The fifth and final reason the Report gives to adopt the European Parliament Resolution is to protect consumers of fair trade products.[170] This final reason echoes statements in the actual Resolution concerned with the potential for labeling abuse by noncompliant companies.[171] The Report explains that the standards for fair trade practices have been promulgated with great care and that these promulgated practices adhere to strict guidelines in order to maintain a high level of quality assurance for their certified products in order to protect the consumer from potential systematic abuses.[172]

V. FAIR TRADE TOWNS

Both national governments and multinational corporations play a significant role in the international coffee trade by influencing the implementation and promotion of fair trade coffee practices.[173] However, an increasing trend among grassroots organizations and local governments provides a new and promising approach to fair trade. One of the most important aspects of fair trade's effectiveness is the demand it creates among consumers for fair trade products. The rise of cities declaring themselves "fair trade towns" serves to raise consumer awareness about the benefits of fair trade coffee at a community level.[174]

The ideological underpinnings of fair trade towns are rooted in the concept of "ethical consumerism." At first blush, this may sound like an oxymoron because, while being ethical brings to mind notions of fairness

167. *See* Report on Fair Trade and Development, *supra* note 159, at 12.

168. *Id.*

169. *Id.* Fair trade practices regulated by individual states independently may present roadblocks to successful expansion. This is an important consideration not only for the EU, but also for states the world over that participate in some way in the fair trade scheme; the idea of supranational governance raises significant question about what level of government would be most effective in developing fair trade policy. *See supra* Parts II.B, III.A.

170. *See* Report on Fair Trade and Development, *supra* note 159, at 12.

171. *See* European Parliament Resolution on Fair Trade and Development, *supra* note 17, ¶ S.

172. *See* Report on Fair Trade and Development, *supra* note 159, at 12.

173. *See generally supra* Part III (detailing international trade agreements and corporate involvement in the fair trade coffee market).

174. *See supra* Parts III.A-B.

and doing right, consumerism is more aimed at individualistic purchasing without regard to consequences.[175] At its core, ethical consumerism is defined as consumers who value social justice by using their purchasing power to buy products from companies that use socially conscious practices in their production methods and trade.[176] This approach uses free market tactics, as opposed to government regulation, to encourage business enterprises to incorporate social and ethical values in their business dealings.[177]

Ethical consumerism is particularly suited to fair trade coffee because it represents the intersection of consumer activism and the goals of fair trade. Consumers with an inclination toward ethical practices support the fair trade coffee movement, which ultimately impacts coffee farmers positively because this increased demand allows farmers to sell their fair trade coffee beans in an expanded market.[178] Ethical consumerism also helps the sustainability of the fair trade coffee movement because it has staying power, as it has grown even in the face of the late-2007 to 2010 economic recession.[179]

Ethical consumerism is not without its critics. Some argue that while ethical consumerism is a helpful goal for long-term stability of fair trade practices, it is not a viable short-term goal for helping the immediate needs of coffee farmers and their families.[180] Furthermore, concerns arise regarding the integrity of information that is disseminated to consumers about companies and their ethical practices.[181] Misleading statements by corporations might serve to undermine the overall success of ethical consumerism as shoppers come to see no essential difference between so-called ethical product choices and actual fair trade goods.[182]

These criticisms point to imperfections in the fair trade process that should be examined and corrected if ethical consumerism is to be effective. However, the underlying idea that consumers have a choice when buying and using products is a core tenet that has encouraged many around the world to promote ethical consumerism within their communities.[183]

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175. *See* Martin Wright, *The Ethical Dilemma Facing Consumers*, GUARDIAN, http://www.guardian.co.uk/starbucks-ethical-living/ethical-consumer-debate (last visited Jan. 9, 2011).

176. *See* Draeger, *supra* note 29, at 359.

177. *See* Brown, *supra* note 54, at 259.

178. *See supra* Part II.B.

179. *See* Wright, *supra* note 175.

180. *See* Draeger, *supra* note 29, at 362.

181. *See id.* at 360-61.

182. *See id.*

183. *See* Allen, *supra* note 19.

A. The First Fair Trade Towns: United Kingdom

The "fair trade town" movement was born in Europe,[184] and the first fair trade town in the world was Garstang, England.[185] Garstang achieved its fair trade status in 2000 with the help of local activist Bruce Crowther, who focused on how fair trade towns lift coffee producers out of poverty.[186] The primary goal in Garstang was to involve the local community and elicit its help in promoting fair trade, a task that included raising awareness of fair trade practices.[187] Crowther emphasized the grassroots process the town went through in order to become a fair trade town.[188] He also said that he "had to work very, very hard to change attitudes" before the town accepted fair trade town status.[189] In order to become officially recognized as a fair trade town, Garstang was required to adhere to five established criteria, which included local businesses, schools, and churches agreeing to sell Fairtrade products.[190] Additionally, the town council passed a resolution supporting Fairtrade.[191]

Today, local recognition of the Fairtrade mark in Garstang has reached ninety percent.[192] Fairtrade products are sold or served in both private and government establishments, including shops, schools, restaurants, the town council, and the local post office.[193] The fair trade town movement has spread to over 400 fair trade towns in the United Kingdom.[194] In fact, the trend has expanded across Europe to over 300 other towns, including Rome, Italy, Copenhagen, Denmark, and Dublin.[195]

Some point out that local farmers view fair trade town status as a threat to their competition in local markets,[196] but Joe Human of the Cumbria Fair Trade Network explained that both local farmers and those in developing countries face common challenges in competing with large corporations.[197] He indicated that the fair trade town effort can be viewed as a harmony between all small-scale farmers: "Fairtrade is not just about a fair price. ... It's also about sustainable farming."[198]

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184. *Id.*
185. *Id.*
186. *See id.*
187. *See id.*
188. *See id.*
189. *See id.*
190. *See* Jenny Wiggins, *Growth in Fairtrade Towns Defies Downturn*, FIN. TIMES, Dec. 18, 2009, at 4.
191. *See id.*
192. Allen, *supra* note 19.
193. *Id.*
194. *See* Wiggins, *supra* note 190.
195. *See id.*
196. *See id.*
197. *See id.*
198. *See id.*

Those who have lobbied for their towns to become official fair trade towns have noted the importance of local organization to achieve success. For example, Sophi Tranchell, who chaired the committee to make London a fair trade town in 2008, felt that the fair trade town movement is significant because it "offers an easier route for people to achieve change than traditional politics."[199]

B. United States Fair Trade Towns

Although slower to embrace the grassroots approach to fair trade practices than EU countries, the fair trade town idea has spread to the United States.[200] Media, Pennsylvania, a small town with a population of approximately 6000 people, became the first official United States fair trade town in 2006.[201] There were five guidelines Media followed in order to become a fair trade town, goals which were first developed in Europe and have since been imported:

> 1) The Media Borough [Town] Council passed a resolution supporting Fair Trade and committing to serve Fair Trade coffee and tea at its functions.
> 2) A range of Fair Trade products are readily available in Media's shops and restaurants.
> 3) Fair Trade products are used by a number of local work places, such as law offices, and community organizations, such as churches.
> 4) Media coverage is provided for the fair trade movement in addition to having popular support for the campaign.
> 5) A local Fair Trade steering group from a diverse representation of institutions is working to ensure continued commitment to Fair Trade Town status.[202]

Today, there are at least twelve more cities across the United States that have joined the fair trade trend, including San Francisco, California.[203] Additionally, various industry actors are becoming more involved in the process of developing fair trade towns in the United States.[204] Recently, the Green Mountain Coffee Roasters Foundation provided TransFair USA with

199. *Id.*

200. *See* FAIR TRADE TOWNS USA, http://www.fairtradetownsusa.org/ (last visited Dec. 19, 2010).

201. DiCamillo, *supra* note 20.

202. *Id.*

203. Allen, *supra* note 19.

204. *See* Sarah Duxbury, *TransFair Gets $1M to Create Fair Trade Towns*, S.F. BUS. TIMES (Mar. 9, 2010, 10:02 AM), http://sanfrancisco.bizjournals.com/sanfrancisco/stories/2010/03/08/daily17.html.

a one million dollar grant to develop fair trade towns across the country.[205] This initiative is beneficial for both socially conscious towns and environmentally-friendly corporations.[206]

The United States represents a vast percentage of fair trade products sales, especially coffee;[207] thus, it is in the interest of fair trade activists to encourage more cities in the United States to become official fair trade towns. The idea of a fair trade town initiative being launched as a grassroots effort would likely appeal to many U.S. communities that value participation in local government and political activism on a small scale that is responsive to the needs of individuals or to a community.[208] The initiative would likely gain support from those who value local autonomy and the ability of a particular community to make a meaningful impact.[209]

VI. SUSTAINING FAIR TRADE COFFEE VIABILITY

Coffee in the global market is a serious force,[210] and how governments and various organizations treat the commodity has a significant impact. However, there is no single solution to help coffee producers. Further, there is no consensus that fair trade practices alone represent a panacea to the problems of pay inequity and a poor standard of life for coffee farmers.[211] Anecdotal evidence reveals that one small-scale fair trade coffee producer receives $1.55 USD per pound for his coffee (approximately ten percent higher than the regular coffee market price), yet after fees for fair trade cooperatives and other taxes, the farmer's net profit is only $0.50 USD per pound.[212] Additionally, although not without possible remedies, there are signs that fair trade's effectiveness to increase profit is limited by growth limitations in the market.[213]

With an eye toward what will be best for those who have the greatest stake in the global coffee market, this Note advocates all efforts designed to help coffee farmers live and work sustainably, healthily, and prosperously, whether those efforts are private or public. One private effort is the Shared Planet scheme developed by Starbucks.[214] The Shared Planet initiative was

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205. *See id.*

206. *See Building Demand for Sustainable Products*, GREEN MOUNTAIN COFFEE ROASTERS, http://www.gmcr.com/csr/PromotingSustainableCoffee.aspx (last visited Dec. 19, 2010).

207. *See supra* Part I.

208. *See infra* Part VI.B.

209. *See id.*

210. *See supra* Part I.

211. *See* Fieser, *supra* note 4.

212. *Id.*

213. *See* FRIDELL, *supra* note 12, at 64-65; *supra* Part II.B.

214. *See Starbucks Shared Planet*, STARBUCKS COFFEE CO., http://www.starbucks.com/responsibility/learn-more/starbucks-shared-planet (last visited Dec. 19, 2010).

developed by the corporate coffee giant in an effort to buy more equitable coffee than what it could purchase under the international fair trade coffee scheme.[215] Because fair trade coffee represents only two percent of the world's supply of coffee, Starbucks desired to satisfy its tremendous demand for coffee in a more equitable manner.[216] This desire led to Starbucks's development of the Shared Planet standards.[217] The Shared Planet initiative established a set of criteria, called Coffee and Farmer Equity (C.A.F.E.) standards, which measure sustainable coffee purchases.[218] The C.A.F.E. standards include a number of social and environmental indicators.[219] Coffee producers participating in the C.A.F.E. standard scheme must be certified by an independent third party in a manner similar to the certification and fair trade coffee initiative standards used by FLO and others.[220] In 2008 seventy-seven percent of the coffee purchased by Starbucks (295 million pounds) was from producers certified under the C.A.F.E. standards program.[221] Private initiatives such as these represent innovative and important inroads to maintaining the viability of efforts to support small-scale coffee farmers. These efforts are another avenue independent of traditional, established fair trade practices to provide coffee producers with access to a fair price for their commodity.

The involvement of corporate entities in fair trade coffee purchases, either through established fair trade certified farms or through self-designed schemes like Shared Planet, are laudable. However, the principles of the fair trade movement and the core motivation of major corporate involvement in fair trade coffee may be at odds. It has been argued that fair trade coffee and corporate practices are, to a certain extent, incompatible because fair trade promotes the interests of small farmers and their empowerment while corporate standards are primarily driven by profitability and are established to elevate a corporation's brand.[222] Corporate involvement in the fair trade network seemingly benefits the corporation more than farmers in the long run.[223] For a minimal commitment to fair trade practices, as opposed to a total commitment to purchase solely fair trade coffee, a corporation receives maximum publicity

215. *See* Benjamin, *supra* note 121.

216. *See id.*

217. *See id.*

218. STARBUCKS COFFEE CO., C.A.F.E. PRACTICES GENERIC EVALUATION GUIDELINES 2.0 2-19 (2007), *available at* http://www.scscertified.com/retail/docs/CAFE_GUI_Evaluation Guidelines_V2.0_093009.pdf.

219. *See id.*

220. *See id.* at 19.

221. STARBUCKS COFFEE CO., FY 2008 GLOBAL RESPONSIBILITY REPORT 57 (2008), *available at* http://assets.starbucks.com/assets/fy08-gr-report.pdf.

222. *See* FRIDELL, *supra* note 12, at 261.

223. *See id.* at 262.

in favor of its practices.[224] This less than complete commitment to fair trade might be a superficial reaction to criticism of the corporation for not engaging in producer-friendly purchasing practices.[225]

Another critique of corporate involvement in fair trade coffee is the fear that corporate influence will dominate the fair trade market.[226] The underlying concern is that coffee producers and others involved in the fair trade network would become subservient to the demands and power of a corporation seeking to guide the movement and direct its participants to the corporation's advantage.[227]

There is additional concern that the system of fair trade coffee certification is simply an antidote to consumer guilt and that its price guarantees are set just high enough to assuage feelings of guilt but just low enough to encourage large-scale purchase and consumption.[228] Essentially, this comes down to a decision between helping to improve modestly the quality of life for many farmers and substantially helping the quality of life for a few farmers.[229]

In light of the various criticisms questioning corporate influence in the fair trade system, it seems that, at this point, maximizing the potential impact non-profit, NGO-led fair trade can have on the coffee trade is the most effective, beneficial approach. As University of California-Berkley researcher Christopher Bacon indicates, "Fair Trade is still, and will remain, a better deal for farmers,"[230] as opposed to letting market forces or the private sector decide the best standards for fair trade coffee.[231]

The possibility of an expansion of fair trade coffee practices may increase the movement's effectiveness. These expansions include not only an increased number of certified farms, but also more varied programs helping producers secure loans, build infrastructure, and undertake other sustainable investments.[232]

There are various ways to stimulate support for fair trade coffee, but this Note focuses primarily on the way fair trade practices can influence market forces, which increase demand for fair trade coffee. This is not to say, however, that a free-market approach is the best route to achieving such a goal; on the contrary, perhaps a particularly effective and more fully comprehensive approach would use regulatory measures in combination with ethical consumerism[233] in order to spur market activity. Ethical

224. *See id.*
225. *See id.*
226. *See id.* at 262-63.
227. *See id.*
228. *See* Richardson, *supra* note 34.
229. *See id.*
230. Fieser, *supra* note 4.
231. *See* Richardson, *supra* note 34.
232. *See supra* Part II.
233. *See supra* Part V.

consumerism informs the purchaser that there are important social and ethical considerations based on their purchases; armed with that information, a knowledgeable consumer will tend to buy those goods and services that incorporate ethical values.[234] An effective campaign to educate consumers and to spur them to purchase in an ethical manner should increase demand for fair trade coffee.[235] Thus, the recommendations offered in this Note emphasize strengthening regulatory mechanisms used by the fair trade network and organizations like FLO in conjunction with measures, both local and national, designed to stimulate ethical activity in the market.

A. U.S. Domestic Policy Recommendations

1. Emulating the Schmidt Report

U.S. congressional responses to the historical plight of small-scale coffee farmers[236] are admirable in that they demonstrate sensitivity to the issues facing coffee-producing communities. They also illustrate that the United States is aware of the problems coffee-producing communities deal with and that these problems can have a significant impact on both the U.S. economy and international relations.[237] Unfortunately, these resolutions serve merely as a half-hearted effort for meaningful change in the fair trade coffee movement. These resolutions seem to be of rather limited effectiveness,[238] and "[a]lthough the government is a major consumer of coffee, it is doubtful that its commitment to curb inequity offered in these governmental measures would have a significant effect on producers."[239] In reality, Congress could do much more to advocate on behalf of those directly benefitting from fair trade practices. For example, Congress could work with other international organizations involved in the global coffee trade.[240] Congress should examine its obligations through trade agreements and treaties and consider the many options available that benefit the coffee-

234. *See* Draeger, *supra* note 29, at 359.

235. *See generally supra* Part V (detailing the fair trade town phenomenon).

236. *See supra* Part III.B.

237. *See generally* Part III (discussing concerns coming from both International Coffee Agreements in the past as well as the House Resolution recognizing, to a limited extent, the benefits of fair trade coffee).

238. *See* Shannon, *supra* note 2, at 188.

239. *Id.* Indeed, it is argued that the government's role as an ethical consumer is not enough and that stronger regulations in the form of a reinvented ICA would be more effective. *Id.* at 188-89.

240. *See generally* Todd Mumford, Note, *Voluntary International Standards: Incorporating "Fair Trade" Within Multilateral Trade Agreements*, 14 SW. J. L. & TRADE AM. 171 (2007) (detailing international trade agreements involving fair trade coffee between the United States and other countries).

producing community.[241] Specifically, the United States should be cognizant of treaty agreements since they have historically been an important aspect of the fair coffee trade movement.[242] Participating in binding agreements with other countries, especially those heavily involved in the production of coffee, demonstrates a serious commitment to positive action in favor of the fair trade movement. Several ideas for crafting agreements that benefit fair trade coffee participants have been proffered[243] and should be reconsidered by Congress.

In addition to the international obligations Congress should consider when committing to fair trade coffee practices, there are significant strides the United States can make domestically. This Note advocates a definitive document promulgated by Congress in the style of the EU's Schmidt Report.[244] This document should include detailed steps that the government can take to examine the future of fair trade coffee and how it affects the United States.

One major advantage of the Schmidt Report is that it lists several approaches the EU should take in order to increase support for the fair trade movement; furthermore, the Report contains specific criteria important to an effective fair trade regime.[245] The Schmidt Report is detailed and provides specific examples of the major problems facing the future of fair trade coffee.[246] A cursory comparison between the Schmidt Report and U.S. House Resolution 349[247] reveals that the latter could benefit from greater specificity and substance. Perhaps because the United States is not a major coffee-producing country, or perhaps because of a tendency toward free market policies,[248] Congress has been resistant to address the coffee crisis and fair trade coffee in any meaningful way since the last ICA in the 1980s.[249] It is ultimately in the interest of the United States to support the growth of fair trade coffee because the United States is one of the world's greatest consumers of coffee,[250] is a major player in the international coffee trade, and has many private corporations closely tied to the coffee industry.[251] This fragile balance of interests requires a level of regulation and stability that fair trade coffee can effectively provide.

A document promulgated by Congress akin to the EU's Schmidt

241. *Id.*
242. *See id.*; *supra* Part III.A.
243. *See* Mumford, *supra* note 240 at 184-91.
244. *See supra* Part IV.A.
245. *See* European Parliament Resolution on Fair Trade and Development, *supra* note 17, ¶ 2(a)-(k).
246. *See id.*
247. *See* H.R. Res. 349, 108th Cong. (2003).
248. *See* Draeger, *supra* note 29, at 345.
249. *See supra* Part III.A.
250. *See* Shannon, *supra* note 2, at 170.
251. *See supra* Part III.C.

Report would be an important first step in the process of paying meaningful attention to fair trade coffee. A more concrete and substantial step than the promulgation of a document would be legislation mandating fair trade certified coffee in federal government buildings and at meetings. An American version of the Schmidt Report could serve as a precursor to such legislation while simultaneously serving to educate both the public and the government on the significance and advantages of fair trade coffee. The Schmidt Report conveys considerable information about the fair trade coffee movement,[252] and a U.S. version should, at a minimum, raise interest in the fair trade coffee movement. Ultimately, the United States should take the Schmidt Report as a guideline for developing its own version of a fair trade coffee promulgation that emphasizes the United States' role in the international coffee trade and the importance of fair trade coffee to U.S. interests.

2. Reaffirmation of a Uniform Labeling Initiative

Fair trade is not a perfect system, and the various labeling initiatives launched by international fair trade organizations sometimes confuse consumers or complicate the buying process.[253] Also, with such a multitude of labels bearing different certifications and guarantees, unscrupulous companies may exploit the lack of uniformity in the scheme.[254] There are many different types of labels available for fair trade products, including multiple labels associated with fair trade coffee.[255] Part of the problem stems from labels that marginally address fair trade coffee practices, yet appear to be associated with fair trade.[256] Such labels are generally geared toward shade-grown coffees or bird-friendly growing practices.[257] While they may be important in and of themselves, they unnecessarily complicate the buying process.[258]

This fragmented system is not optimal.[259] In order to create increased demand for fair trade coffee by way of consumer awareness and education, a unified labeling scheme is required. Empowering the consumer to trust a meaningful label will be one of the most effective tools in increasing demand for fair trade coffee. Others have advocated a uniform labeling scheme,[260] and this Note affirms that consumers will be most easily

252. *See* European Parliament Resolution on Fair Trade and Development, *supra* note 17, ¶¶ A-X.

253. *See supra* Part II.B.

254. *See* Draeger, *supra* note 29, at 360-61; *supra* Part V.

255. *See* Brown, *supra* note 54, at 262.

256. *See generally id.* (explaining various labels and their significance).

257. *See id.*

258. *See id.*

259. *See id.*

260. *See id.* at 279; Mumford, *supra* note 240, at 190.

informed about and trustworthy of a single label signifying an accepted standard. This idea seems to be coming to fruition; whereas in past years FLO member countries used their own national labels, FLO has gradually introduced a uniform label for many countries.[261] The United States, however, continues to use its own unique label.[262]

B. Local Government Efforts

The fair trade town trend seen throughout Europe has been effective in raising local consumers' awareness regarding fair trade coffee practices.[263] The concept was not accepted without some convincing from grassroots advocates,[264] but the fair trade town idea has remained successful by weathering the recent economic recession and is now in a state of growth.[265]

As mentioned, the United States is not ignorant of Europe's fair trade town phenomenon.[266] It has at least a dozen cities that are certified fair trade, a trend that also seems to be growing.[267] Increasing the number of fair trade towns all over the world, specifically in the United States, given its high demand for coffee, would greatly benefit the fair trade coffee movement. A fair trade town is an innovative idea to support the fair trade coffee movement because it seeks to educate and involve people on an individual level within the consumer's own community. The fair trade town idea represents a relatively simple and direct way citizens can become involved in the coffee trade, even if on a small scale. However, in the aggregate, small-scale involvement becomes significant.

Fair trade towns are also a unique way in which local government can become involved both within the coffee industry and constituents' lives. A local government that passes a fair trade bill not only adds to the potential demand for fair trade products but also actively responds to the desires of socially conscious consumers who desire their purchases to be ethical and have a beneficial impact on countless others in an international economy. Local government action of this sort also serves to educate consumers and give a governmental imprimatur to the effectiveness of the fair trade movement. Fair trade towns should be encouraged as a way to effectuate change from grassroots advocacy.

In addition to local government acting conscientiously, the fair trade

261. *See About the Mark*, FAIRTRADE LABELLING ORGS. INT'L, http://www.fairtrade.net/about_the_mark.html (last visited Dec. 19, 2010).

262. *See id.*

263. *See supra* Part V.A.

264. *See* Wiggins, *supra* note 190.

265. *See id.*

266. *See supra* Part V.B.

267. *See* Allen, *supra* note 19.

town initiative aligns with the concept of ethical consumerism.[268] Ethical consumerism acts on an individual level and gives the consumer a sense of power, even if that occurs at the grocery store checkout.[269] Various labels on coffee products tend to dilute the strength of what a meaningful label actually purports to do. The lack of fair trade coffee being offered in many local stores has also likely contributed to the slow growth of purchases.[270] The addition of a fair trade town initiative in a community would greatly reduce consumer confusion, increase consumer awareness of the benefits of fair trade products, and increase the availability of fair trade coffee and other fair trade products. Armed with information, choice, and a desire to act ethically, a consumer is likely to act ethically and purchase fair trade coffee.[271] The motivation to purchase fair trade coffee can only be bolstered by a system supported on a grassroots level.

VII. CONCLUSION

When examining what practices or schemes will be most successful in increasing support for the fair trade movement, remembering the ultimate beneficiaries of the fair trade movement is imperative. Initiatives such as ethical consumerism make the conscientious purchaser feel good about their purchases by becoming part of a something larger. When ethical consumerism is used to foster support for fair trade, it can help those less advantaged by creating sustainable communities for coffee producers. People involved in the laborious farming of the coffee plant have been greatly exploited. Many of those hard working farmers who are not yet participating in fair trade coffee practices are still exploited today. The fair trade coffee movement was established in order to decrease inequalities and has done much to improve the equities among those in the international coffee trade. However, despite the inequities, there is still much to be done.

Some statistics from Mexico illustrate the existing abuses within the coffee trade. Mexico, the world's fifth largest producer of coffee, is home to approximately 280,000 coffee growers, around 200,000 of whom are small-scale farmers.[272] Over sixty percent of these farmers are indigenous.[273] Many coffee producers in Mexico reside in communities lacking essential infrastructure like hospitals, electricity, schools, improved

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268. *See supra* Part V.

269. *Id.*

270. *See supra* Part II.B.

271. *See supra* Part V. It may be important to note that the concept of ethical consumerism becomes more complicated in the face of certain socio-economic realities like the inability to pay slightly higher prices for fair trade coffee. The idea is best applied where, all other things being equal and with proper information, a consumer will support others and choose fair trade coffee instead of alternatives.

272. FRIDELL, *supra* note 12, at 174-75.

273. *Id.*

roads, or running water. [274] Approximately eighty-four percent of the places in Mexico where coffee is a major agricultural crop have very high poverty indicators.[275] Communities like these that are wholly dependent on the crop of the coffee plant demonstrate the promise of an effective fair trade coffee movement. When these Mexican coffee producers are certified fair trade farmers, they are paid equitably, and along with those with whom they deal, reinvest in the community to ensure the long-term viability of the producers and the places in which they operate.

Focus on the coffee producer must remain steadfast when deciding how best to approach the sustained viability of the fair trade coffee movement. Fair trade has the potential to benefit various parties: consumers desiring to make ethical purchasing decisions, legislatures mindful of the impact their decisions have on international trade, or corporations hoping to improve their image and brand in the face of criticism. However, the proper focus must remain on the most deserving beneficiaries of the fair trade movement – the small-scale producers – for whom the movement was created. If other interests are permitted to dominate the direction of fair trade coffee practices, the future of the fair trade movement is uncertain. If fair trade remains committed to its core principles, however, its future is bright, and its sustainability is achievable.

274. *See id.*
275. *Id.*

DETERMINING THE APPROPRIATE DEFINITION OF RELIGION AND OBLIGATION TO ACCOMMODATE THE RELIGIOUS EMPLOYEE UNDER TITLE VII: A COMPARISON OF RELIGIOUS DISCRIMINATION PROTECTION IN THE UNITED STATES AND UNITED KINGDOM

Bryan M. Likins*

INTRODUCTION

"Few areas of law touch people more directly or deal quite as intimately with issues pertaining to human personality and its daily unfolding than does the law of work."[1] Those who participate in the workplace are directly impacted by the law of work. Even those who are not active participants in the workplace are indirectly impacted by the law of work through daily contact with businesses and their employees. Therefore, many scholars believe the treatment of the religious employee within the workplace serves as an exemplar of how religion should be treated in public law.[2] Others believe the treatment of religion in labor law reflects the general status of religion in any nation's law and culture.[3] Despite efforts to avoid dealing with the problems religious employees face in today's workplace, religion seems to be the hound from which we can never flee.[4] Most modern legal systems are forced to confront questions about religion continuously in labor law and other contexts.[5]

"The United States is no stranger to religion as a social and political force."[6] However, despite the United States' familiarity with religion in the workplace, the uptick in allegations of discrimination against employees who desired to exercise legally protected religious rights in their respective

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1. Thomas C. Kohler, *The Kenneth M. Piper Lecture: Religion in the Workplace: Faith, Action, and the Religious Foundations of American Employment Law*, 83 CHI.-KENT L. REV. 975, 986 (2008).

2. *See* Kenneth D. Wald, *Religion in the Workplace: Religion and the Workplace: A Social Science Perspective*, 30 COMP. LAB. L. & POL'Y J. 471, 475 (2009).

3. *See id.* at 474.

4. *See* Kohler, *supra* note 1, at 989.

5. *See id.*

6. Steven D. Jamar, Article, *Accommodating Religion at Work: A Principled Approach to Title VII and Religious Freedom*, 40 N.Y.L. SCH. L. REV. 719, 721 (1996).

workplaces has surprised lawyers, political scientists, and political theorists.[7] "Between 1997 and 2007, the number of religious discrimination charges filed with the Equal Employment Opportunity Commission (EEOC) increased 100 percent."[8] "In six of the eleven years following 1992, the increase in such claims was greater than five percent per annum."[9] For example, the "EEOC received 2,466 charges of religious discrimination in 2004."[10] This increase has become so problematic that the EEOC found it necessary to reach out to religious communities.[11] Such a substantial growth in allegations of religious discrimination and unlawful failure to accommodate religious practices seems almost "like a running sore on the body politic, and one unlikely to be healed anytime soon."[12]

A plethora of factors has contributed to this unexpected increase. Some identify the increased number of hours in the average American workweek.[13] It logically flows that, as employers require employees to work for longer periods, the possibility for conflict with an employee's desire to observe religious holidays and attend worship services could increase. Other events, such as the tragedy on September 11, 2001, could also be indirectly responsible for the increase in claims because such events have changed the way certain religious minorities are viewed.[14] Therefore, negative attitudes could be at least partially responsible for alleged discriminatory treatment and the resultant increase in complaints with the EEOC. Some scholars are also convinced that greater religious diversity in the workplace, such as increases in Buddhists, Muslims, and Hindus participating in the workplace, has amplified the likelihood of clashing religious views.[15] Yet, no matter the cause, "[t]his troubling trend in the treatment of faith in the American workplace deserves close examination."[16]

This Note develops several means by which the treatment of employees of faith can be improved in hopes of reversing recent trends. Part I examines the breadth of religious discrimination protection in the United States and the United Kingdom. It analyzes the definition of "religion" and "religion and belief" in pertinent statutes. Part I also discusses basic principles of religious

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7. *See* Wald, *supra* note 2, at 472.

8. Leslie E. Silverman, *Understanding the New EEOC Guidelines on Religious Discrimination: An Immediate Look at the Legal Ramifications of the EEOC's New Compliance Manual Section on Religious Discrimination in the Workplace* 1 (2009), *available at* Westlaw Aspatore, 2009 WL 1428692.

9. Richard T. Foltin & James D. Standish, *Reconciling Faith and Livelihood: Religion in the Workplace and Title VII*, 31 HUM. RTS. 19, 24 (2004).

10. *See* Peter M. Panken, *Religion and the Workplace: Harmonizing Work and Worship* 2, in 1 ALI-ABA COURSE OF STUDY MATERIALS, CURRENT DEVELOPMENTS IN EMPLOYMENT LAW (2005).

11. *See* Silverman, *supra* note 8, at 1.

12. Kohler, *supra* note 1, at 975.

13. *See* Silverman, *supra* note 8, at 1.

14. *See id.*

15. *See id.*

16. Foltin & Standish, *supra* note 9, at 19.

discrimination, the evolution of protection of religion in the workplace, the underlying statutes protecting religion in the workplace, and particular problems with religion in the workplace. The United States and the United Kingdom are analyzed in separate sub-sections. Finally, a brief sub-section explains the differences between the two states.

Part II focuses on employers' obligations to accommodate religious employees. It discusses the source, evolution, and development of the duty to accommodate. It covers examples of conflicts between the United States' and United Kingdom's religious employee protection systems to elucidate both how the accommodation duty works in practice and the problems with and differences between the two systems.

In Part III, conclusions are stated and specific recommendations are made. The suggestions specify the ways in which the U.S. system of protection under Title VII can be improved to further protect the religious employee. However, the author hopes the improvements endorsed in Part III are universally applicable beyond Title VII and the United States.

I. DEFINITION OF RELIGION

At first glance, discussing or developing a legal definition of "religion" may seem unnecessary or unfeasible. Indeed, many academics believe the definition of religion is "hopelessly ambiguous"; however, lawyers and judges do not have the luxury of accepting this postulation.[17] Citizens often assume religion is simply about "churches and dogma and worship within organized faith communities. Yet, in practice, there is an astonishing diversity to what people connote by the concept 'religion.'"[18] "[E]ach nation has a unique culture of religion and state that manifests in a system of laws and policies governing the domains where state and religion intersect."[19] Therefore, every country must independently determine the definition it assigns to the term religion.

A. Importance of the Definition of Religion

The Western assumption that law and religion can be neatly distinguished is challenged in many cultures where the two concepts are tightly intertwined.[20] Within the last few decades, the definition of religion has been notoriously contested.[21]

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17. *See* T. Jeremy Gunn, Conference: *Religion, Democracy, & Human Rights: The Complexity of Religion and the Definition of "Religion" in International Law*, 16 HARV. HUM. RTS. J. 189, 191 (2003).

18. Wald, *supra* note 2, at 477.

19. *Id.* at 476.

20. *See* LAW AND RELIGION IN THEORETICAL AND HISTORICAL CONTEXT 10 (Peter Crane et al. eds., 2008).

21. *See id.* at 7.

> Domestic and international courts have grappled with [the definition of religion], often in the context of legal protections for religious freedom contained in constitutions or treaties. As societies become more pluralistic and more individualistic, the task of defining what religion is becomes ever more complex. People who claim that they have a religion or that they deserve the same protection as those who have a religion are no longer necessarily members of a relatively limited number of discrete communities of co-believers with settled practices and beliefs. Instead, they may belong to small, idiosyncratic groups. They may be free-thinkers or have composed a series of spiritual beliefs taken from a variety of sources. They may reject institutionalized religion but still consider themselves religious or spiritual in the personal sense.[22]

"Legal definitions do not simply describe the phenomenon of religion, they establish rules for regulating social and legal relations among people who themselves may have sharply different attitudes about what religion is and *which manifestations of it are entitled to protection.*"[23] Therefore, a working definition of religion becomes requisite in providing a principled basis for deciding religion cases and determining when a belief will qualify for protection.[24]

B. United States

1. Evolution of Religious Protection

The source of protection for the religious employee in the U.S. workplace is more straightforward compared to analogous protections in British and European law.[25] With the Title VII of the Civil Rights Act of 1964, the U.S. Congress passed the first comprehensive federal employment discrimination legislation that prohibited employment discrimination because of, *inter alia*, an individual's religion.[26] Under Title VII, a claimant's (plaintiff's) prima facie

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22. *Id.* at 7-8.

23. Gunn, *supra* note 17, at 195 (emphasis added).

24. *See* LUCY VICKERS, RELIGIOUS FREEDOM, RELIGIOUS DISCRIMINATION, AND THE WORKPLACE 15 (2008).

25. *See* discussion *infra* Part I.C.

26. *See* Civil Rights Act of 1964 (Title VII), 42 U.S.C. §§ 2000e-2000e-17 (1991); Piva v. Xerox Corp., 376 F.Supp. 242, 246 (N.D. Cal. 1974) (describing Title VII as "the first comprehensive federal legislation in the field of employment discrimination"); Smith v. N. Am. Rockwell Corp., 50 F.R.D. 515, 518 (N.D. Okla. 1970) (indicating that the Act is "generally heralded as the first effort by the United States Government to outlaw discrimination in private employment on the basis of race, religion, national origin, and sex").

case consists of three elements: 1) the employee holding a sincere religious belief that conflicts with an employment practice, 2) the employer being put on notice of the conflict, and 3) the employee being disciplined or otherwise suffering an adverse consequence for adherence to a religious belief.[27]

Although the statute clearly protects the religious employee, neither the text of the statute nor the legislative history was clear about the definition of religion.[28] "Title VII instead merely purported to prohibit religious discrimination to the same extent it prohibits discrimination against any other statutorily protected class."[29] Determining Title VII's definition of religion is the problem underlying many religious discrimination cases brought under Title VII.[30] Deriving an adequate solution to this complex inquiry is a daunting task.[31]

2. Struggling to Find a Definition

More than 100 years ago, the U.S. Supreme Court maintained a very narrow view of religion.[32] Originally, in order to qualify as a religion, a group's belief system had to refer to belief or worship of a deity.[33] This deity requirement remained in Supreme Court jurisprudence until the 1960s.[34]

Soon after the passage of Title VII, the U.S. Supreme Court drew a more expansive view of religion[35] in *United States v. Seeger*.[36] Rather than simply looking for the worship of a deity, the *Seeger* Court asked "whether a given belief that is sincere and meaningful occupies the place in the life of its possessor parallel to that filled by the orthodox belief in God of one who clearly qualifies for [protection]."[37] In *Welsh v. United States*, the Supreme Court extended the *Seeger* definition to include beliefs, which even the believer, might not classify as religious.[38]

However, despite the expansion of the definition of religion, the Supreme Court's definition has been described as "polythetic" or "non-essentialist," meaning that there are no specified requirements or elements in order for a

27. *See* Susannah P. Mroz, *True Believers?: Problems of Definition in Title VII Religious Discrimination Jurisprudence*, 39 IND. L. REV. 145, 151 (2005).

28. *See id.*

29. Michael D. Moberly, Article, *Bad News for Those Proclaiming the Good News?: The Employer's Ambiguous Duty to Accommodate Religious Proselytizing*, 42 SANTA CLARA L. REV. 1, 10 (2001).

30. *See id.* at 158.

31. *See id.* at 145.

32. *See* Davis v. Beason, 133 U.S. 333 (1890).

33. *See id.*

34. *See* Torcaso v. Watkins, 367 U.S. 488, 495 (1961).

35. *See* Panken, *supra* note 10, at 3.

36. United States v. Seeger, 380 U.S. 163 (1965).

37. *Id.* at 166.

38. *See* Welsh v. United States, 398 U.S. 333, 342-43 (1970).

belief system to qualify as a religion.[39] The Supreme Court's polythetic definition draws on the Lockean tradition in American law which "assumes that religious rights are inherent in individuals[,] and the state has no competence to define what is or is not authentically religious."[40] In practice, courts will not question whether a particular religious belief or practice is reasonable.[41] Such a broad definition seems problematic because the holder of the belief could seemingly define nearly any personal belief as religious in order to obtain Title VII protection.[42] However, courts have devised a solution to mitigate such a possibility. While a belief in deity has been removed, not every belief system qualifies for protection. U.S. courts have declined to safeguard personal, cultural, political, or social preferences that employees might attempt to define as mandatory religious practices.[43]

Furthermore, while courts are not willing to delve into defining a reasonable religious belief, they are willing to consider the sincerity of any purported belief.[44] Proving the sincerity of one's belief is part of establishing that one has a bona fide religious belief.[45] Furthermore, proof of a sincere religious belief is the first element of the prima facie case that an employee must show in order to be successful under Title VII.[46]

Employers faced with religious discrimination suits remain free to challenge the sincerity of an employee's belief by demonstrating that the employee's conduct has been inconsistent with or contrary to the asserted belief.[47] The sincerity analysis tends to focus on whether the person actually believes the purported belief.[48] Therefore, "even seemingly 'religious' beliefs do not qualify as 'religious' if they are not 'sincere.'"[49] While there is no formal or informal test, decisions such as *Hussein v. The Waldorf-Astoria*[50] and *Equal Employment Opportunity Commission v. Union Independiente de la*

39. Gunn, *supra* note 17, at 194.

40. Wald, *supra* note 2, at 479.

41. Mroz, *supra* note 27, at 156-67.

42. *See Seeger*, 380 U.S. at 168.

43. *See* Panken, *supra* note 10, at 4.

44. *See* Mroz, *supra* note 27, at 156-67.

45. *See* Equal Emp't Opportunity Comm'n v. Union Independiente de la Autoridad de Acueductos y Alcantarillados, 279 F.3d 49, 55 (1st Cir. 2002); Hussein v. Waldorf-Astoria, 134 F. Supp. 2d 591, 596 (S.D.N.Y. 2001).

46. *See* Andrew M. Campbell, *What Constitutes Employer's Reasonable Accommodation of Employee's Religious Preferences Under Title VII of Civil Rights Act of 1964*, 134 A.L.R. FED. 1, 26 (1996).

47. *See* Panken, *supra* note 10, at 4.

48. *See* Mroz, *supra* note 27, at 167.

49. *Id.* at 168.

50. *See Hussein*, 134 F. Supp. 2d at 597 (suggesting that truly religious beliefs cause certain actions consistent with the purported belief; denying a Title VII claim based upon a finding that the plaintiff did not hold a bona fide religious belief); *see also* Mroz, *supra* note 27, at 166-68.

Autoridad de Acueductos y Alcantarillados[51] implied that sincere religious beliefs cause believers to engage in behaviors consistent with those beliefs.[52]

Although no formal elements must be met for a belief system to successfully garner Title VII protection, inferences may be drawn from broad principles in U.S. case law to determine when a religious belief will qualify for Title VII protection. First, a religion is a belief system. [53] Second, religious belief systems address a discrete set of subjects.[54] Third, religious beliefs cause believers to engage in certain actions.[55] Fourth, religious people can be identified by comparing their purported beliefs to their actions.[56] Fifth, only truly sincere beliefs qualify for protection in the U.S. workplace under Title VII.[57]

3. Problems with this Definition

A literal reading of the previous principles indicates a particularly broad definition of what qualifies as a religion. Almost anyone could allege that his or her beliefs are religious. For example, a person would have to do little more than create a website, write covenants to be obeyed, have a few meetings, and follow what he or she asserts to believe to qualify as a religion. In practice, however, courts often hesitate to take the expansive view of *Seeger* at face value when considering non-traditional religions. Some courts have voiced reservations when applying *Welsh* because they question the idea that something qualifies as religion under Title VII when the holder of the belief, by his or her own testament, does not classify it as such.[58]

Other problems might not seem obvious on the surface. Under the current definition of religion, those who practice traditional religions are presumed religious and almost automatically receive Title VII protection while those adhering to less familiar belief systems are subjected to more exacting analysis and are less likely to be protected.[59] This concern for unequal treatment of minority religions is exacerbated because, in many cases, adherents to non-traditional religions are more likely to be subjected to discrimination based upon their odd beliefs, practices, or membership within minority

51. *See* Equal Emp't Opportunity Comm'n v. Union Independiente de la Autoridad de Acueductos y Alcantarillados, 279 F.3d 49, 56 (1st Cir. 2002) (stating that religion is a set of beliefs and those beliefs result in certain actions; holding that plaintiff's Title VII claim must fail because her actions, which were incompatible with her alleged beliefs, meant that she did not hold a bona fide religious belief); *see also* Mroz, *supra* note 27, at 168-72.

52. *See* Mroz, *supra* note 27, at 168.

53. *See id.* at 172-73.

54. *See id.*

55. *See id.*

56. *See id.*

57. *See id.*

58. *See id.*

59. *See id.* at 173-74.

classes.[60]

One additional problem with the current definition of religion is that most early cases interpreting the meaning of religion, including *Seeger* and *Welsh*, attempted to define religion in the context of the conscientious objector exception to serving in the military.[61] This definition was almost wholly adopted by courts in the context of Title VII with little, if any, consideration for the different policy rationales upon which the statutes or constitutional provisions for religious protection were based.[62] Therefore, consideration should be given to whether the definition of religion, as adopted within the context of the conscientious objector, should be modified to more fully address Title VII's unique problems.

Finally, many requests for religious accommodation or claims of religious discrimination are denied because of a plaintiff's perceived lack of sincerity in the religious belief. For example, most religions have a cornucopia of prohibitions including abstention from fornication, drunkenness or consumption of any alcoholic beverage, divorce, and other equivalent "evils."[63] However, if even a slight "deviation from a professed set of beliefs disqualifies a person from the category of 'religion,' very few people will be protected by Title VII."[64] Therefore, any or all of these conceptual errors in defining religion could lead to the failure to understand the nature of religious discrimination and persecution; this could preclude meritorious claimants from receiving deserved relief.[65]

C. United Kingdom

While the debate over the definition of religion has raged for quite some time in the United States,[66] the definition of religion has only recently become controversial in the United Kingdom.[67] "[T]he role of the Church of England as the established church is being placed under strain with the dual tensions of the rise of non-discriminatory human rights norms and the increasing religious pluralism of the population."[68] The United Kingdom is a "largely secular, albeit religiously diverse, society in which significant numbers of people

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60. See *id.*

61. *See* Welsh v. United States, 398 U.S. 333 (1970); United States v. Seeger, 380 U.S. 163 (1965).

62. *See generally Welsh*, 398 U.S. 333; *Seeger*, 380 U.S. 163 (lacking discussion of underlying policy rationales for conscientious objector protection and Title VII protection and the relevance, or lack thereof, of these differences).

63. Mroz, *supra* note 27, at 173-74.

64. *Id.* at 174.

65. *See* Gunn, *supra* note 17, at 215.

66. *See supra* Part I.B.

67. *See infra* Part I.C.1.

68. LAW AND RELIGION IN THEORETICAL AND HISTORICAL CONTEXT, *supra* note 20, at 2.

embrace a variety of faiths or systems of belief."[69] As of 2004, there were approximately "41.9 million Christians, 0.6 million Hindus, 0.3 million Jews, 1.7 million Muslims, 0.4 million Sikhs, 0.2 million Buddhists, and 0.2 million adherents to other faiths in the United Kingdom."[70]

1. Pre-2003 and Lack of Protection

Until 2003, there was very little protection for the religious employee in the United Kingdom because the definition of religion was particularly narrow and there was not an explicit statutory prohibition against discrimination on the basis of race in the workplace. The 1980 decision of *In re South Place Ethical Society Barralet v. Attorney-General* [71] exemplifies the theistic view in place before 2003.[72] The majority defined religion as follows: "It seems . . . that two of the essential attributes of religions are . . . faith in a god and worship of that god."[73] Although this seems to be a very traditional view of religion, there was no monotheistic requirement, which allowed faiths such as Hinduism to also be classified as religion. [74] The paramount trouble with this definition was that if reason or personal conviction led:

> [P]eople not to accept . . . any known religion, but they [did] believe in the excellence of the qualities such as truth, beauty and love, or believe in the Platonic conception of the ideal, *their beliefs may be to them the equivalent of a religion, but viewed objectively they are not religion* . . . in its natural and accustomed sense.[75]

During this period, there was scant protection of the religious citizen and, more specifically, the religious employee. The Race Relations Act indirectly protected some religions under English and Scottish law.[76] Such protection only was accessible by members of religions closely associated with ethnic or racial minorities such as Sikhism and Judaism.[77] Significantly, protection for

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69. Peter Crumper, Article, *The United Kingdom and the U.N. Declaration on the Elimination of Intolerance and Discrimination Based on Religion or Belief*, 21 EMORY INT'L L. REV. 13, 13 (2007).

70. Mark Hill, *The Permissible Scope of Legal Limitations on the Freedom of Religion or Belief in the United Kingdom*, 19 EMORY INT'L L. REV. 1129, 1174 (2005).

71. *See* In re South Place Ethical Soc'y Barralet v. Attorney-General, [1980] 1 W.L.R. 1565 at 1573 (Eng.).

72. *See id.*

73. *Id.* at 1572.

74. *See* Hill, *supra* note 70, at 1142.

75. *Id.* (emphasis added).

76. *See* Peter Griffith, *Protecting the Absence of Religious Belief? The New Definition of Religion or Belief Equality Legislation*, 2 RELIGION & HUM. RTS. 149, 150 (2007).

77. *See id.*

religious individuals incapable of classifying themselves in terms of their ethnic origin was nonexistent.[78] Because discrimination was not prohibited, those of a religious persuasion other than the dominant faiths of the Church of England and Protestantism had few rights or privileges.[79] However, in 1997 a "quiet revolution" of treatment of religious expression in the workplace began.[80]

2. Evolution of Religious Protection

The United Kingdom utilizes a dualist approach to international law, which, in contrast to a monist approach, treats domestic law and international law as two distinct systems.[81] "[I]nternational treaties signed and ratified by the United Kingdom are not part of the domestic law . . . . Consequently, in order to be enforceable and to bind at the domestic level, such treaties must be domestically incorporated in an Act of Parliament."[82] The 2000 incorporation by Parliament of the Human Rights Act of 1998 (HRA) into British domestic law was a "constitutional milestone."[83] The HRA incorporates Article 9 of the European Convention on Human Rights (ECHR) into British law.[84] The HRA "protects the rights of employees in the public sector."[85] Under the HRA, British "courts have been obliged to apply the rights guaranteed by the [ECHR]"[86] to all citizens and to "ensure that the actions of public authorities are compatible with the ECHR."[87]

The ECHR guarantees freedom of thought, conscience, and religion.[88] Article 9 explicitly protects the right to change one's religion or belief and the right to manifest this religion or belief "in worship, teaching, practice and observance," subject to certain limitations such as protection of public safety and order, health, morals, and the rights and freedoms of others.[89] "In 2002, the law of discrimination in employment was extended to the ground of religion and belief in implementation of the European Community Directive 2000/78."[90] This Directive established a framework for equal treatment in employment and

78. *See id.*

79. *See* Crumper, *supra* note 69, at 14.

80. Mark Freedland & Lucy Vickers, *Country Studies: United Kingdom: Religious Expression in the Workplace in the United Kingdom*, 30 COMP. LAB. L. & POL'Y J. 597, 624 (2009).

81. *See generally* MALCOLM N. SHAW, INTERNATIONAL LAW 105-14 (4th ed. 1997) (explaining in detail the monist and dualist theories).

82. Hill, *supra* note 70, at 1129-30.

83. Crumper, *supra* note 69, at 16.

84. *Id.*

85. Freedland & Vickers, *supra* note 80, at 602.

86. Hill, *supra* note 70, at 1130.

87. Crumper, *supra* note 69, at 17.

88. *See id.* at 16-17.

89. *See* European Convention on Human Rights art. 9, ¶ 2, Nov. 4, 1950, 213 U.N.T.S. 221.

90. Freedland & Vickers, *supra* note 80, at 598.

occupation.[91] It also required all member states to protect against discrimination on grounds of religion and belief in the areas of employment, occupation, and vocational training.[92] The British government implemented this Directive on December 12, 2003,[93] in the Employment Equality (Religion or Belief) Regulations[94] (the Regulations).[95] The Regulations outlaw four types of conduct when based upon one's religion: (1) direct discrimination, (2) indirect discrimination, (3) harassment, and (4) victimization.[96] The Regulations were structured and modeled after the "Race Relations Act [of] 1976 and the Sex Discrimination Act [of] 1975. Some provisions are also similar to provisions in the Disability Discrimination Act [of] 1995."[97]

3. Struggling to Find a Definition

Although the HRA, from Article 9 of the ECHR, required religion and belief to be protected, it did nothing to clarify what religion and belief included. In fact, there was an absence of specificity in the ECHR itself.[98] This omission or lack of clarity was most likely deliberate because what religions and beliefs should be protected was ardently debated during the passage of the ECHR.[99] Thus, when the United Kingdom incorporated Article 9, it did not define precisely what religion and belief encompassed, and it still remains open today.[100]

The Regulations (the British adoption of the ECHR) unambiguously shield the religious citizen from employment and occupation discrimination on religion and belief grounds.[101]

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91. *See* Council Directive 2000/78, 2000 O.J. (L 303) 16 (EC); Griffith, *supra* note 76, at 150 n.3.

92. *See* VICKERS, *supra* note 24, at 121.

93. *See* Nicol Scampion, *The Employment Equality (Religion or Belief) Regulations 2003: The Cases so Far and Anticipated Issues*, TANFIELD CHAMBERS 12, *available at* http://www.tanfieldchambers.co.uk/Asp/uploadedFiles/File/seminar%20notes/The%20Employment%20Equality%20(Religion%20or%20Belief)%20Regulations%202003%20Nicol%20Scampion%208th%20March%202007.pdf (last visited Nov. 26, 2010).

94. *See* The Employment Equality (Religion or Belief) Regulations 2003, 2003, S.I. 2003/1660 (U.K.) [hereinafter Regulations].

95. Griffith, *supra* note 76, at 150.

96. *See* Scampion, *supra* note 93, at 12.

97. DEPARTMENT OF TRADE AND INDUSTRY, EXPLANATORY NOTES FOR THE EMPLOYMENT EQUALITY (SEXUAL ORIENTATION) REGULATIONS 2003 AND EMPLOYMENT EQUALITY (RELIGION OR BELIEF) REGULATIONS ¶ 3 (2003), *available at* http://webarchive.nationalarchives.gov.uk/tna/+/http://www.dti.gov.uk/er/equality/so_rb_longexplan3.pdf (last visited Nov. 26, 2010) [hereinafter EXPLANATORY NOTES].

98. *See* VICKERS, *supra* note 24, at 14.

99. *See id.*

100. *See* ACAS, RELIGION OR BELIEF AND THE WORKPLACE: A GUIDE FOR EMPLOYERS AND EMPLOYEES 4 (2004), *available at* http://www.acas.org.uk/CHttpHandler.ashx?id=107&p=0 [hereinafter GUIDE FOR EMPLOYERS].

101. *See* Freedland & Vickers, *supra* note 80, at 601.

> Regulation 6 provides that it is unlawful to discriminate on grounds of religion or belief in the arrangements made for determining who to employ; in the terms of employment; and by refusing to offer employment. Once employed, it is unlawful to discriminate on grounds of religion or belief in the terms of employment afforded; in opportunities for promotion; or by dismissal or subjection to other detriment.[102]

By overtly protecting religion and belief, the Regulations overcame the clear inconsistency between religious groups that were and were not protected under the Race Relations Act of 1976.[103] The Regulations broadly apply to almost everyone involved in both public and private work: employees, contractors, office-holders, partnerships, and agency workers.[104] The terms religion and religious belief were intended to be "broad one[s] . . . in line with the freedom of religion guaranteed by article 9 of the ECHR."[105]

The Regulations defined religion or belief as "any religion, religious belief, or similar philosophical belief."[106] "Despite their non-religious content, it is clear that [philosophical] beliefs are intended to be protected, and yet equally clear that other non-religious views, such as political views, are not."[107] The great divide, and difficulty in definition, lies in determining what is a "religious or philosophical belief" (and thus is protected) and what is not (and thus not protected)."[108] In the United Kingdom, borderline religions are likely to be defined as belief, instead of religion. Yet, borderline beliefs will most often qualify for protection.[109]

The Equality Act of 2006 amended the definition of religion and belief. In pertinent part, this statute provides: "(a) '[R]eligion' means any religion, (b) 'belief' means any religious or philosophical belief, (c) a reference to religion includes a reference to lack of religions, and (d) a reference to belief includes a reference to lack of belief."[110] Removal of the word "similar" enabled the statute to include, for example, humanism, atheism, and agnosticism in the group of protected ideologies while not broadening the term religion to include them.[111] Although the Equality Act contains no set criteria for evaluating the meaning of religion or belief, the British courts, in practice, will likely consider questions such as whether a believer practices collective worship, whether there

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102. VICKERS, *supra* note 24, at 152-53.

103. *See id.* at 122.

104. *See id.* For the list of all protected categories, *see* Regulations, *supra* note 94, at ¶¶ 6-20.

105. EXPLANATORY NOTES, *supra* note 97, ¶ 11.

106. Regulations, *supra* note 94, ¶2(1).

107. VICKERS, *supra* note 24, at 15.

108. *See id.*

109. *See id.*

110. Equality Bill, 2005-6, H.L. Bill [99] cl.44. (U.K.).

111. *See* VICKERS, *supra* note 24, at 23.

is a clear belief system, and whether a purported religion or belief profoundly affects the way of life or world view for the believer.[112]

4. Problems with this Definition

Some academics in the United Kingdom fear that the revised definition of religion or belief will lead to the Regulations being "interpreted in ways in which would extend the scope of the Regulations to a large range of beliefs and thereby protect a very large group of people in ways which were not intended either by the Regulations themselves or by the amendment of the definition."[113] Such fears were voiced during debate on the bill in the House of Lords.[114]

At least one influential scholar believes these fears are overstated. Lucy Vickers, a Professor at Oxford University and perhaps the most renowned and well-respected scholar on religion in the British and European workplace, believes that such worries are unfounded based on the Explanatory Notes (Notes) accompanying the *original* version of the Regulations.[115] In these Notes, an analogy which defined a "similar philosophical belief" effectively stated the "belief should occupy a place in the person's life parallel to that filled by the God/Gods of those holding a particular religious belief."[116] She believes that this analogy will be used to interpret the new Regulations even though the word "similar" is no longer included.[117]

However, the debate still rages as to whether U.K. courts can and will interpret the statute literally in order to expand the number of protected groups or whether the courts will read the statute much like the previous one that included the word similar.[118] It seems the United Kingdom "is left with a legislative provision which appears to say one thing while Parliament, or at least the Minister responsible for the Bill, meant it to mean another."[119] British courts will either have to broadly define "religion and philosophical belief" or will have to strain to narrowly define "religion and philosophical belief" and render almost absurd decisions in a strained attempt to subdue the expansion of coverage.[120]

To further complicate matters, British courts cannot simply adopt the European Union (EU) case law of Article 9 because the EU inclusion of "conscience and thought," in addition to religion and philosophical belief,[121] has been interpreted by the European Court to include practices like

112. *See* GUIDE FOR EMPLOYERS, *supra* note 100, at 4.
113. Griffith, *supra* note 76, at 151.
114. 13 Jul. 2005 Parl. Deb., H.C. (2005) 1108 (U.K.). *See* Griffith, *supra* note 76, at 154.
115. *See* VICKERS, *supra* note 24, at 30.
116. *See* EXPLANATORY NOTES, *supra* note 97, ¶ 13.
117. VICKERS, *supra* note 24, at 23.
118. *See id.*; Griffith, *supra* note 76, at 156-58.
119. Griffith, *supra* note 76, at 157.
120. *See id.*
121. *See id.* at 158.

veganism[122] and pacifism.[123] These non-religious belief systems are outside the intended coverage of the Equality Act.[124] Thus, simply utilizing case law of the European Court is foreclosed as a resolution to this definitional enigma, leaving the definition of both religion and philosophical belief relatively instable when compared to the United States' definition.

D. Differences and Rationales

From a historical perspective, at least one glaring demarcation exists between the United States and United Kingdom. The group responsible for founding the United States was comprised largely of religious dissidents who came to find solace from molestation abroad, specifically from Britain. Therefore, since the time of its founding, the United States has had an explicit constitutional provision proscribing the establishment of a state religion.[125]

In contrast, the United Kingdom has always had an established religion.[126] "[T]he mere presence of an Established Church is not, per se, incompatible with a nation's human-rights obligations."[127] However, the "status of the Church of England nonetheless symbolizes a disparity of treatment" between the nation's different religious groups.[128] Throughout British history, the recognition of a single state religion has been the basis of antipathy toward different religions, specifically Roman Catholics.[129]

Although simply having an established religion is not proof that a state mistreats citizens with divergent religious views, a history of legal discrimination on the basis of religion possibly has long-lasting effects that cannot be eradicated by the passage of a statute forbidding such conduct.[130]

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122. *See* H v. United Kingdom, App. No. 18187/91, 16 Eur. H.R. Rep. 44, 44 (1993).

123. *See* Arrowsmith v. United Kingdom, App. No. 7050/75, 3 Eur. H.R. Rep. 218, 228 (1978).

124. *See* Griffith, *supra* note 76, at 150-51.

125. *See* U.S. CONST. amend. I. This Amendment states, in relevant part, that "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof. . . ." *Id.*

126. *See generally* Crumper, *supra* note 69, at 21-26 (discussing the history of the Church of England and some of the problems, especially constitutional ones, associated with having an established church).

127. *Id.* at 22.

128. *See id.* at 40.

129. *See id.* at 15. Even today, the Sovereign cannot convert or be married to a Roman Catholic. *See* Act of Settlement, 1700, 12 & 13 Will. 3, c. 2, §§ 1-2 (Eng.); Crumper, *supra* note 69, at 25-29. Roman Catholic priests could not serve in the House of Commons until 2001. *Id.* The United States Constitution explicitly forbids a religious test for public service. *See* U.S. CONST. art VI, cl. 3.

130. Nothing in this Note is intended to imply that the British Government, in general, or the Crown, in particular, is not fulfilling its Human Rights obligations toward religious citizens or any others. Notably, Regulation 36 provides that the Regulations apply to acts by the government, including the Crown. Further, Regulation 37 provides that the Regulations apply

Favorable treatment for the followers of the majority religion might affect the decisions of the members of British courts, legislatures, employers, and the citizen at-large. Thus, it is possible that adherents to the national religion enjoy unintentionally favorable treatment by the public, employers, legislature, and even the British courts.

In terms of the relevant language in the ECHR, the inclusion of "and belief" and the absence of such language in Title VII suggest that borderline religions will qualify for protection in the United Kingdom but not in the United States. While non-traditional religious beliefs are required to prove they are not simply moral or ethical beliefs in order to fall under the penumbra of Title VII, such religions need not fight to be classified as such in the United Kingdom. Instead, they can qualify under the belief prong.[131] For example, beliefs such as atheism or humanism automatically obtain coverage in the United Kingdom,[132] while these seemingly non-religious belief systems will likely fail under Title VII. In more concrete terms, many moral and ethical beliefs excluded in the United States[133] would likely receive no challenge under the British religion and belief prong.

The difference in the language between the United Kingdom's and United States' religious protection statutes also has a more general ramification. The term religion is used in Title VII while religion and belief is used in the Equality Act. Not only will those adhering to minority religion find inclusion less likely under a religion only regime, the category of protected belief systems will be larger under a religion and belief analysis. This observation is not simply a logical extrapolation that religion is unavoidably narrower than religion *and* belief; rather, this observation rests upon the jurisprudence of the respective courts as noted.

II. Obligation to Accommodate

"In the employment setting, the term accommodate is [typically] used to create an affirmative duty on an employer to do something extra to meet the religious needs of the employee."[134] "Often times, accommodation comes in the form of modifying a policy, excusing the employee from a particular job requirement, or making a schedule change so the employee can attend a religious event."[135] In other instances, accommodations "merely require an employer to refrain from acting to the detriment of a protected group or require an employer to take steps to see that no protected group is illegally

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also to the House of Commons and House of Lords. *See* EXPLANATORY NOTES, *supra* note 97, ¶¶ 175-78; Regulations, *supra* note 94, ¶¶ 36-37.

131. *See* VICKERS, *supra* note 24, at 22.

132. *See id.* at 15.

133. *See supra* Part I.B.2.

134. Jamar, *supra* note 6, at 784.

135. Daniel R. Kelly & Brian T. Benkstein, *Karma, Dogma, Dilemma: Religious Accommodation at Work*, 66 BENCH & B. MINN. 26, 28 (2009).

disadvantaged."[136]

Even the broadest definition of religion (or religion and belief) would be hollow if an employer were not obliged to take steps to accommodate the religious employee. A world where employers were not allowed to intentionally discriminate would not look much different from a world without any sort of religious protection. To maximize religious protection, employers should be required to modify procedures and policies that disadvantage employees of faith. Imposing a negative duty that prohibits discriminatory practices or imposing an affirmative duty that requires accommodation of the religious employee can advance the laudatory goal of ensuring equal access to employment opportunities. The United Kingdom utilizes the former approach while the United States the latter.[137]

A. Obligation in the United States

A reasonable religious accommodation is "any adjustment to the work environment that will allow the employee to practice his religion."[138] A positive obligation to accommodate religious employees has not always existed under Title VII. "In its original form, Title VII did not explicitly require employers to accommodate employees' religious practices."[139] Though Congress made religious discrimination unlawful, it neglected to address the scope of an employer's accommodation obligation under section 703(a)(1) of Title VII and failed to indicate if an employer had an affirmative duty to accommodate the religious practices of its employees.[140] Problems from this lacuna were evident almost from the beginning of Title VII's implementation.[141] For example, if an employer did not wish to hire Jews, it could legally discriminate under the original version of Title VII by simply requiring Saturday work.[142]

The EEOC quickly resolved to close this loophole and interpreted Title VII as imposing such an affirmative duty.[143] In 1966, the EEOC issued guidelines that encouraged employers to set normal working hours and to accommodate religious practices unless the practices caused "serious inconveniences."[144] The EEOC later issued regulations that required an

136. Jamar, *supra* note 6, at 741.

137. This paragraph represents the author's belief about the importance of the duty to accommodate.

138. Panken, *supra* note 10, at 2.

139. Mroz, *supra* note 27, at 147.

140. *See* Peter Zablotsky, Article, *After the Fall: The Employer's Duty to Accommodate Employee Religious Practices under Title VII after* Ansonia Board of Education v. Philbrook, 50 U. PITT. L. REV. 513, 513-14 (1989).

141. *See* Foltin & Standish, *supra* note 9, at 20.

142. *See id.*

143. *See* Zablotsky, *supra* note 140, at 514.

144. Mroz, *supra* note 27, at 147.

accommodation with an exception that employers did not have to accommodate if it caused an undue burden.[145] However, most courts held that a positive duty to accommodate was outside the purview of Title VII.[146] This divergence was possible because the EEOC's interpretive guidelines do not have the force of law.[147]

The conflict over accommodation reached its pinnacle in 1970 in the Sixth Circuit Court of Appeals case, *Dewey v. Reynolds Metals Co.*[148] The Sixth Circuit rejected the EEOC's mandatory accommodation interpretation.[149] "The *Dewey* court's controversial rejection of the EEOC's interpretation of Title VII was subsequently affirmed by an equally divided Supreme Court."[150]

1. Source and Definition of Employer's Duty

In 1972, Congress reacted to *Dewey*[151] by amending Title VII and "explicitly requir[ing] employers to accommodate the religious practices of their employees."[152] In effect, the definition of religious discrimination, as contained in the 1972 amendment, made it unlawful for an employer not to accommodate the religious practices of its employees absent undue hardship to the employer's business.[153] Hardship refers to a detriment to the conduct of the employer's business.[154]

Although the amendment showed progress in protecting the religious employee, courts had little guidance as to what Congress intended the amendment to accomplish.[155] For example, the legislative history proved "unhelpful in ascertaining the *extent* of the obligation being created."[156] Three specific areas evolved where sufficient guidance was not present and the courts

145. *See* Foltin & Standish, *supra* note 9, at 20.

146. Zablotsky, *supra* note 140, at 514. *See* Dewey v. Reynolds Metals Co., 402 U.S. 689 (1971), *aff'g* 429 F.2d 324 (6th Cir. 1970); Linscott v. Millers Falls Co., 316 F.Supp. 1369, 1372 (D. Mass. 1970) (no accommodation required where union dues payment was supported by compelling government interest), *aff'd*, 440 F.2d 14 (1st Cir. 1971), *cert. denied*, 404 U.S. 872 (1971); Kettle v. Johnson & Johnson, 337 F.Supp. 892, 895 (E.D. Ark. 1972) (EEOC guidelines requiring accommodation exceed the mandate of the Civil Rights Act).

147. *See* Moberly, *supra* note 29, at 12. *See generally* John S. Moot, Comments, *An Analysis of Judicial Deference to EEOC Interpretative Guidelines*, 1 ADMIN. L.J. 213 (1987).

148. *See* Dewey v. Reynolds Metals Co., 429 F.2d 324, 334 (6th Cir. 1970), *aff'd per curiam*, 402 U.S. 689 (1971).

149. *See* Moberly, *supra* note 29, at 14-15.

150. *Id.* at 15; *Dewey*, 402 U.S. at 689.

151. *See* Jamar, *supra* note 6, at 741; Moberly, *supra* note 29, at 12.

152. Mroz, *supra* note 27, at 147-48.

153. *See* Zablotsky, *supra* note 140, at 515.

154. *See* Jamar, *supra* note 6, at 743; discussion *infra* Part II.A.2.

155. *See* Foltin & Standish, *supra* note 9, at 20.

156. Sara L. Silbiger, Note, *Heaven Can Wait: Judicial Interpretation of Title VII's Religious Accommodation Requirement Since* Trans World Airlines v. Hardison, 53 FORDHAM L. REV. 839, 842 (1985).

stepped in to fill the void. The amendment did not define 1) the scope or definition of reasonable accommodation, 2) the scope or definition of undue hardship, and 3) the relationship between these two principles.[157] The U.S. Supreme Court resolved these issues in two seminal decisions: one addressing what constitutes undue hardship and the other reasonable accommodation.[158]

2. Hardison, Philbrook, *and the Employer's Lightened Burden*

In 1977, *Trans World Airlines v. Hardison*[159] was the first time the Supreme Court addressed the concepts of reasonable accommodation and undue hardship.[160] In *Hardison*, the "Court held that any accommodation imposing more than a de minimis cost constitutes an 'undue hardship' for the purposes of Title VII."[161] "Since its articulation in 1976 [in *Hardison*], the phrase de minimis cost has become virtually synonymous with the term undue hardship."[162] By endorsing this standard, the majority's decision narrowed an employer's duty to accommodate by setting a dreadfully low threshold for undue hardship.[163]

The holding drew harsh criticism from Justice Marshall in dissent and from many academics and scholars. *Hardison* has been disparaged as marking "the beginning of the contemporary Supreme Court's debilitation of employees' Title VII protections against unlawful discrimination on the basis of religion."[164] In his dissent, Justice Marshall stated that he read Title VII as requiring employers to grant privileges to religious employees as part of the accommodations process.[165] He further argued that big employers, like Trans World Airlines, could bear these "more than de minimis costs" without constituting undue hardship.[166] In probably his most pointed critique, Justice Marshall proclaimed that the majority's reading so vitiated the obligation to reasonably accommodate as to result in effectively nullifying it.[167] Justice Marshall's prediction has appeared to come true as evidence exists that the obligation to accommodate has been essentially nullified.[168]

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157. *See* Zablotsky, *supra* note 140, at 516-17.

158. *Id.* at 518.

159. *See* Trans World Airlines v. Hardison, 432 U.S. 63 (1977).

160. *See* Laurel A. Bedig, Comment, *The Supreme Court Narrows an Employer's Duty to Accommodate an Employee's Religious Practices Under Title VII:* Ansonia Board of Education v. Philbrook, 53 BROOK. L. REV. 245, 246 (1987).

161. Mroz, *supra* note 27, at 148.

162. Zablotsky, *supra* note 140, at 543.

163. *See* Bedig, *supra* note 160, at 246.

164. David L. Gregory, *Government Regulation of Religion Through Labor and Employment Discrimination Laws*, 22 STETSON L. REV. 27, 30 (1992).

165. *See id.* at 32.

166. *See id.*

167. *See* Foltin & Standish, *supra* note 9, at 23.

168. *See* Ansonia Bd. of Educ. v. Philbrook, 479 U.S. 60, 62-66 (1986), *aff'g* 757 F.2d 476 (2d Cir. 1985); Gregory, *supra* note 164, at 30.

The Supreme Court further narrowed the accommodations required of employers[169] in 1986 in *Ansonia Board of Education v. Philbrook.*[170] The Second Circuit Court of Appeals held that "[w]here the employer and the employee each propose a reasonable accommodation, Title VII requires the employer to accept the proposal the employee prefers unless that accommodation causes undue hardship on the employer's . . . business."[171] While the Second Circuit's holding was consistent with the EEOC's interpretation of accommodation, the Supreme Court explicitly disagreed, stating that the EEOC's interpretation was "simply inconsistent with the plain meaning of the statute."[172] The majority held "that an employer fulfills its duty to accommodate under Title VII so long as it offers a reasonable accommodation to the employee."[173]

"[W]here the Employer has already reasonably accommodated the employee's religious needs, the statutory inquiry is at an end. The employer need not further show that each of the employee's alternative accommodations would result in undue hardship."[174] Accordingly, the undue hardship issue only becomes relevant when the employer claims it is unable to offer *any* reasonable accommodation.[175] "Essentially, an employer must attempt to accommodate the religious beliefs and practices of his or her employees so as to remove conflict between the employee's religious belief[,] and [in] the performance of his or her employment duties is not necessarily required to adopt the accommodation the employee insists on."[176] The *Philbrook* majority reasoned that in enacting 701(j) and amending Title VII, Congress was motivated by a desire to ensure that employees were given additional opportunities to observe religious practices at reasonable costs.[177]

3. *Examples of the Duty to Accommodate*

Although the duty of employers has been diminished quite significantly, many would argue employees still bring claims with moderate success.[178] Speaking most broadly, courts finding a failure to accommodate on the part of the employer have stressed that an employer is obligated to initiate finding an

169. *See* Bedig, *supra* note 160, at 247.

170. *See Philbrook*, 479 U.S. at 68.

171. Philbrook v. Ansonia Bd. of Educ., 757 F.2d 476, 484 (2d Cir. 1985), *aff'd* 479 U.S. 60 (1986).

172. *Philbrook*, 479 U.S. at 69 n.6.

173. Mroz, *supra* note 27, at 148.

174. *Philbrook*, 479 U.S. at 68.

175. *See id.* at 69.

176. Peter M. Panken & Lisa J. Teich, *Religion and the Workplace: Harmonizing Work and Worship – Some Recent Trends and Developments* 1341, 1352, in ALI-ABA Course of Study, Airline and Railroad Labor and Employment Law (2008).

177. *See* Campbell, *supra* note 46, at 32.

178. *See supra* Part II.A.2.

accommodation, that the employee has a duty to cooperate in finding an accommodation, and that failure by the employer to take the first step will lead to finding a failure to accommodate in most every case.[179]

Problems in Title VII claims arise in the framework of requests to accommodate particular days off work for religious observance.[180] This holds true both for current and prospective employees.[181] While there is not an absolute right to refuse to work on one's own Sabbath or on particular religious holidays, section 701(j) of Title VII "clearly anticipates that some employees will absolutely refuse to work on their Sabbath and that this firmly held religious belief require[s] some offer of accommodation by employers."[182] Once an employee brings this issue to an employer's attention, the duty to accommodate an employee's request for days off for religious observance is satisfied so long as the employer offers some sort of flexibility such as shift swapping, unpaid time off, usage of personal days, etc.[183]

On the other hand, requests for modifications to uniforms or dress codes are more complex because a diversity of interests and rights collide. This collision includes the freedom of religion and of expression for the employee, the employer's freedom to maintain a religiously neutral workplace, the negative rights of the staff and customers, and the interests of promoting diversity within the workplace.[184] Seemingly, some situations call for an actual duty to accommodate more than others. For example, allowing an employee to wear a headscarf, a neatly groomed beard, or a skirt would present little or no possibility of actual economic costs on the employer in most cases.[185]

However, mere hypothetical claims that an employer does not wish to deviate from company policy or concerns over possible negative effects on the image of the employer will not amount to economic hardship (undue burden) and will not alleviate the employer of the duty to accommodate.[186] Proof of actual economic loss, perhaps in the form of a customer voicing offense and declining to do business with the employer, could satisfy the de minimis cost standard and remove the employer's obligation to accommodate. This justification for denial of an accommodation request presents a further quandary.[187] Customer preference is not sufficient to justify discrimination in the context of race or gender discrimination[188] but appears to be enough in the religious context. This begs the question, if mere preference of customers

179. Campbell, *supra* note 46, at 28.

180. *See id.* at 27.

181. *See* Panken, *supra* note 10, at 4.

182. Equal Emp't Opportunity Comm'n v. Ithaca Indus., 849 F.2d 116, 118 (4th Cir. 1988); Campbell, *supra* note 46, at 52.

183. *See* VICKERS, *supra* note 24, at 188-89.

184. *See* Freedland & Vickers, *supra* note 80, at 613.

185. *See id.* at 614-15.

186. *See* VICKERS, *supra* note 24, at 189.

187. *Id.* at 189.

188. *See* Diaz v. Pan American World Airways, 442 F.2d 385, 389 (5th Cir. 1971).

cannot make legal otherwise illegal discriminatory acts in the context of race or gender, why treat religion differently? This question, with no obvious answer, is explored in Part III of this Note.

4. Problems in the United States

Today, it seems well settled that an employer's obligation to accommodate is satisfied once it proposes a single reasonable option to accommodate.[189] There is no duty for an employer to entertain some other accommodation that is more desired by an employee than the accommodation proposed by the employer.[190] The "interpretation of the duty to accommodate has [become] somewhat restrictive, leaving employers with a most slender of duties to accommodate."[191] Combining the holdings of *Hardison* and *Philbrook* makes the duty to accommodate more fictional than real. What is given with the creation of the duty to accommodate is taken by the very low level of hardship needed to defeat the duty to accommodate.[192]

While a narrow, and therefore less meaningful, duty to accommodate religious practices might result in a reduction in litigation over the scope of the employer's duty to accommodate, it has the "unfortunate repercussion of penalizing those members of our society who belong to religious minorities."[193] This correlation might be imperceptible on the surface. Consider that minority religions are more likely to have conflicts due to the decreased likelihood that their practices and holy days are recognized by most employers. Therefore, the number of claims by minority religions will be greater compared to majority religions. Thus, since narrowing the duty to accommodate will decrease the likelihood of success for claims under all religions, and since minority religions or beliefs are more likely to be litigated in court, the effects of a narrow definition will fall disproportionately on non-traditional religions.

Critics have pointed out that justification for the narrow definition has no basis in the language or legislative history of Title VII.[194] Scholars agree that after *Philbrook*, the "likelihood of an employee obtaining resolution of religious and work conflicts in an effective manner is lessened."[195] This contrasts with the express purpose of Title VII and its 1972 amendment. As Title VII's sponsoring Senator remarked, the purpose of the amendment was to protect religious observers whose employers failed to adjust work schedules and guidelines in addition to reaffirming in a more explicit manner that a duty to accommodate existed.[196]

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189. *See* Campbell, *supra* note 46, at 25-27.
190. *See id.* at 27.
191. VICKERS, *supra* note 24, at 186.
192. *See id.* at 187.
193. Bedig, *supra* note 160, at 248.
194. *See* Campbell, *supra* note 46, at 32.
195. Bedig, *supra* note 160, at 268.
196. *See generally* 118 CONG. REC. 705, 705-06 (1972) (statement of Sen. Randolph).

Beyond this, it seems inconsistent for the Supreme Court to emphasize the congressional desire for flexibility as the basis for denying the employee the right to select a reasonable method of accommodation, then to use flexibility to allow an employer to satisfy the accommodation duty by offering any reasonable alternative without considering any of the employee's reasonable alternatives.[197] Furthermore, the Supreme Court in *Philbrook* stated the reason for not considering the employee's accommodation, so long as the employer offered at least one reasonable accommodation as well, is that it feared the employee would hold out for the single accommodation that most benefitted the employee. But, in so holding, the employer now has that very same power and can simply offer the one reasonable accommodation in its own best interests.[198]

From a policy perspective, comparable problems arise. There are three alternative ways to interpret and enforce the concepts of accommodation and undue hardship. The first is a neutral option that balances accommodation and undue hardship and gives equal weight to both. The second option, adopted in *Philbrook*, benefits employers and focuses primarily on reasonable accommodation. The final option is employee-benefitting, wherein undue hardship controls.[199] If the 1972 amendment was expressly intended to benefit the employee by placing a previously unrecognized duty on employers to accommodate, why would the Supreme Court adopt the option that benefits the employer when the amendments were to help the religious employee?[200]

B. Obligation in the United Kingdom

Until recently the United Kingdom has provided few, if any, direct protections for religious employees,[201] and there was also little responsibility for employers to accommodate. Though there are established churches in England and Scotland, "the law of the State makes little systematic provision for the safeguarding of . . . the observance of religious law and practice in the workplace. Such law is dispersed and particular. Furthermore, the existing law is difficult from which to discern general principles of broad application."[202] There is no explicit statutory or common law right for even the most basic religious practices such as time off for observance of religious holy days.[203]

1. Source and Definition of the Employer's Duty

The model utilized in both the United Kingdom and Europe differs from the United States because it does not explicitly impose an obligation upon the

197. *See* Zablotsky, *supra* note 140, at 564.
198. *See id.* at 566-67.
199. *See id.* at 543-68.
200. *See id.* at 543-68; Bedig, *supra* note 160, at 256.
201. *See supra* Part I.C.1.
202. Hill, *supra* note 70, at 1134.
203. *See id.* at 1136; *supra* Part I.C.1.

employer.[204] The Regulations, which govern the treatment of religious employees, protect "against direct and indirect discrimination, and they do not impose a specific duty on employers to make reasonable accommodations for the needs of the religious employee."[205] There is a negative duty to not act in a discriminatory fashion, which allows the religious action to continue, unless there is good reason to discriminate and the employee practices his religion or belief in an inappropriate manner.[206] "Where a complainant can show that [he or she has] been disadvantaged . . . and that persons of a particular religion or belief are particularly disadvantaged by this treatment, then the burden is on the discriminator to show a justification."[207] Notably, the scheme of accommodation in Britain is also required in disability discrimination.[208]

An "act of discrimination is justifiable only if an employer can demonstrate that there was no viable alternative method of achieving the outcome desired."[209] The overarching legal question is whether the restriction on the religious activity is proportionate to a legitimate aim.[210] The Department of Trade and Industry's Explanatory Notes to the Regulations explains this concept:

> Where the application of a practice, group disadvantage, and individual disadvantage are established, the alleged discriminator must show that the provision, criterion or practice pursues a legitimate aim, and is a proportionate means of doing so. The discriminator's justification must be objective (i.e. demonstrating legitimacy and proportionality), and will be subjected to close scrutiny by courts and tribunals; it is not sufficient for the discriminator merely to argue that his view of justification is a reasonable one.[211]

Based on these Explanatory Notes, satisfaction of the proportionality and legitimacy requirement means that an act of discrimination against a religious employee is lawful. Justification for an employer's discriminatory acts usually occurs with indirect discrimination, where neutral criteria are applied and have a disparate impact on those holding a religion or belief.[212] "A wide variety of aims may be considered as legitimate."[213] Legitimate aims include business needs, economic efficiency, profitability, administrative efficiency, and the

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204. *See* VICKERS, *supra* note 24, at 220.
205. *Id.*
206. *Id.*
207. Scampion, *supra* note 93, at 14.
208. *See* VICKERS, *supra* note 24, 220.
209. *See* Hill, *supra* note 70, at 1165.
210. *See* Freedland & Vickers, *supra* note 80, at 614; Scampion, *supra* note 93, at 13-14.
211. EXPLANATORY NOTES, *supra* note 97, ¶ 39.
212. *See id.*; Scampion, *supra* note 93, at 13-15.
213. EXPLANATORY NOTES, *supra* note 97, ¶ 40.

available supply of labor.[214] However, "aims related to the discriminatory effects of a practice cannot be considered as legitimate."[215]

Proportionality analysis focuses on whether the means utilized are "an appropriate and necessary means of achieving the legitimate aim in question."[216] The ultimate decision often depends on the facts of the case.[217] However, speaking most generally, "an appropriate means is one which is suitable to achieve the aim in question, and which actually does so. A necessary means is one without which the aim could not be achieved; it is not simply a convenient means."[218] Courts also consider the available alternative ways in which the aim could be achieved with fewer resultant discriminatory effects, with fewer employees allegedly affected by discrimination, or with a lesser degree of disadvantage because of a religious practice.[219]

Proportionality also relates to the economics surrounding the situation. For example, courts investigate the size of the alleged violating organization, the cost that non-discrimination might have on the organization, and whether or not this cost would be excessive for a particular organization.[220] Thus, what might be legal discrimination by one employer might be illegal discrimination by another. The dispositive could simply be the size or profitability of the employers' operations.

> Whether or not accommodation should be required in any particular case will thus depend on whether it is proportionate to do so, bearing in mind the relative strength of the competing interests in question, and whether the aim can be realised in a way that reduces the adverse impact on those other interests.[221]

Because Article 9 protects religious freedom as both an individual and a group right, religious freedom includes the right to create religiously homogenous workplaces.[222] As a result, employers do not have to modify practices and are allowed to discriminate on the basis of religion so long as they are not taking into account the religious persuasion of the *employee*.[223] For example, a Catholic employer could lawfully refuse to employ one who has been divorced.[224] However, this right of religious ethos organizations is now

214. This is a nonexclusive list. *See id.*
215. *Id.*
216. *Id.* ¶ 41.
217. *See id.*
218. *Id.*
219. *See id.*
220. *See id.* ¶ 42.
221. VICKERS, *supra* note 24, at 54.
222. *See* Freedland & Vickers, *supra* note 80, at 602.
223. *Id.* at 603-04.
224. *See id.* at 604.

limited by the Regulations in cases where the employment practices of these groups disproportionately discriminate on religious grounds.[225] Thus, even if the employer gives a legitimate justification for the religious requirement, the employer might be required to rationalize the requirement as applied to the specific individual in question. This more stringent standard forces an employer to show that accommodating just one employee would not be feasible or would defeat its legitimate reason for having the requirement.[226] Therefore, such a limitation increases the potential for effective protection of members of majority and minority religious groups.[227]

The "proportionality equation," as Lucy Vickers calls it, can be summarized in three steps:

> The first issue in the . . . equation is to assess the relative strength of the competing interests. . . . The second issue is to consider the range of interests with which such interests may compete in the workplace, such as an employer's financial interests and the equality interests of other employees. These . . . will intersect with each other, and may act singly or cumulatively to suggest that protection should be limited. Finally, a range of additional contextual factors will be considered which may have the effect on the determination of whether it is proportionate to require protection. Issues in this category include the type of employer, as well as background issues such as whether the workplace is viewed as a public or private space.[228]

2. *Examples of the Obligation*

There are very few seminal cases that explain and define the duty of non-discrimination. However, looking at the principles of proportionality and legitimate aim in practice assists in clarifying the duty of non-discrimination.

A refusal to accommodate an employee's request for a change in hours to enable a religious employee to partake in a religious observance usually amounts to indirect discrimination.[229] This refusal is tantamount to putting an employee at a disadvantage by requiring an employee to work a particular timetable.[230] Under the proportionality requirement, the factors a court may

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225. *See id.* at 603.

226. *See* VICKERS, *supra* note 24, at 133-34.

227. *See id.* at 134.

228. *Id.* at 55.

229. *See id.* at 155 (noting that this "could be direct discrimination if an employer allows some religious individuals time off and not others, and the reason for the different treatment is religion.").

230. *See* Freedland & Vickers, *supra* note 80, at 616.

consider include the ease with which requests can be swapped or covered, the availability and costs of covering, the length of time of the request, and finally, the frequency of requests.[231] If volunteers are available to take the employee's shift, if the time to cover is short, or the employer truly did not need the employee during the time, the refusal would likely be inappropriate and thus discriminatory.[232]

"Employers' requirements that staff comply with a particular dress code can put religious individuals at particular disadvantage, and where this is the case they need to be justified."[233] In order for this type of discrimination to serve a legitimate aim, there needs to be a clear, objective basis for any restriction on religious dress.[234] Hypothetical reasons why the uniform or dress restriction might be useful will not suffice; instead, the employer must show the dress code is necessary.[235] However, the employer could have the legitimate aim of allowing customers to be free from the effects of religious expression. This might suffice for objective basis requirement, but one must still prove proportionality.[236] The issue of proportionality can be complicated regarding bans on items such as headscarves or veils because the negative right of customers and other employees to be free from religion is also important.[237] The possible positive effect a ban on these items might have on customers or fellow employees will be balanced against the negative effect on the employee as part of the proportionality analysis.[238]

3. Problems in the United Kingdom

The proportionality equation places courts in a difficult position.[239] While proportionality is a mathematical term that implies a calculation can be made with significant precision, "in the legal context, one is measuring incommensurable interests, and mathematical precision is impossible."[240] Furthermore, because interests are incommensurable in nature, precision and pure objectivity are not feasible.[241] Resolving this issue becomes even more complex when one considers the almost incalculable number of interests that might compete in one case. Essentially, standards or guiding principles are difficult to decipher; therefore, it is necessary to decide each conflict on a case-by-case basis. While an individualized approach has the benefit of allowing

231. *See id.*
232. *See id.*
233. *Id.* at 613.
234. *See* VICKERS, *supra* note 24, at 163.
235. *See id.*
236. *See id.*
237. *See id.* at 158.
238. *See id.* at 162.
239. *See id.*
240. *Id.* at 54.
241. *See id.* at 55.

analysis of each conflict in context, it also leads to the adverse consequence of thwarting predictability. This uncertainty might negatively affect employers, and to a lesser extent employees, in ordering their affairs. If each case is truly fact-dependent, ostensibly comparable cases could have divergent outcomes based upon one factual difference.

The absence of an explicit duty to accommodate can lead to inadequate protection for the religious employee. Such a duty admits that changes to the workplace are indispensable if the needs of particular individuals or groups are to be fully addressed.[242] Because religious practices vary extensively, an individualized duty to accommodate will often improve protections of religious interests at work when compared to a generalized non-discrimination duty.[243] The benefits and burdens of the United Kingdom's and United States' systems are discussed below and further illuminate the problems that are, or might be, faced in the United Kingdom.

C. Differences and Rationales

American employers have an affirmative, statutory duty to accommodate the requests of religious employees when employment practices clash with the employee's sincerely held religious beliefs unless this would cause an undue hardship.[244] In contrast, British employers have a negative duty to forego implementation or discontinue the use of employment practices that have the effect of discriminating against religious employees unless the practice is proportionate to further the employer's legitimate interest.[245] The explanation for the difference is the divergence in the underlying statutory language.[246] The

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242. *See id.* at 221.

243. *See id.*

244. *See supra* Part II.B.

245. *See supra* Part II.C.

246. The amendment to the CRA of 1964, 42 U.S.C. § 2000e(j), states: "The term 'religion' includes all aspects of religious observance and practice, as well as belief, unless an employer demonstrates that he is unable to reasonably accommodate to an employee's or prospective employee's religious observance or practice without undue hardship on the conduct of the employer's business." On the other hand, Regulation 3 provides:

> (1) For the purposes of these Regulations, a person ("A") discriminates against another person ("B") if -
>
> (a) on grounds of religion or belief, A treats B less favorably than he treats or would treat other persons; or
>
> (b) A applies to B a provision, criterion or practice which he applies or would apply equally to persons not of the same religion or belief as B, but -
>
> (i) which puts or would put persons of the same religion or belief as B at a particular disadvantage when compared with other persons,
>
> (ii) which puts B at that disadvantage, and
>
> (iii) *which A cannot show to be a proportionate means of achieving a legitimate aim.*
>
> (2) The reference in paragraph (1)(a) to religion or belief does not include A's religion or belief.

theory supporting the accommodation duty admits that treating differently situated people similarly can amount to discrimination and that, in many cases, the employer needs to take a minimal affirmative step and account for the religious difference of its employees.[247]

The most glaring difference between accommodation and non-discrimination is that the affirmative accommodation duty puts the onus squarely upon the employer to make an effort to accommodate the needs of the religious employee.[248] This difference has the *potential* to create a heightened level of protection for religious interests in the workplace and to overcome the difficulties caused by individuals being forced to prove indirect discrimination, or disparate impact, on groups of fellow-believers.[249] This prospective advantage has led some scholars in the United Kingdom to advocate for the introduction of the duty to accommodate in order to better protect religious employees.[250]

However, when looking at how the United States Supreme Court has delineated undue hardships and reasonable accommodation,[251] a very narrow duty, or the ability to negate an affirmative duty with a showing as negligible as "de minimis cost," would provide diminutive benefits. Concerns also arise regarding whether the duty to accommodate has a negative impact. Instead of ensuring that employers are changing the structures that cause these problems, employers might be reacting to policies that are harmful.[252] Also, a stringent affirmative duty, or an exception that is more difficult to overcome than de minimis cost, could go too far in protecting the religious employee at the expense of the non-religious employee or, more likely, the employer. This debate has persisted among scholars in the United Kingdom; as of late 2009, no drastic changes seem imminent.[253]

It is noteworthy that the burden placed upon the employer is contextual in the United Kingdom but not in the United States. Whether an accommodation creates an undue burden is absolute under the Supreme Court's present interpretation. Accommodating a religious employee is not required if it would place more than a de minimis cost upon the employer, whether it is a small business with a two dozen employees[254] or a Fortune 500 company with tens of

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(3) A comparison of B's case with that of another person under paragraph (1) must be such that the relevant circumstances in the one case are the same, or not materially different, in the other.

Regulations, *supra* note 94, ¶ 3 (emphasis added).

247. *See* VICKERS, *supra* note 24, at 221.

248. *See id.* at 220.

249. *See id.* at 220 & 129.

250. *See generally* BOB HEPPLE ET AL., EQUALITY: A NEW FRAMEWORK 47-49 (2000) (stating that there is support in the academic world for introducing an affirmative duty on employers).

251. See *supra* Parts II.A.1, II.A.4, II.A.5.

252. *See* VICKERS, *supra* note 24, at 221.

253. *See* HEPPLE, *supra* note 250.

254. *See Federal Laws Prohibiting Job Discrimination Questions and Answers*, EQUAL EMPLOYMENT OPPORTUNITY COMMISSION, http://www.eeoc.gov/facts/qanda.html (last modified Nov. 21, 2009) (listing all equal employment opportunity statutes which apply to each

thousands. However, the United Kingdom follows a proportionality analysis using economics specific to a company to determine if religious accommodation is feasible. Therefore, these different systems are likely to cause different outcomes for similar scenarios.[255]

III. RECOMMENDATIONS AND CONCLUSIONS

Title VII and its subsequent amendments fall short in defending rights of the religious employee at work.[256] One academic pointedly summarized these concerns:

> Efforts to ensure that people of faith are treated fairly in the American workplace have met with mixed success over the last four decades. While the passage of Title VII of the Civil Rights Act represented a major milestone, its full promise has yet to be realized. Even after the amendments to Title VII in 1972 and the litigation of numerous cases, people of faith remain dangerously vulnerable to the arbitrary refusal of employers to accommodate their religious practices. In a country founded by those fleeing religious intolerance, and in which religious freedom is enshrined in our most basic law, it is not too much to hope that we will soon achieve another milestone in civil rights, this time by assuring that Americans of all creeds are accorded respect by employers, able to remain true to their faith and participate as full partners in the workplace. [257]

Such a view emphasizes the perspective of the religious employee. From the employer's point of view, the situation might look very different. Unavoidable marketplace interaction necessitates an employee to "contract away" or give up some privacy and autonomy.[258] However, some aspects of personhood cannot be sold or contracted away without "ceasing to be a person."[259] The law should set the parameters within which the employee must act but should not force the employee to alienate those things most dear to him just to participate in employment. Below are ways in which Title VII can be improved so employees of faith are better protected in the workplace.

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employer; for example, Title VII does not apply to employers with fewer than fifteen employees).

255. *See supra* Part II.

256. Foltin & Standish, *supra* note 9, at 24.

257. *Id.*

258. *See* Freedland & Vickers, *supra* note 80, at 625.

259. *See id.*

A. Determining the Proper Definition of Religion

It may be enticing to narrowly define religion and taper the duty to accommodate based on a belief that claims of workplace discrimination because of religious affiliation are trivial. However, such a sanguine view is problematic because it naturally defines religion in terms of the dominant culture and often leaves those of minority faiths and those who regard religion as the essence of their personal identity subordinate to the de facto tyranny of the majority.[260]

The other side of the coin is to broadly define religion to include most conceivable forms of religion as well as comparable philosophical beliefs or convictions. The United Kingdom subscribes to this definition.[261] While religions of all varieties are protected in the United Kingdom, other non-religious beliefs such as agnosticism, humanism, and even pacifism also fall within the penumbra of such a definition.[262] An amendment or re-interpretation of the term religion as used in Title VII could broaden the groups that obtain protection. However, inclusion of varied philosophical beliefs and other non-religious beliefs, no matter how central they might be for the holder, was clearly outside Congress's purview when it adopted and amended Title VII.[263]

Although it is not problem-free,[264] the United States Supreme Court's existing definition of religion remains most desirable. The greatest reservation in accepting the Supreme Court's narrow definition of religion is the difficulty that minority or lesser-known religions have in attaining protection compared to mainstream religions. Yet, asking "whether a given belief that is sincere and meaningful occupies the place in the life of its possessor parallel to that filled by the orthodox belief in God of one who clearly qualifies for [protection]"[265] is a fair and workable standard for determining what should be classified as religion. The Court has removed the requirement of worshipping a deity,[266] the monotheistic requirement,[267] as well as necessitating the holder of the belief to classify it as religion in order to receive protection.[268]

Therefore, the Supreme Court's definition strikes an appropriate balance.

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260. *See* Wald, *supra* note 2, at 483.

261. *See supra* Part I.C.4.

262. *See* EXPLANATORY NOTES, *supra* note 97, ¶ 13.

263. While Congress might desire to expand the protection beyond religion to include certain political or philosophical beliefs, this Note's recommendations are based on the intention of Congress at the time the CRA was passed and amended. The intention at that time was to eliminate discrimination in the workplace because of, *inter alia*, religion. *See* Civil Rights Act of 1964 (Title VII), 42 U.S.C. §§ 2000e-2(a)(1)-(2) (1991).

264. *See supra* Part I.B.3.

265. United States v. Seeger, 380 U.S. 163, 166 (1965).

266. *See* Torcaso v. Watkins, 367 U.S. 488, 489-90 (1961).

267. *See* Gunn, *supra* note 17, at 165.

268. *See* Mroz, *supra* note 27, at 172-73.

In most cases, true religion will qualify for protection. Concerns with the Court's contemporary treatment of religion are generally related to the disqualification of a particular plaintiff based on the insincerity of a purported faith, not the categorical disqualification of his or her faith. While some may take issue with the sincerity requirement, it serves as a beneficial test by which to judge if the person allegedly discriminated against truly adheres to a religion.[269]

B. The United States Congress Should Change the Obligation to Accommodate by Re-defining the Term Undue Hardship

While the definition of religion adopted in the United States suitably balances the competing interests of employees and employers, the Supreme Court's interpretations of the Civil Rights Act of 1991 have precluded the full realization of the amendment's intended effect.[270] Nonetheless, the legislature, not the courts, is the appropriate vehicle through which modifications of the duty to accommodate should be addressed.

In reference to accommodating the religious employee, the United States' design is superior to the equivalent British system because the former includes an explicit and affirmative duty on the employer to accommodate employees.[271] While neither scheme is without problems,[272] a duty to accommodate is essential for religious workers to be truly protected from discrimination in the workplace. The American system strikes a fair balance among the competing interests of employers, employees, and customers.[273] It also provides an individualized "approach to providing protection, and ensures that religious staff can only be disadvantaged when there is a real reason to do so."[274]

Admittedly, the right to resign from participation in the workplace is the ultimate protection for freedom of religion. However, this should be the last resort when scrutinizing any conflict, not the starting point. A religious employee should be forced to exercise this right only when the accommodation required to resolve the conflict within the workplace results in a legitimate and substantial hardship to the employer.

If Congress adopted a new definition for undue hardship that nullified the Supreme Court's current definition, Title VII would be revolutionized and would give full effect to the undue hardship requirement of religion and the workplace. An undue hardship should not be defined as a situation that imposes "more than de minimis costs," but rather as a situation which imposes

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269. Holding a sincere religious belief is one of the prima facie requirements for actionable discrimination under Title VII. *See supra* Part I.B.1.

270. *See supra* Part II.A.5.

271. *Compare supra* Parts II.A.4., II.B.3.

272. *See supra* Parts II.A.5., II.B.4.

273. *See* VICKERS, *supra* note 24, at 223.

274. *Id.*

"significant difficulty or expense" on the employer.[275] Under this new determination of undue hardship, courts would look to factors such as the cost of the accommodation in relation to the size and operating costs of the employer, as well as the number of individual employees seeking an accommodation.[276]

While this designation dramatically departs from the way in which the Supreme Court interprets the term, it is much more consistent with the protections afforded in antidiscrimination legislation for other protected classes such as the disabled in the American with Disabilities Act.[277] When comparing the way gender and religion are treated under Title VII, a divergence is evident. For example, in *International Union v. Johnson Controls, Inc.*,[278] the Supreme Court stated: "The extra cost of employing members of one sex . . . does not provide an affirmative Title VII defense for a discriminatory refusal to hire members of that gender."[279] While the Court states that anything more than de minimis cost alleviates the employer of its Title VII duty in the context of religion, it clearly states that this is unacceptable for gender.[280]

One area in which the United States could benefit from the Regulations is with contextual examination. In Britain, when analyzing an employer's refusal to change a work rule or regulation that negatively and disproportionately impacts those holding to a particular religion or belief, the examination is contextual.[281] Even without a duty to accommodate, there could be circumstances under which greater protection is afforded to religious employees under the British scheme. Imagine a large employer that has a "no time off" policy over a particular busy period. However, several employees requested time off during this period due to a religious holiday. Assume that the simplest solution to this conflict would be to have other employees not practicing this religion pick up these shifts, even if this meant the payment of overtime. In the United Kingdom, an additional cost of paying a few employees time-and-a-half, as compared to regular pay, would be viewed proportionally. Not allowing these employees time off would likely be deemed discrimination, despite the additional costs of paying overtime. In contrast, in the United States, the failure to accommodate these requests would likely *not* be discriminatory because the payment of overtime, as compared to regular pay, constitutes more than de minimis cost.

Changing the definition of undue burden, and, by extension, the duty to

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275. *See The Workplace Religious Freedom Act*, INST. FOR PUB. AFFAIRS, http://www.ou.org/public/vote/2000/wrfa.htm (last visited Nov. 26, 2010).

276. *See id.*

277. *See* Foltin & Standish, *supra* note 9, at 24.

278. *See* Int'l Union v. Johnson Controls, Inc., 499 U.S. 187 (1991).

279. *Id.* at 210.

280. *See also* Foltin & Standish, *supra* note 9, at 23 (asking if the Supreme Court is treating claims of religious discrimination less seriously than other forms, such as race and gender discrimination).

281. *See* EXPLANATORY NOTES, *supra* note 97, ¶ 41; *supra* Part II.B.1.

accommodate, is not novel. Both houses of Congress have considered legislation that would have redefined undue burden almost identically to that advocated in this Note.[282] This proposed bill, called the Workplace Religious Freedom Act of 1997, garnered support from a diverse assemblage of religious organizations.[283] The bill has been introduced in Congress multiple times between 1997 and 2005 but has never survived discussions in sub-committees.[284]

Congress, in amending the definitions of any terms, must choose its words very carefully. If it decides to amend, due deliberation is necessary to avoid the same problems the United Kingdom encountered when it adopted the Equality Act of 2006.[285] The potentially negative effects of re-defining terms in a haphazard manner "can be uncertainty at best and legislation which is inappropriate or impossible to effectively implement on its own terms at worst."[286] Beyond this, Congress must instruct as to the precise definition lest the same problems that evolved pursuant to the passage of the CRA of 1991 repeat themselves.

C. An Additional Modification to the Duty to Accommodate Will Give Full Effect to All the Language of the CRA of 1991

Congress should explicitly require an employer to implement a reasonable accommodation suggested by the employee that more fully resolves or eliminates a conflict so long as it does not lead to undue hardship (under either the current definition or the definition of undue hardship advocated for in

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282. In July of 2007, Senator John Kerry (D-MA) and Dan Coats (R-IN) introduced a bill called the Workplace Religious Freedom Act of 1997 (WRFA; S. 1124). Rep. William Goodling (R-PA) introduced a House version, H.R. 2848. *See Religious Freedom in the Workplace,* ONT. CONSULTANTS ON RELIGIOUS TOLERANCE, http://www.religioustolerance.org/wrfa.htm (last visited Nov. 26, 2010).

283. These religious organizations included but were not limited to: American Jewish Committee; American Jewish Congress; Anti-Defamation League; Baptist Joint Committee on Public Affairs; Center for Jewish and Christian Values; Central Conference of American Rabbis; Christian Legal Society; Church of Scientology International; Council on Religious Freedom; General Conference of Seventh-day Adventists; Hadassah-WZOA; International Association of Jewish Lawyers and Jurists; Jewish Council for Public Affairs; National Association of Evangelicals; National Council of the Churches of Christ in the USA; National Jewish Coalition; National Jewish Coalition; National Sikh Center; North American Council for Muslim Women; Presbyterian Church (USA), Washington Office; Southern Baptist Convention Ethics and Religious Liberty Commission; Traditional Values Coalition; Union of American Hebrew Congregations; United Church of Christ United Methodist Church General Board on Church and Society; and United Synagogue of Conservative Judaism. *See id.*

284. *See* Federal Legislation Clinic, *Title VII and Flexible Work Arrangement to Accommodate Religious Practice & Belief,* GEORGETOWN UNIVERSITY LAW CENTER, http://workplaceflexibility2010.org/images/uploads/FWA_TitleVII.doc (last visited Nov. 26, 2010).

285. *See* Griffith, *supra* note 76, at 151-59; *supra* Part I.C.3-4.

286. *See* Griffith, *supra* note 76, at 162.

this Note). Doing so would ensure that these legislatively-related concepts would be considered in tandem. This proposed amendment is similar to the reading Justice Marshall endorsed in his dissent in *Philbrook*.[287] As Title VII stands today, in a post-*Hardison* and post-*Philbrook* world, the concepts of undue hardship and reasonable accommodation are often separated, or undue hardship is not addressed at all. According to *Philbrook*, if the employer offers a single reasonable accommodation, its duty concludes despite there being a much more suitable accommodation available that would not result in undue hardship.[288]

Logically, accommodation offered by the employer will often be that which is most advantageous to the *employer*, as opposed to the *employee*. If an employee rejects the proposed accommodation because it does not eliminate the conflict between religion and work, an analysis of the employee's proposal should commence. Otherwise, employers will never have to face the undue hardship portion of the statute.[289] It is reasonable to assume that, when enacting legislation to protect the religious employee, Congress intended for the employee to have a voice in the accommodation process.[290]

Such a reading would treat the undue burden portion of the standard as the outer limits of what an employer must do to accommodate. That is, an employer must accommodate a religious employee's request so long as the accommodation further resolved the conflict and was not an undue burden. This view has been explicitly endorsed by the EEOC.[291] If more than one means of accommodation exists which will not cause an undue hardship, an employer should be obligated to implement the one that disadvantages the *employee* least with respect to his employment opportunities.[292]

D. The Rationale Behind Changing the Duty to Accommodate

Even though Congress amended Title VII in the CRA of 1991, it "did not define the terms 'reasonable accommodation' or 'undue hardship' and has not amended the definition of 'religion' in which such terms are used or otherwise given substantive guidance as to the meaning of such terms since 1972."[293] Because the Supreme Court failed to clarify the concepts of reasonable accommodation and undue hardship, different applications among the circuits will continue.[294] These modifications increase the threshold for showing undue

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287. *See* Ansonia Bd. of Educ. v. Philbrook, 479 U.S. 60, 73-74 (1986) (Marshal, J. Dissenting).

288. *See id.* at 68-69.

289. *See* Bedig, *supra* note 160, at 256.

290. *Id.* at 257.

291. *See* Reasonable Accommodation Without Undue Hardship as Required by Section 701(J) of Title VII of the Civil Rights Act of 1964, 29 C.F.R. § 1605.2(c) (1986).

292. *See id.*

293. Campbell, *supra* note 46, at 26.

294. *See* Bedig, *supra* note 160, at 246.

hardship and treat hardship and reasonable accommodation as interrelated and inseparable; they are more in tune with the amendments passed by Congress in 1972. The amendment was added to protect the religious employee and to specifically require the employer to take at least some affirmative steps, which it was not explicitly required to take under the original version of Title VII in 1964.[295]

CONCLUSION

Today, the United States affords greater protection to religious employees relative to the United Kingdom. The Supreme Court's contemporary definition of religion is broad enough to ensure that almost every religious individual can qualify under Title VII. However, more must be done to guard against discrimination.

No recent changes would indicate a reversal or even a slowing of the swell in religious discrimination claims with the EEOC in the near future. The courts have been unwilling or unable to deal with these issues in the past, and they are unlikely to do so soon. However, Congress sits in a central position to play a vital role in ensuring full realization of the protections intended when Title VII was passed and amended. After careful consideration, through modification and amendment, Congress can redefine the term undue burden and how the concepts of undue burden and reasonable accommodation should be analyzed. Congress should also give guidance and direction to the courts in how the protections of Title VII should apply in practice.

Such changes further the goal of equality in at least two ways. First, the implementation of the recommendations advanced in this Note serve to place protection against religious discrimination on par with race, gender, and disability. There would no longer be analytic variation among these groups whose safeguards emanate from the same statute. Second, employees of faith in the United States would be able to participate in the workplace without compromising their religious convictions. Through eliminating discrimination, believers will no longer suffer disadvantage because of their adherence to their faith.

Comparing the way challenges relating to religion are treated in the British and American workplace serves as an example of how other countries can address similar problems. From the definition of religion as it relates to the breadth of protection to the decision about whether to adopt a negative non-discrimination or positive accommodation duty, the recommendations advanced

295. *See* Jamar, *supra* note 6, at 742. "This amendment was the first legal recognition that religion-based cases needed to be treated differently from other cases. The normal duty under Title VII is not to treat employees differently in an adverse manner based on the listed characteristics. But, as a result of the amendment, an *employer has an affirmative duty to treat certain employees differently, and some would argue favorably*, by accommodating their religious needs." *Id.* (emphasis added).

in this Note enable others to solve challenges related to discrimination in the workplace. These are not peculiarly British or American dilemmas; they are illustrative of those faced across the globe. Until religious discrimination is eliminated, legal and academic scholars must continue to develop novel solutions, and governments must adapt their approaches to solve this ever-present concern.

SOME SECRETS DO NOT HURT EVERYONE: THE CASE FOR ADDITIONAL DISCOUNT WINDOW REFORM IN THE UNITED STATES' FEDERAL RESERVE

Ryan W. Tanselle*

INTRODUCTION

The global financial crisis, which began in the summer of 2007, brought about extraordinary and increased intervention in the financial sector by various developed countries and their central banks.[1] These countries and associated central banks include the United States' Federal Reserve, the United Kingdom's Bank of England, and the European Union's European Central Bank.[2] Most increased intervention occurred through each central bank's lender of last resort facility.[3] According to classical central bank ideology, one of the main functions of a central bank's lender of last resort facility is to provide liquidity to illiquid institutions facing a temporary shortage of cash.[4] The recent global financial crisis stretched this classical ideal to its limit.[5]

Historically, before a central bank lent its taxpayer's money to private institutions, the central bank would determine whether the institution requesting money was illiquid or insolvent.[6] While illiquidity is a sign that a bank could be insolvent, it alone is not determinative of insolvency.[7]

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1. A central bank is the "[p]rincipal monetary authority of a nation, which performs several key functions, including conducting monetary policy to stabilize the economy and level of prices." BD. OF GOVERNORS OF THE FED. RESERVE SYS., THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS 1 (9th ed. 2005), http://www.federalreserve.gov/pf/pdf/pf_complete.pdf [hereinafter PURPOSES & FUNCTIONS]. *See infra* Part I.A. (discussing the definition of central banks).

2. *See generally* Andrew Campbell & Rosa Lastra, *Revisiting the Lender of Last Resort*, 24 BANKING & FIN. L. REV. 453 (2009) (discussing the increased role of the Federal Reserve, Bank of England, and European Central Bank during the recent global financial crisis).

3. *See infra* Part IV.B. (discussing central bank activities in response to the financial crisis).

4. Campbell & Lastra, *supra* note 2, at 465.

5. *See infra* Part IV.A. (discussing events leading to the financial crisis including a discussion of normal bank activities when facing a temporary cash squeeze).

6. *See infra* Part IV.A.

7. *See infra* Part IV.

Therefore, in order to protect illiquid banks from the stigma attached[8] to using the same lender of last resort facility as insolvent banks, secrecy exists regarding the disclosure of traditional lender of last resort loans made to financial institutions.[9]

In response to the recent global financial crisis, central banks assumed much greater lender of last resort power in an effort to stabilize the financial system.[10] For example, central banks began "bailing out" institutions that were facing insolvency.[11] Because institutions facing insolvency are riskier than institutions facing illiquidity, central banks have been under pressure to disclose their use of taxpayer funds in such transactions. Some disclosure proposals specifically focused on lifting the veil of secrecy in the United States Federal Reserve's primary lender of last resort facility, the Discount Window.[12] For example, the proposed Federal Reserve Transparency Act of 2009 required an annual audit of the Federal Reserve.[13]

Even though steps for reform, such as the Federal Reserve Transparency Act of 2009, were never undertaken, other reform measures were implemented. The first step toward lifting the veil of Discount Window secrecy came in *Bloomberg L.P. v. Board of Governors of Federal Reserve System*.[14] In this case, the Federal Reserve was ordered to disclose documents related to Discount Window lending under the Freedom of Information Act.[15] However, a more important step toward lifting the veil of Discount Window secrecy came on July 21, 2010, when the United States Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act.[16] The Act was a compromise among numerous proposals for financial reform[17] and provides, among other reform measures, that the Federal Reserve will disclose certain details about *all* Discount Window

8. Campbell & Lastra, *supra* note 2, at 470.

9. *See infra* Part III. (discussing central bank secrecy).

10. Campbell & Lastra, *supra* note 2, at 454.

11. *See infra* Part IV.B. (discussing central bank activities in response to the financial crisis).

12. *See infra* Part II.B. (discussing the Discount Window's role in the Federal Reserve); *see also* Matthew Winkler, Editorial, *Transparency and the Fed*, WALL ST. J., Sept. 18, 2009, at A21, *available at* http://online.wsj.com/article/SB10001424052970204518504574418761585852036.html.

13. Federal Reserve Transparency Act of 2009, H.R. 1207, 111th Cong. § 2 (2009).

14. Bloomberg L.P. v. Bd. of Governors of Fed. Reserve Sys., 649 F.Supp.2d 262 (S.D.N.Y. 2009), *aff'd*, 601 F.3d 143 (2d Cir. 2010), *petition for cert. filed*, 79 U.S.L.W. 3271 (U.S. Oct. 26, 2010) (No. 10-543).

15. *See infra* Part IV.C.

16. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

17. *See generally* Alison Vekshin & Phil Mattingly, *Lawmakers Reach Compromise on Financial Regulation*, BLOOMBERG (June 26, 2010, 12:01 AM), http://www.bloomberg.com/news/2010-06-25/lawmakers-reach-compromise-on-financial-regulation.html.

lending within two years of each loan.[18] Specifically, the Federal Reserve must now disclose the "name and identifying details of the depository institution; [t]he amount borrowed by the depository institution; [t]he interest rate paid by the depository institution; and [i]nformation identifying the types and amounts of collateral pledged in connection with any discount window loan."[19]

Although the disclosure requirements in the Dodd-Frank Wall Street Reform and Consumer Protection Act appear harmless, the potential implications for *any* disclosure in an intertwined and increasingly global financial market are significant, as evidenced by the disclosure of Northern Rock's receipt of lender of last resort money from the Bank of England.[20] Northern Rock's disclosure showed that news of a single bank's financial troubles could set off a chain of events that could cripple a global economy.[21] Therefore, in order to lift the veil of central bank secrecy while protecting the institutions that use a central bank's lender of last resort facilities, disclosure of the use of lender of last resort facilities should only occur for high-risk institutions.

This Note examines the increasing transparency in central banks and whether such transparency should be extended to a central bank's lender of last resort facilities. Part I analyzes the traditional roles and legal foundations of the Federal Reserve, Bank of England, and European Central Bank. Part II discusses lender of last resort theory and its implementation in the Federal Reserve, Bank of England, and European Central Bank. Part III explores central bank secrecy. Part IV outlines the myriad of central bank responses to the financial crisis. Finally, Part V posits that the Discount Window disclosure requirements in Dodd-Frank Wall Street Reform and Consumer Protection Act are too broad. Instead of requiring the disclosure of all Discount Window facility usage, the Federal Reserve should only be required to disclose Discount Window loans made to risky institutions.

I. THE TRADITIONAL ROLES OF THE FEDERAL RESERVE SYSTEM, BANK OF ENGLAND, AND EUROPEAN CENTRAL BANK

The Federal Reserve System, Bank of England, and European Central Bank are all central banks that function in the same broad manner.[22] A central bank is defined as the "[p]rincipal monetary authority of a nation,

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18. *Frequently Asked Questions – Discount Window Lending Programs,* FED. RESERVE DISC. WINDOW, http://www.frbdiscountwindow.org/dwfaqs.cfm?hdrID=14&dtlID=75 (last updated Aug. 10, 2010). *See also* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

19. *Frequently Asked Questions – Discount Window Lending Programs, supra* note 18.

20. *See infra* Part IV.A.

21. *Id.*

22. PURPOSES & FUNCTIONS, *supra* note 1.

which performs several key functions, including conducting monetary policy to stabilize the economy and level of prices."[23] The need for a national central bank and unified monetary policy arose from the vulnerability of the nineteenth and early twentieth century United States' banking system. In that period, the "failure of the [United States'] banking system to effectively provide funding to troubled depository institutions contributed significantly to the economy's vulnerability to financial panics."[24] The failure was caused by the unavailability of short-term credit from the government, which banks rely on when they have a series of unexpected withdrawals.[25]

A. The Federal Reserve System – Central Bank of the United States of America

The Central Bank of the United States is the Federal Reserve System,[26] which derives its legal authority from the Federal Reserve Act.[27] The Federal Reserve's operational framework is described as being "independent within the government" because it is supervised by Congress but operated by presidentially-appointed and congressionally-approved economists.[28] The duties of the Federal Reserve fall into four general areas: conducting monetary policy with an eye toward "maximum employment, stable prices, and moderate long-term interest rates"; "supervising and regulating banking institutions"; ensuring the stability of the financial system and minimizing any risk in the financial markets; and "providing financial services to depository institutions" and governments.[29]

B. The Bank of England – Central Bank of the United Kingdom

The United Kingdom's central bank is the Bank of England.[30] It "exists to ensure monetary stability and to contribute to financial stability."[31] The Bank of England's main monetary stability function is to

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23. *Id.* at 109.

24. *Id.* at 1.

25. *Id.*

26. *Id.*

27. *Id.* at 2; Federal Reserve Act, 12 U.S.C. §§ 221-522 (2010; *see also Federal Reserve Act: Section 13*, BD. OF GOVERNORS OF THE FED. RESERVE SYS., http://www.federalreserve.gov/aboutthefed/section13.htm (last updated Aug. 13, 2008) (Federal Reserve Act with the Federal Reserve's non-United States Code numeration).

28. PURPOSES & FUNCTIONS, *supra* note 1, at 1.

29. *Id.*

30. BANK OF ENGLAND, http://www.bankofengland.co.uk/index.htm (last visited Nov. 22, 2010).

31. *Core Purposes*, BANK OF ENGLAND, http://www.bankofengland.co.uk/about/corepurposes/index.htm (last visited Nov. 22, 2010).

safeguard the value of its currency.[32] More relevant to this Note is the Bank of England's financial stability function. Specifically, the Bank of England is responsible for "ensuring the stability of the monetary system" and "overseeing financial system infrastructure."[33]

C. The European Central Bank – Central Bank of the European Union

The European Union's central bank is the European Central Bank.[34] Legal authority for the European Central Bank stems from the Treaty Establishing the European Community and the Statute of the European System of Central Banks and the European Central Bank.[35] Like the Bank of England, the primary objective of the European Central Bank is "to maintain price stability."[36] The European Central Bank is also responsible for the implementation of monetary policy, smooth operation of payment systems, and financial stability and supervision.[37] The monetary policy task is most relevant to this Note and includes promoting price stability, fostering a high level of employment, and creating sustainable and non-inflationary growth.[38]

The European Central Bank is markedly different in structure than its counterparts in the United States and England due to its multinational jurisdiction.[39] The European Central Bank is part of the larger European System of Central Banks.[40] The European System of Central Banks consists of the European Central Bank and individual national central banks, regardless of whether they have adopted the euro.[41] The European

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32. *Core Purposes - Monetary Stability*, BANK OF ENGLAND, http://www.bankofengland.co.uk/about/corepurposes/monetary_stability.htm (last visited Nov. 22, 2010).

33. Bank of Eng., Memorandum of Understanding between HM Treasury, the Bank of England, and the Financial Services Authority, http://www.bankofengland.co.uk /about/legislation/mou.pdf (last visited Nov. 22, 2010).

34. *ECB, ESCB, and the Eurosystem*, EUR. CENT. BANK, http://www.ecb.int/ ecb/orga/escb/html/index.en.html (last visited Nov. 22, 2010).

35. *Id. See also* Consolidated Version of the Treaty Establishing the European Union, Dec. 29, 2006, 2006 O.J. (C321) 1, http://eur-lex.europa.eu/en/treaties/dat/12002E/pdf/ 12002E_EN.pdf; Protocol (No. 4) on the Statute of the European System of Central Banks and of the European Central Bank, art. 14.3, May, 9, 2008, 2008 OJ (C 115) 230), http://www.ecb.int/ecb/legal/pdf/en_statute_from_c_11520080509en02010328.pdf (unofficial consolidated version of the Statute of the European System of Central Banks and of the European Central Bank).

36. *Tasks*, EUR. CENT. BANK, http://www.ecb.int/ecb/orga/tasks/html/index.en.html (last visited Nov. 22, 2010).

37. *Id.*

38. *Objective of Monetary Policy*, EUR. CENT. BANK, http://www.ecb.europa.eu/ mopo/intro/objective/html/index.en.html (last visited Nov. 22, 2010).

39. *ECB, ESCB, and the Eurosystem, supra* note 34.

40. *Id.*

41. *Id.*

Central Bank is also part of the Eurosystem, a governing body for individual national banks that have adopted the euro.[42]

Unlike the Federal Reserve and Bank of England, the European Central Bank does not act on its own accord when it conducts monetary policy operations.[43] Instead, each individual national bank in the European System of Central Banks carries out its monetary policy independent of the European Central Bank's directives.[44] However, banks within the Eurosystem must act in accordance with the guidelines set forth by the European Central Bank.[45] Therefore, the European Central Bank functions on two levels. First, it directs the monetary policy actions of central banks that are within the Eurosystem.[46] Second, it hopes to influence the monetary policy actions of central banks that are within the European System of Central Banks but are not within the Eurosystem.[47]

II. THE LENDER OF LAST RESORT

On a basic level, central banks provide liquidity instead of capital to financial institutions.[48] Liquidity is the "ability to convert an asset to cash quickly."[49] In contrast, capital is simply "financial assets."[50] Therefore, by synthesizing the basic role of a central bank with the definitions of liquidity and capital, it follows that a central bank should facilitate actions, such as providing liquidity, that make it *easier* for a financial institution to function.[51] However, a central bank should *not* take actions that *enable* a financial institution to function, such as providing capital.[52]

To help achieve the goal of providing liquidity to financial institutions, all three central banks serve as the lender of last resort for financial institutions under their control.[53] The lender of last resort facility has two features that make it different from other central bank functions.[54]

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42. *Id.*

43. Protocol (No. 4) on the Statute of the European System of Central Banks and of the European Central Bank, art. 12.1, May 9, 2008, 2008 OJ (C 115) 230), http://www.ecb.int/ecb/legal/pdf/en_statute_from_c_11520080509en02010328.pdf.

44. *Id.* art. 14.4.

45. *Id.* art. 14.3.

46. *Governing Council,* EUR. CENT. BANK, http://www.ecb.int/ecb/orga/decisions/govc/html/index.en.html (last visited Nov. 22, 2010).

47. *Id.*

48. Campbell & Lastra, *supra* note 2, at 457.

49. Definition of Liquidity, INVESTOPEDIA, http://www.investopedia.com/terms/l/liquidity.asp (last visited Nov. 22, 2010).

50. Definition of Capital, INVESTOPEDIA, http://www.investopedia.com/terms/c/capital.asp (last visited Nov. 22, 2010).

51. Campbell & Lastra, *supra* note 2, at 470.

52. *Id.*

53. *Id.* at 458-59.

54. *Id.* at 463-64.

First, the lender of last resort facility allows liquidity to flow almost immediately from a central bank in to a financial institution in need.[55] Second, most central banks have an unlimited amount of funds available to its lender of last resort facilities.[56]

A. Overview of Lender of Last Resort Theory

The lender of last resort facility has four pillars that central banks have historically used as a basis for lending to financial institutions.[57] Before the recent global financial crisis, central banks generally adhered to these four pillars when undertaking lender of last resort lending.[58] However, as the financial crisis worsened, central banks strayed from the four pillars.[59]

The first pillar is that assistance should be given to banks that are illiquid but *not* insolvent.[60] However, because illiquidity is a sign of possible insolvency, the distinction between the two may be difficult to discern.[61] The second pillar states that assistance should be given at a high rate of interest to compensate for the risk of lending to an illiquid institution.[62] In other words, because the central bank is the lender of last resort, a barrier in the form of a high or penalty-like interest rate should be established in order to prevent individual financial institutions from encountering any moral hazard problems.[63] Moral hazard, defined as the "incentive to take unusual risks,"[64] can arise due to the relative ease of access to emergency funds via the lender of last resort facility.[65] Third, assistance should be given to banks that can provide adequate and safe collateral.[66] Fourth, a central bank should disperse lender of last resort funds in a discretionary manner.[67]

A "widespread *reluctance* to allow banks to fail, even when clearly insolvent" has led central banks to stray from the four traditional pillars of lender of last resort lending.[68] This reluctance to allow failure may be

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55. *Id.* at 463.
56. *Id.* at 464.
57. *Id.* at 465.
58. *Id.* at 466.
59. *See infra* Part IV.B.
60. Campbell & Lastra, *supra* note 2, at 465.
61. *See generally id.* at 467 (discussing Northern Rock's turn from an illiquid to insolvent institution).
62. *Id.*
63. *Id.* at 465.
64. Definition of Moral Hazard, INVESTOPEDIA, http://www.investopedia.com/terms/m/moralhazard.asp (last visited Nov. 22, 2010).
65. Campbell & Lastra, *supra* note 2, at 465.
66. *Id.* at 465-66.
67. *Id.* at 466.
68. *Id.* at 466-67 (emphasis added).

attributed to the fact that central banks have weighed the "risk to contagion posed by a refusal to assist an insolvent bank" more heavily than the "effect on moral hazard that a bailout would create."[69] Therefore, in an effort to deter widespread panic from the failure of a financial institution, central banks have violated the traditional lender of last resort pillars.[70]

> Central banks, in their traditional lender of last resort (LOLR) role, can lend "against good collateral at a penalty rate" to an individual bank facing temporary liquidity problems, but that is otherwise regarded as solvent. The rationale would be that the failure of such a bank would lead to serious economic damage, including to the customers of the bank. The moral hazard of an increase in risk-taking resulting from the provision of LOLR lending is reduced by making liquidity available only at a penalty rate. . . . Because they are made to individual institutions, they are flexible with respect to type of collateral and term of the facility. LOLR operations remain in the [armory] of all central banks.[71]

The lender of last resort facility, due to its ability to provide immediate and unlimited liquidity, is an important aspect of a central bank's operations during times of individual, national, or international crises.[72] In addition, the lender of last resort facility "functions as a safety valve . . .; in circumstances where extensions of credit can help relieve liquidity strains in the banking system, the [lender of last resort] also helps to assure the basic stability of financial markets."[73]

The ability of a central bank to rapidly respond to a crisis through its lender of last resort facility is crucial.[74] As demonstrated by the financial turmoil that began in 2007, financial crises can have broad economic effects.[75] Thus, immediate access to liquidity can be "very important for containing the spread of a financial crisis that can have significant

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69. *Id.* at 467.

70. *See id.*

71. *Liquidity Support Facility for Northern Rock PLC*, BANK OF ENGLAND, (Sept. 14, 2007), http://www.bankofengland.co.uk/publications/news/2007/090.htm [hereinafter *Liquidity Support*].

72. Campbell & Lastra, *supra* note 2, at 467.

73. *Discount Window*, THE FED. RESERVE BANK OF MINNEAPOLIS, http://www.minneapolisfed.org/banking/discount/ (last visited Nov. 22, 2010).

74. Eric Hughson & Marc Weidenmier, *Financial Markets and a Lender of Last Resort: Lessons from the Founding of the Federal Reserve*, VOX EU (Nov. 28, 2008), http://www.voxeu.org/index.php?q=node/2625.

75. *Id. See infra* Part IV.A.

macroeconomic effects."[76]

B. The Discount Window: The Lender of Last Resort in the Federal Reserve System

In the Federal Reserve System, the lender of last resort facility is called the Discount Window.[77] "The Discount Window is the long-standing program through which the twelve Federal Reserve Banks make short-term loans (often overnight) to depository institutions, and it can serve as 'an emergency, back-up source of liquidity' for borrowing depository institutions that lack other options."[78] Specifically, the Discount Window can be used to supply temporary funding to institutions experiencing significant financial difficulties if that institution's collapse would have an adverse effect on the financial system.[79] In addition, the Discount Window may be used cautiously to help facilitate the "orderly resolution of a failing institution."[80] These various uses have caused the Discount Window to be described as a "sort of soup kitchen for the waifs and strays of America's banking world. When lenders are in dire straits and no one else will heed their cries for help, there's always Uncle Sam, in the form of the . . . Discount Window, as a final port of call."[81]

The Discount Window is also important to the United States because it helps control the federal funds rate.[82] The federal funds rate is the "[r]ate charged by a depository institution on an overnight loan of federal funds to another depository institution; [the] rate may vary from day to day and from bank to bank."[83] Controlling the federal funds rate through the Discount Window is essential to the Federal Reserve because the "Federal Reserve implements monetary policy through its control over the federal funds rate."[84]

To receive credit through the Discount Window, a bank must present sufficient collateral to the Federal Reserve.[85] Once sufficient collateral is presented, there are three types of credit available through the Discount

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76. Hughson & Wedenmier, *supra* note 74.

77. Campbell & Lastra, *supra* note 2, at 491.

78. Bloomberg L.P. v. Bd. of Governors of Fed. Reserve Sys., 601 F.3d 143, 146 n.1 (2d Cir. 2010), *petition for cert. filed*, 79 U.S.L.W. 3271 (U.S. Oct. 26, 2010) (No. 10-543).

79. PURPOSES & FUNCTIONS, *supra* note 1, at 46.

80. *Id.*

81. *30 Second Guides: Discount Window*, THIS IS MONEY, (Aug. 21, 2007, 12:00 AM), http://www.thisismoney.co.uk/30-second-guides/article.html?in_article_id=423570&in_page_id=53611&ct=5.

82. PURPOSES & FUNCTIONS, *supra* note 1, at 45.

83. *Id.* at 114.

84. *Id.* at 3.

85. *Id.* at 50.

Window.[86] The first type of credit is primary credit.[87] Primary credit is generally available to financially sound financial institutions on an overnight basis.[88] Primary credit is a back-up source of funding for banks in occasional need of temporary liquidity.[89] Therefore, as a penalty for using the Discount Window, the primary credit rate is typically 100 basis points (one percent) above the target federal funds rate and is commonly called the discount rate.[90]

Secondary credit is available to institutions ineligible for primary credit.[91] These institutions are typically less financially sound than institutions that are able to take advantage of primary credit.[92] Therefore, the interest rate associated with secondary credit is 150 basis points above the target federal funds rate.[93]

Finally, the Federal Reserve also offers seasonal credit through the Discount Window.[94] Seasonal credit is available to small firms that experience "significant seasonal swings in their loans and deposits."[95] Generally speaking, banks in agricultural and tourist areas qualify for seasonal credit.[96] Therefore, unlike Discount Window lending using primary or secondary credit, seasonal credit is not used by institutions facing financial difficulties.[97]

C. The Sterling Monetary Framework: The Lender of Last Resort in the Bank of England

The Bank of England recently established the Sterling Monetary Framework as its lender of last resort facility.[98] In 2008, the Sterling Monetary Framework replaced the Bank of England's Standing Facilities, which "allowed banks to borrow [an] unlimited amount from the Bank of England at any time."[99] The Bank of England developed the Sterling Monetary Framework because it believed the August 2007 Northern Rock crisis stigmatized the Standing Facilities.[100] The Sterling Monetary Framework consists of two parts: the Operational Standing Facility and the

86. *Id.* at 46.
87. *Id.*
88. *Id.*
89. *Id.*
90. *Id.* at 48.
91. *Id.*
92. *Id.*
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.* at 49.
97. *Id.*
98. Campbell & Lastra, *supra* note 2, at 484-85.
99. *Id.* at 484.
100. *Id. See infra* Part IV.A.

Discount Window Facility.[101]

The Operational Standing Facility is an overnight lending facility for firms facing a temporary shortage in cash.[102] The purpose of Operational Standing Facilities is to give banks a way "to manage unexpected (frictional) payment shocks."[103] Operational Standing Facilities are composed of two parts: a depositing facility and a lending facility.[104] Important to this Note is the lending facility, which enables a bank to borrow overnight funds from the Bank of England against sufficient collateral for a penalty rate of seventy-five basis points.[105] Financial institutions that need longer-term help use the Discount Window Facility instead of the Operational Standing Lending Facility.[106]

"The purpose of the [Discount Window Facility] is to provide liquidity insurance to the banking system. The Discount Window Facility is not intended for firms facing fundamental problems of solvency or viability."[107] Therefore, the Bank of England's Discount Window Facility was not designed to be used by institutions in need of a government bailout to continue operations even though it has a longer-term lending period than the Operational Standing Facility.[108]

Borrowers from the Discount Window Facility are required to borrow funds for either 30 days or 364 days.[109] The penalty rate for Discount Window Facility lending is generally based on the type of collateral that a financial institution is able to provide.[110] Therefore, the penalty lending rate is lower if a bank is able to provide high quality collateral.[111] If high quality collateral is provided, the Discount Window Facility minimum

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101. *Sterling Monetary Framework*, BANK OF ENGLAND, http://www.bankofengland.co.uk/markets/money/index.htm (last visited Nov. 22, 2010).

102. *See* BANK OF ENG., DOCUMENTATION FOR THE BANK OF ENGLAND'S OPERATIONS UNDER THE STERLING MONETARY FRAMEWORK (June 15, 2010), *available at* http://www.bankofengland.co.uk/markets/money/documentation/100615operating.pdf (discussing in detail the purpose and operational intricacies of the Discount Window Facility and the Operational Standing Facilities).

103. *Sterling Monetary Framework: Operational Standing Facilities*, BANK OF ENGLAND, http://www.bankofengland.co.uk/markets/money/osf/index.htm (last visited Nov. 22, 2010) [hereinafter *Operational Standing Facilities*].

104. *Id.*

105. *Id.*

106. *See generally, Sterling Monetary Framework: Discount Window Facility*, BANK OF ENGLAND, http://www.bankofengland.co.uk/markets/money/dwf/index.htm (last visited Nov. 22, 2010) [hereinafter *Discount Window Facility*].

107. *Id.*

108. *See id.*

109. *Id.*

110. *See* BANK OF ENGLAND, BANK OF ENGLAND CONSOLIDATED MARKET NOTICE: DISCOUNT: WINDOW FACILITY 5 (Mar. 29, 2010), *available at* http://www.bankofengland.co.uk/markets/ marketnotice100326dwfcon.pdf.

111. *See id.*

penalty rate is only fifty basis points.[112]

D. The Marginal Lending Facility: The Lender of Last Resort in the European Central Bank

The European Central Bank's lender of last resort facility is the marginal lending facility.[113] The marginal lending facility helps financial institutions "obtain overnight liquidity from the central bank, against the presentation of sufficient eligible assets."[114] The marginal lending facility, like the Bank of England's Operational Standing Facilities, consists of both a depository facility and a marginal lending facility.[115] To receive funds through the marginal lending facility, a financial institution must present sufficient collateral.[116] Once the institution has presented sufficient collateral, it can receive funds at a penalty rate of 175 basis points.[117]

Financial institutions within the European System of Central Banks and the Eurosystem face a different set of hurdles when going to European Central Bank for lender of last resort funds. Since the European Central Bank is not a national central bank, it cannot extend long-term credit through its marginal lending facility.[118] However, the European Central Bank is able to provide direct temporary liquidity assistance to member banks.[119] Thus, it must rely on national central banks within the European System of Central Banks and Eurosystem to make long-term, but not short-term, lender of last resort decisions regarding institutions in their respective countries.[120]

III. VIEWS ON CENTRAL BANK TRANSPARENCY

A. Historical Aversion to Central Bank Transparency

Historically, most central banks were strong advocates of central bank secrecy.[121] "The historical reluctance of central banks to become open and transparent is well known. Many journalists, academics, and Members of

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112. *Id.*

113. *Discount Windows*, BANK IMPLODE-O-METER (Jan. 21,2008, 09:52 AM), http://bankimplode.com/blog/2008/01/21/european-central-bank-discount-window/.

114. *Standing Facilities*, EUR.CENT. BANK, http://www.ecb.int/mopo/implement/sf/html/index.en.html (last visited Nov. 22, 2010).

115. *Id.*

116. *Id.* (click on the "Data" tab).

117. *Id.*

118. Campbell & Lastra, *supra* note 2, at 464.

119. *Id.*

120. *Id. See also supra* Part I.C. (discussing the European Central Bank's legal framework).

121. JOINT ECON. COMM., 106TH CONG., TRANSPARENCY AND FEDERAL RESERVE MONETARY POLICY (1999), *available at* http://www.house.gov/jec/fed/fed/transpar.pdf.

Congress have recognized that secrecy and ambiguity are part of the culture of central banks."[122] One of the strongest arguments for central bank secrecy was that decisions regarding monetary policy were too complex for the uneducated individual to understand.[123] Central bankers reasoned it was better to keep laypersons in the dark about central bank operations in order to prevent market panic.[124]

The Federal Reserve has been a particularly strong proponent of central bank secrecy.[125] The Federal Reserve "explicitly defended secrecy [and] opposed full disclosure . . . . The argument has been that fuller disclosure would promote unnecessary volatility in financial markets . . . and interfere with the execution of monetary policy."[126] Even in recent years, the Federal Reserve was somewhat secretive, as evidenced by carefully guarded statements from former Federal Reserve Chairman Alan Greenspan.[127] "Americans had grown used to the cryptic statements of Mr. Greenspan in his day and the merest pause or grumble would be solemnly interpreted by semi-professional Greenspan-watchers for the rest of us waiting with bated breath."[128]

Another argument in favor of central bank secrecy was that the central bank serves as the lender of last resort.[129] "Part of the responsibility of the [lender of last resort] was to maintain public confidence in the banking system while at the same time protecting the proprietary information of troubled banks. This function contributed to the culture of central bank secrecy which [arguably] continues to this day."[130] This secrecy was deemed necessary due to the potential harm a financial institution may face if its proprietary data were misinterpreted by members of the public as a result of a lender of last resort usage disclosure.

> More fundamentally, historical central bank opposition to transparency seemingly relates to a distrust of market mechanisms stemming from the original lender-of-last-resort function of central banks . . . . The original lender-of-last-resort (LOLR) function of central banks was premised on a belief in the inability of market mechanisms to prevent contagious bank runs causing contractions of the

122. *Id.* at 3.
123. *See id.* at 2-3.
124. *See id.* at 3.
125. *Id.*
126. *Id.*
127. Lune, *Central Bank Transparency: Good or Bad?*, NAKED CAPITALISM (Aug. 1 2008, 9:52 PM), http://www.nakedcapitalism.com/2008/08/central-bank-transparency-good-or-bad.html [hereinafter *Central Bank Transparency*].
128. *Id.*
129. JOINT ECON. COMM., *supra* note 121, at 3.
130. *Id.* at 3 n.7.

> money supply and economic activity. Earlier provision[s] of LOLR services involved the use of the Discount Window which necessarily involved proprietary information about individual bank loans and the individual portfolios of banks.[131]

Therefore, central banks were extremely unwilling to give out any kind of data about the financial institutions which used their lender of last resort facilities.[132]

B. Recent Increases in Central Bank Transparency

The cloud of secrecy surrounding central banks began to lift recently. "In the span of fifteen years, central bank transparency . . . is now an accepted broad goal to which all central banks pay at least lip service."[133] Central bank secrecy has decreased, in part, because "many central banks have become remarkably more transparent by placing much greater weight on their communication."[134] Central bank communication increased as a response to the increased risk central banks faced as financial markets and instruments grew more complex.[135]

> In recent years, however, the regulatory system not only failed to manage risk, it also failed to require disclosure of risk through sufficient transparency. American financial markets are profoundly dependent upon transparency. After all, the fundamental risk/reward corollary depends on the ability of market participants to have confidence in their ability to accurately judge risk.[136]

Increased central bank transparency reflects the efficient market hypothesis, which is the idea that market participants will make the best decision if they have all available market, or in this case, central bank

131. *Id.* at 3.

132. *See id.*

133. ADAM S. POSEN, INST. FOR INT'L ECON., SIX PRACTICAL VIEWS OF CENTRAL BANK TRANSPARENCY 1 (2002), *available at* http://www.iie.com/publications/papers/posen0502.pdf.

134. Alan S. Blinder et al., *What We Know and What We Would Like to Know About Central Bank Communication*, VOX EU (May 15, 2008), http://www.voxeu.org/index.php?q=node/1143.

135. CONG. OVERSIGHT PANEL, SPECIAL REPORT ON REGULATORY REFORM (Jan. 2009), *available at* http://cop.senate.gov/documents/cop-012909-report-regulatoryreform.pdf.

136. *Id.* at 3.

information.[137] In accordance with the efficient market hypothesis, increased transparency is generally a positive and necessary component of the market. [138] Moreover, secrecy is against the principles of the efficient market hypothesis and therefore should be avoided under efficient market hypothesis ideology.[139] "Today's changing financial environment demands more transparent Federal Reserve monetary policy. Such transparency would to help establish understandable rules and procedures, eliminate unnecessary market uncertainties and volatility, and to minimize the costs of anti-inflation monetary policy."[140]

"Transparent monetary policy is characterized by openness and a lack of secrecy and ambiguity. Transparency is multi-dimensional and includes the clarification of policy goals, of policy procedures, and the timeliness in reporting policy decisions."[141] There are many advantages to having a transparent monetary policy.[142] "It can work to (1) clarify policy objectives, (2) improve the workings of financial markets, (3) enhance central bank credibility, (4) reduce the chances of monetary policies manipulation for political purposes, (5) foster better monetary policymaking, and (6) complement congressional monetary policy oversight responsibilities."[143] A simplified view of the benefits of increased central bank transparency is that "greater transparency is beneficial, improving democratic accountability by making it easier to judge whether a central bank is committed to its announced policy and improving policy effectiveness by facilitating the interpretation of policy changes."[144] In addition, there is some empirical data suggesting that increased central bank transparency leads to real-world benefits.[145]

C. Criticism of Increased Central Bank Transparency

The increase in central bank transparency is not without criticism. One view is that "transparency should not be seen as good for whatever ails

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137. Definition of Efficient Market Hypotheses (EMH), INVESTOPEDIA http://www.investopedia.com/terms/e/efficientmarkethypothesis.asp (last visited Nov. 22, 2010).

138. *See* JOINT ECON. COMM., *supra* note 121, at 4-8.

139. Definition of Efficient Market Hypotheses (EMH), *supra* note 137.

140. JOINT ECON. COMM., *supra* note 121, at 1.

141. *Id.* at 9.

142. *Id.*

143. *Id.*

144. Ellen E. Meade & David Stasavage, *The Dangers of Increased Transparency in Monetary Policymaking*, VOX EU (June 26, 2008), http://www.voxeu.org/index.php?q=node/1271.

145. Christopher Crowe & Ellen E. Meade, *Central Bank Independence and Transparency: Not Just Cheap Talk*, VOX EU (July 31, 2008), http://www.voxeu.org/index.php?q=node/1489 ("[G]reater transparency is associated with more accurate private sector forecasts.").

central banks."[146] Another view is that central bank transparency undermines the political independence of most major central banks.[147] However, most empirical evidence is in contrast with the decreased political independence criticism.[148] One report shows that "[t]ransparency tends to be beneficial when information asymmetries are themselves the cause of inefficiencies in the economy but can be costly in a second-best environment where the central bank is able to offset other inefficiencies by exploiting its informational advantage."[149] Skepticism of increased central bank transparency also stems from the idea that increased transparency may show a lack of accountability in central banks.[150] An oft-cited benefit of central bank transparency is that increased transparency leads to increased accountability.[151] Thus, when a central bank is more transparent, it should have less room to take unpopular courses of action or go against its own word.[152] However, a transparent central bank can inadvertently show a lack of accountability by not following its published policy objectives.[153]

Finally, the increase in central bank transparency may lead to concessionary behaviors by members of a central bank's board.[154] "[G]reater transparency of central bank policymaking – in which committee deliberations are made more open to the public – may prevent the full and frank discussion needed to make the best decisions."[155] For example, after Congress ordered the Federal Reserve to publish verbatim transcripts of its Federal Open Market Committee (FOMC) meetings, most FOMC members were reluctant to say what they were truly thinking for fear of public repercussion.[156] "While before 1993, FOMC discussions were [characterized] by frequent 'off the cuff' remarks and interruptions, since 1993 there has been an increase in prepared statements that may result in less real deliberation."[157] However, current Federal Reserve Chairman Ben Bernanke prefers that members of the Federal Reserve Board of Governors voice their disagreements through published meeting notes.[158]

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146. POSEN, *supra* note 133, at 19.

147. *Id.* at 3.

148. *Id.* at 22.

149. Crowe & Meade, *supra* note 145.

150. POSEN, *supra* note 133, at 20-21.

151. *Id.* at 3.

152. *Id.* at 20-21.

153. *Id.*

154. Meade & Stasavage, *supra* note 144.

155. *Id.* Generally, this concern is nothing new; James Madison believed the secrecy surrounding the Constitutional Convention of 1787 was one of the major reasons for its success. *Id.*

156. *Id.*

157. *Id.*

158. *Central Bank Transparency, supra* note 127.

D. Increased Transparency and the Lender of Last Resort

Most historical increases in central bank transparency dealt with macroeconomic monetary policy, not with the lender of last resort function.[159] However, increased transparency regarding the lender of last resort is prevalent within the Bank of England.[160] Sir Edward George, former Governor of the Bank of England, wrote that the disclosure of lender of last resort usage should be kept secret until the risk of market volatility passes.[161] To this end, the Bank of England has statutorily mandated the disclosure of the aggregate usage of the Operational Lending Facility only after an appropriate time period has passed.[162] However, this disclosure does not require Discount Window Facility disclosure and does not require disclosure of the names and financial details of individual institutions receiving funds through either facility.[163]

The Dodd-Frank Wall Street Reform and Consumer Protection Act has done the most to increase central bank transparency in the United States' Federal Reserve System.[164] It provides, among other reform measures, that the Federal Reserve will disclose certain details about *all* Discount Window lending with a maximum of a two year lag.[165] However, this increase in central bank transparency may be too great of an increase and could cause harm to financial institutions in the United States.[166]

IV. LENDER OF LAST RESORT AND THE RECENT FINANCIAL CRISIS

The recent global financial crisis has been characterized by some economists as the worst financial crisis since the Great Depression of the 1930s.[167] Federal Reserve Chairman Ben Bernanke said that the "current crisis has been one of the most difficult financial and economic episodes in modern history."[168] While the financial crisis has affected virtually all

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159. Blinder et al., *supra* note 134.

160. Campbell & Lastra, *supra* note 2, at 487.

161. *Id.*

162. *Id.* at 484-85.

163. *Id.*

164. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

165. *Id.*

166. *See infra* Part V.

167. Cambridge Energy Research Assocs. & IHS Global Insight, Press Release, *Three Top Economists Agree 2009 Worst Financial Crisis Since Great Depression; Risks Increase If Right Steps Are Not Taken*, REUTERS, (Feb. 27, 2009, 10:22 AM), http://www.reuters.com/article/pressRelease/idUS193520+27-Feb-2009+BW20090227.

168. Ben S. Bernanke, Chairman, Bd. of Governors of Fed. Reserve Sys., Address at Morehouse College, Atlanta, Georgia: Four Questions About the Financial Crisis (Apr. 14, 2009), *in 2009 Speeches*, BD. GOVERNORS FED. RES. SYS., http://www.federalreserve.gov/newsevents/speech/bernanke20090414a.htm (last updated Apr. 14, 2009).

global economies, most analysts who studied the economic crisis agree that it began with the subprime mortgage crisis in the United States, which began showing its severity in 2007.[169]

A. Events Contributing to the Financial Crisis

The subprime mortgage crisis was a "financial crisis that arose in the mortgage market after a sharp increase in mortgage foreclosures, mainly subprime, collapsed numerous mortgage lenders and hedge funds."[170] A subprime mortgage is a "type of mortgage that is normally made out to borrowers with lower credit ratings."[171] In turn, banks typically charge a higher rate of interest to subprime borrowers in order to compensate for their increased risk of default.[172] In the early twenty-first century, lending to subprime borrowers presented few problems because interest rates were kept very low by the Federal Reserve in an effort to resuscitate the United States economy after both the September 11, 2001, tragedy and the burst of the technology bubble.[173] Interest rates remained low through 2004, hovering around one percent.[174] However, as interest rates jumped from 1% in 2004 to 5.35% in 2006, many subprime borrowers could not afford the higher interest payments and defaulted on their mortgages.[175] Between February and March 2007, twenty-five subprime lenders declared bankruptcy.[176]

The effect of the subprime mortgage defaults went beyond the subprime lenders.[177] Many subprime lenders sold their subprime mortgages to banks and other investors in bundles called Collateralized Debt Obligations (CDOs).[178] Because subprime borrowers were defaulting on

169. *See* MAURO F. GUILLÉN, THE GLOBAL ECONOMIC & FINANCIAL CRISIS: A TIMELINE 1, *available at* http://lauder.wharton.upenn.edu/pdf/Chronology%20Economic%20%20Financial%20Crisis.pdf (last visited Nov. 22, 2010); INT'L MONETARY FUND, WORLD ECONOMIC OUTLOOK: CRISIS AND RECOVERY 2 (Apr. 2009), *available at* http://www.imf.org/external/pubs/ ft/weo/2009/01/pdf/text.pdf; *Timeline: Credit Crunch to Downturn*, BBC NEWS, (Aug. 7, 2009, 9:54 AM), http://news.bbc.co.uk/2/hi/7521250.stm [hereinafter *Credit Crunch to Downturn*]; *Timeline: Global Economy in Crisis*, COUNCIL ON FOREIGN RELATIONS, http://www.cfr.org/ publication/18709/ (last visited Nov. 22, 2010) (click on Meltdown (2007-Present) tab, navigate to February 2007 slide using previous and/or next buttons) [hereinafter *Global Economy in Crisis*].

170. Definition of Subprime Meltdown, INVESTOPEDIA, http://www.investopedia.com/terms/s/subprime-meltdown.asp (last visited Nov. 22, 2010).

171. Definition of Subprime Mortgage, INVESTOPEDIA, http://www.investopedia.com/terms/s/subprime_mortgage.asp (last visited Nov. 22, 2010).

172. *Id.*

173. Definition of Subprime Meltdown, *supra* note 170.

174. *Credit Crunch to Downturn*, *supra* note 169.

175. *Id.*

176. *Global Economy in Crisis*, *supra* note 169.

177. *Credit Crunch to Downturn*, *supra* note 169, at interactive slide 1 of 10.

178. *Id.*

their mortgages, the subprime mortgages that comprised the CDOs stopped receiving payments from borrowers.[179] When payments were not being made by the borrowers, CDO investors also stopped receiving payment.[180] The severity of the crisis became clear in July and August 2007 when investment banks Bear Stearns and BNP Paribas informed investors they would receive little, if any, money from their CDO-backed investment funds.[181]

Additionally, banks are required to keep a minimum amount of capital on hand and will normally loan capital amounts in excess of the minimum to banks in need of capital via the interbank loan market.[182] As worries began to surface about the amount of subprime investments banks held and the potential for losses from such investments, the interbank loan markets in both New York and London began to dry up.[183] For example, in September 2007, the London Interbank Offered Rate (LIBOR) went higher than the penalty rate the Bank of England charged to a bank wishing to use its lender of last resort facility.[184]

The equivalent of LIBOR in the United States is the Federal Funds Rate.[185] Even though the New York-based Federal Open Market Committee sets *targets* for the Federal Funds Rate, the rate, like LIBOR, is ultimately decided by the market.[186] In late 2007, both LIBOR and the Federal Funds Rate were very high, indicating that "banks [were] reluctant to lend money to each other."[187] This reluctance arose because "banks [did] not want to lend out their spare liquidity because there [was] uncertainty - both about whether the bank will need the cash itself in coming months, and about the financial health of the borrowing bank."[188]

One of the most dramatic examples of the liquidity freeze in the interbank loan market was the collapse of Northern Rock Bank.[189] Northern Rock was the United Kingdom's fifth largest mortgage lender in 2006 following a period of rapid expansion.[190] This expansion was largely the result of Northern Rock's decision to abandon the traditional method of

179. *Id.*

180. *Id.*

181. GUILLÉN, *supra* note 169, at 1.

182. Definition of Interbank Rate, INVESTOPEDIA, http://www.investopedia.com/terms/i/interbankrate.asp (last visited Nov. 22, 2010).

183. Campbell & Lastra, *supra* note 2, at 461.

184. *Credit Woes Hit Bank Lending Rate*, BBC NEWS, (Sept. 4, 2007, 12:13 PM), http://news.bbc.co.uk/2/hi/business/6977798.stm.

185. Definition of Federal Funds Rate, INVESTOPEDIA, http://www.investopedia.com/terms/f/federalfundsrate.asp (last visited Nov. 22, 2010).

186. *Id.*

187. *Credit Woes Hit Bank Lending Rate*, *supra* note 184.

188. *Id.*

189. Campbell & Lastra, *supra* note 2, at 473-74.

190. *Id.* at 474.

mortgage funding of using depositors' funds for mortgage lending while keeping enough money in reserve to withstand any withdrawals.[191] Only twenty-five percent of Northern Rock's mortgage funding came from its deposits.[192] Instead, Northern Rock elected to raise money for lending directly from the money markets through the securitization of its loan portfolio.[193] Securitization is the "process through which an issuer creates a financial instrument by combining other financial assets and then marketing different tiers of the repackaged instruments to investors."[194] However, when the credit markets lost their liquidity, Northern Rock encountered major funding issues.[195] On August 10, 2007, Northern Rock realized that it needed three billion dollars in immediate funding; however, the bank was unable to get such funds in the regular interbank markets.[196] Ultimately, the Bank of England decided that it would lend to Northern Rock through a special liquidity support facility.[197]

Despite the Bank of England's efforts to keep news of its lending to Northern Rock secret, the information leaked and caused a bank run,[198] which further chilled the credit markets.[199] "The fact that Northern Rock was receiving financial support sparked public" panic and began a "dramatic" bank run.[200] Live news coverage of the "lengthy lines at some Northern Rock branches" took over all of the United Kingdom's television channels and was shown in the United States as well.[201] What resulted was the biggest run on a British bank in more than a century as customers withdrew money until the government intervened and guaranteed depositors' savings.[202]

Despite the turmoil in 2007, the "global economy bent but did not buckle."[203] However, in early 2008, financial market troubles continued with the decline of United States investment banking firm Bear Stearns.[204] Bear Stearns faced severe liquidity problems in March 2008, a time at which it was Wall Street's fifth-largest investment bank.[205] Bear Stearns was so intertwined in the financial markets that investors feared the collapse

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191. *Id.*
192. *Id.*
193. *Id.*
194. Definition of Securitization, INVESTOPEDIA, http://www.investopedia.com/terms/s/securitization.asp (last visited Nov. 22, 2010).
195. Campbell & Lastra, *supra* note 2, at 475.
196. *Id.*
197. *Liquidity Support*, *supra* note 71.
198. Campbell & Lastra, *supra* note 2, at 476-77.
199. *Id.* at 477.
200. *Id.* at 476.
201. *Id.*
202. GUILLÉN, *supra* note 169, at 2.
203. INT'L MONETARY FUND, *supra* note 169, at 2.
204. *Credit Woes Hit Bank Lending Rate*, *supra* note 184.
205. *Id.*

of Bear Stearns would "spark a collapse of the financial sector."[206] Bear Stearns, whose stock traded for $172 per share in late 2007 and early 2008, was ultimately bought by JPMorgan Chase for $10 per share in a sale backed by the United States government through the Discount Window.[207] "The collapse and sale of one of the most iconic institutions on Wall Street spark[ed] broad fears about the future of the financial sector."[208] Ultimately, the collapse of Bear Sterns was just the first in a series of financial institution failures. For example, in July 2008, Fannie Mae and Freddie Mac, the United States' two largest lenders, were given assistance, but not a bailout, by the United States government over fears that they were no longer liquid.[209]

However, in September 2008, the financial crisis began to show its true severity.[210] "The [financial] situation deteriorated rapidly after the dramatic blowout of the financial crisis in September 2008."[211] The severity of the situation was especially noticeable in the largest economies. "In the advanced economies, fears about growing losses on U.S.-related assets at major European banks caused wholesale markets to freeze in September 2008, with a number of failing banks requiring state intervention."[212] Alan Greenspan, Ben Bernanke's predecessor as Chairman of the Board of Governors of the Federal Reserve System, said the entire situation was "probably a once in a century type of event."[213]

In September 2008, Fannie Mae and Freddie Mac, two institutions that received earlier government assistance, were completely bailed out by the United States government.[214] Additionally, Lehman Brothers, another Wall Street investment bank, filed for Chapter 11 bankruptcy protection in September 2008, becoming the first major United States investment bank to do so.[215] Furthermore, American International Group (AIG), the largest insurer in the United States, received a large bailout from the United States government in September 2008.[216] Finally, federal regulators closed Washington Mutual, a commercial bank, in September 2008 in what was the largest bank failure in United States history.[217]

The financial contagion was not limited to the United States.[218] For

206. *Global Economy in Crisis*, *supra* note 169.
207. *Id.*
208. *Id.*
209. *Credit Crunch to Downturn*, *supra* note 169.
210. INT'L MONETARY FUND, *supra* note 169, at 75.
211. *Id.* at 2.
212. *Id.*
213. *Credit Crunch to Downturn*, *supra* note 169.
214. *Id.*
215. *Id.*
216. *Id.*
217. *Id.*
218. *Id.*

example, in the United Kingdom, Lloyds TSB, a commercial bank, took over HBOS, Britain's then-largest lender.[219] In addition, European insurance and banking giant Fortis was nationalized to ensure that it could continue its operations.[220]

Finally, the large increase in the extension of credit by commercial banks to less than creditworthy individuals and entities also contributed to the financial crisis.[221] "Aspects of this broader credit boom included widespread declines in underwriting standards, breakdowns in lending oversight by investors and rating agencies, increased reliance on complex and opaque credit instruments that proved fragile under stress, and unusually low compensation for risk-taking."[222] "These events prompted a huge increase in perceived counterparty risk as banks faced large write-downs, the solvency of many of the most established financial names came into question, the demand for liquidity jumped to new heights, and market volatility surged once more."[223]

B. Central Bank Response to the Financial Crisis

The financial crisis showed that banks were unwilling to lend, even to other banks, no matter how much of their own money was available.[224] For example, the European Central Bank's deposit facility saw increased usage during the financial crisis as banks "saved up" their liquidity instead of lending to other banks.[225] Therefore, to combat the liquidity freeze, most central banks expanded their traditional lender of last resort roles.[226] Lender of last resort expansion was accomplished by conducting financial operations that were larger than usual or different from their regular schedule.[227] For example, central banks tried to keep markets liquid by ensuring there was adequate overnight funding through their short-term

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219. *Id.*

220. *Id.*

221. Ben S. Bernanke, Chairman, Bd. of Governors of Fed. Reserve Sys., Address at the Stamp Lecture, London School of Economics, London, England: The Crisis and the Policy Response (January 13, 2009), *in Speeches 2009*, BD. OF GOVERNORS FED. RES. SYS., http://www.federalreserve.gov/newsevents/speech/bernanke20090113a.htm (last updated Jan. 13, 2009) [hereinafter Bernanke, *Crisis and Response*].

222. *Id.*

223. INT'L MONETARY FUND, *supra* note 169, at 2.

224. Emese Bartha, *ECB Deposit Facility Use Heavy, Rising*, DOW JONES NEWS WIRES, (Oct. 16, 2008, 7:54 AM), http://www.fxstreet.com/news/forex-news/article.aspx?StoryId=7a610916-a198-4175-9d99-fa9cf7a5977b.

225. *Id.*

226. COMM. ON THE GLOBAL FIN. SYSTEM, BANK FOR INT'L SETTLEMENTS, CGFS PAPERS NO. 31, CENTRAL BANK OPERATIONS IN RESPONSE TO THE FINANCIAL TURMOIL 5 (2008), *available at* http://www.bis.org/publ/cgfs31.pdf [hereinafter CGFS PAPERS NO. 31].

227. *Id.*

lender of last resort facilities.[228]

Specifically, the Federal Reserve undertook significant actions to combat the financial crisis.[229] When the crisis first began, the Federal Reserve cut the discount rate, the rate the Federal Reserve uses to lend to depository institutions at the Discount Window.[230] The Federal Reserve also cut the Federal Funds Rate,[231] which is the "[r]ate charged by a depository institution on an overnight loan of federal funds to another depository institution."[232] Federal Reserve Chairman Ben Bernanke stated that in "historical comparison, this policy response stands out as exceptionally rapid and proactive."[233] The Federal Reserve's actions during the financial crisis were classified as actions to ease United States' monetary policy.[234] By easing the monetary policy, the Federal Reserve made it more attractive, in theory, for borrowers to get money by pushing the interbank interest rate lower.[235]

The Federal Reserve also took steps to restore the credit markets to functionality and provide liquidity to the private sector.[236] In doing so, the Federal Reserve "deployed a number of additional policy tools, some of which were previously in [their] toolkit and some of which ha[d] been created as the need arose."[237] One tool that the Federal Reserve used, like all central banks, was increased communication with the markets about its expectations of market conditions during the financial crisis.[238] In addition to traditional policy tools, the Federal Reserve began using an "extraordinary" set of tools.[239]

> Over the course of the crisis, the [Federal Reserve] has taken a number of extraordinary actions to ensure that financial institutions have adequate access to short-term credit. These actions include creating new facilities for auctioning credit and making primary securities dealers, as well as banks, eligible to borrow at the [Federal Reserve's]

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228. *Id.* at 6.

229. *See* Campbell & Lastra, *supra* note 2, at 490.

230. Bernanke, *Crisis and Response*, *supra* note 221.

231. *Id.*

232. PURPOSES & FUNCTIONS, *supra* note 1, at 114.

233. Bernanke, *Crisis and Response*, *supra* note 221.

234. *Id.*

235. Definition of Loose Credit, INVESTOPEDIA, http://www.investopedia.com/terms/l/loose_credit.asp (last visited Nov. 22, 2010).

236. Bernanke, *Crisis and Response*, *supra* note 221.

237. *Id.*

238. *Id.* *See supra* Part III.B. (discussing the increased use of communication to help ease central bank secrecy); *see also* CGFS PAPERS NO. 31, *supra* note 226, at 22-40 (providing an in-depth analysis of specific actions each central bank took from August 2007-June 2008).

239. Bernanke, *Crisis and Response*, *supra* note 221.

> Discount Window. [The Federal Reserve] lowered the spread between the discount rate and the federal funds rate target . . . ; increased the term of Discount Window loans from overnight to 90 days; created the Term Auction Facility, which auctions credit to depository institutions for terms up to three months; put into place the Term Securities Lending Facility, which allows primary dealers to borrow Treasury securities from the [Federal Reserve] against less-liquid collateral; and initiated the Primary Dealer Credit Facility as a source of liquidity for those firms, among other actions.[240]

In explaining the risk involved with these extraordinary actions, Federal Reserve officials stated that the "the provision of credit to financial institutions exposes the Federal Reserve to only minimal credit risk; the loans that we make to banks and primary dealers through our various facilities are generally overcollateralized and made with recourse to the borrowing firm."[241] An overcollateralized loan is a loan where more collateral than what would normally be necessary is given to the bank in order to fund the loan.[242] A loan made with recourse simply means that the lender, in this case the Federal Reserve, has the right to collect on the collateral.[243] Therefore, the "Federal Reserve has never suffered any losses in the course of its normal lending to banks."[244]

The Federal Reserve also created new lending programs that were designed to serve another classic central bank purpose as "liquidity provider of last resort."[245] These actions included providing liquidity for both the commercial paper and money market mutual funds markets.[246] The Federal Reserve purchased, and thus removed from the market, longer-term securities in exchange for more liquid, shorter-term assets that went to the market in order to help keep money in the financial market flowing.[247] Additionally, the Federal Reserve created various special purpose vehicles called Maiden Lane I, II, and III.[248] These Maiden Lane transactions created limited liability companies that the Federal Reserve used to

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240. *Id.*

241. *Id.*

242. Definition of Overcollateralization – OC, INVESTOPEDIA, http://www.investopedia.com/terms/o/overcollateralization.asp (last visited Nov. 22, 2010).

243. Definition of Recourse, INVESTOPEDIA, http://www.investopedia.com/terms/r/recourse.asp (last visited Nov. 22, 2010).

244. Bernanke, *Crisis and Response*, *supra* note 221.

245. *Id.*

246. *Id.*

247. *Id.*

248. *Maiden Lane Transactions*, FED. RES. BANK OF N.Y., http://www.newyorkfed.org/markets/maidenlane.html (last visited Nov. 22 2010).

facilitate the buyout of Bear Stearns and the bailout of AIG.[249] No matter which new lending program was used, the Federal Reserve ended up lending or purchasing securities.[250]

While the sheer volume of the Federal Reserve's actions made them unusual, if not extraordinary, the fact that the Federal Reserve began lending to non-depository institutions was perhaps even more extraordinary.[251] Until early 2008, the Federal Reserve was restricted to lending to depository institutions.[252] In order to give assistance to non-depository institutions, the Federal Reserve invoked Section 13.3 of the Federal Reserve Act.[253] Section 13.3 provides the following:

> In unusual and exigent circumstances, the Board of Governors of the Federal Reserve System . . . may authorize any Federal reserve bank, during such periods as the said board may determine, at rates established in accordance with the provisions of section 357 of this title, to discount for any individual, partnership, or corporation, notes, drafts, and bills of exchange when such notes, drafts, and bills of exchange are indorsed or otherwise secured to the satisfaction of the Federal reserve bank: *Provided,* That before discounting any such note, draft, or bill of exchange for an individual or a partnership or corporation the Federal reserve bank shall obtain evidence that such individual, partnership, or corporation is unable to secure adequate credit accommodations from other banking institutions. All such discounts for individuals, partnerships, or corporations shall be subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe.[254]

The financial crisis was the "first time since the 1930s that the [Federal Reserve] used this provision."[255] Section 13.3 of the Federal Reserve Act enabled the Federal Reserve to undertake extraordinary and unusual central bank actions such as bailing out AIG, Bear Stearns, and others.[256]

The Bank of England also took many steps to ensure liquidity and to act as a lender of last resort.[257] One of the first steps it took was lending

249. *Id.*
250. Bernanke, *Crisis and Response*, *supra* note 221.
251. Campbell & Lastra, *supra* note 2, at 491.
252. *Id.* at 492.
253. *Id. See also* Federal Reserve Act, 12 U.S.C. § 343 (2010).
254. 12 U.S.C. § 343 (2010).
255. Campbell & Lastra, *supra* note 2, at 492.
256. *Id.* at 492-94.
257. *Id.*

emergency liquidity assistance funds to Northern Rock.[258] While this eventually helped end the bank run on Northern Rock,[259] it likely led to the stigmatization of the Bank of England's lender of last resort facilities, which in turn led to the creation of the Sterling Monetary Framework in October 2008.[260] The Bank of England took other steps to help ease the financial crisis, including lowering interest rates, allowing banks to swap risky mortgages for safer government bonds, and injecting money into the markets.[261]

The European Central Bank also took steps to ensure that its marginal lending facility was widely available for use in order to help facilitate the flow of liquidity.[262] Such actions included changing the interest rate of its overnight loans and fine-tuning overnight loan operations in order to ease money flow, refinancing longer-term loans, performing various reserve management operations, and participating with foreign central banks in coordinated liquidity-easing ventures.[263]

C. Current State of Reform and Increased Transparency

Opposition to increased activity by the United States' Federal Reserve was used to push for proposals to limit the power of the Federal Reserve.[264] One such proposal, which was never passed, was the Federal Reserve Transparency Act of 2009.[265] Other pushes for global financial reform came at worldwide conferences, such as the 2009 G-20 summit in Pittsburgh, Pennsylvania and the 2010 World Economic Forum in Davos, Switzerland.[266]

In the United States, the passage of the Dodd-Frank Wall Street

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258. *Id.* at 476-77.

259. *Id.* at 477.

260. *Id.* at 484.

261. *Credit Crunch to Downturn*, *supra* note 169.

262. *See* CGFS PAPERS NO. 31, *supra* note 226, at 22-40 (providing an in-depth analysis of specific actions each central bank took from August 2007 to June 2008).

263. *Id.*

264. Sudeep Reddy, *Bernanke Foes Seek to Curtail Fed*, WALL ST. J., Dec. 16, 2009, at A4, *available at* http://online.wsj.com/article/SB126091294891892399.html?mod=WSJ_hpp_MIDDLENexttoWhatsNewsTop#articleTabs%3Darticle.

265. Federal Reserve Transparency Act of 2009, H.R. 1207, 111th Cong. (2009).

266. *See* Bob Davis & Stephen Fidler, *Nations Ready Big Changes to Global Economic Policy*, WALL ST. J., Sept. 22, 2009, at A1, *available at* http://online.wsj.com/article/SB125348959155226421.html (stating that financial sector overhaul was a key issue at the 2009 Group of Twenty (G-20) meeting in Pittsburgh, Pennsylvania); Marcus Walker & Emma Moody, *At Davos, Bankers Are on the Run*, WALL ST. J., Jan. 29, 2010, *available at* http://online.wsj.com/article/SB10001424052748704343104575033373335750804.html (stating that financial reform was broadly discussed at the early 2010 World Economic Forum).

Reform and Consumer Protection Act initiated financial sector reform.[267] As previously stated, the Act, with regard to Discount Window lending disclosure, requires the Federal Reserve to disclose the "name and identifying details of the depository institution; [t]he amount borrowed by the depository institution; [t]he interest rate paid by the depository institution; and [i]nformation identifying the types and amounts of collateral pledged in connection with any [D]iscount [W]indow loan."[268] This mandatory disclosure must occur within two years of the initial Discount Window lending date for the primary, secondary, and seasonal lending programs.[269] Early disclosure is permissible if certain criteria are met.[270]

In addition, a United States District Court ordered the Federal Reserve to disclose records related to the use of various government lending facilities, including its lender of last resort facility.[271] This case, *Bloomberg L.P. v. Bd. of Governors of Fed. Reserve Sys.*, arose from a Freedom of Information Act request by Bloomberg.[272] Bloomberg "sought (in relevant part) detail[s] about loans that the twelve Federal Reserve Banks made to private banks in April and May 2008 at the Discount Window and pursuant to ad hoc emergency lending programs."[273] The details Bloomberg specifically wanted, "loan by loan, [were] the name of the borrowing bank, the amount of the loan, the origination and maturity dates, and the collateral given."[274] The document request was filed under the Freedom of Information Act, which "obliges federal agencies to make government documents available to the public, subject to various exemptions."[275]

The Federal Reserve fought against disclosure of such information.[276] "Lawyers for the Federal Reserve Board argued . . . that the [Federal Reserve] wasn't required to make public information about individual banks borrowing from its Discount Window and other last-resort lending programs."[277] Specifically, the Federal Reserve's lawyers argued that

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267. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

268. *Frequently Asked Questions - Discount Window Lending Programs*, *supra* note 18. *See also* Dodd-Frank Wall Street Reform and Consumer Protection Act, 124 Stat. 1376.

269. *Frequently Asked Questions- Discount Window Lending Programs*, *supra* note 18.

270. *Id.*

271. Bloomberg L.P. v. Bd. of Governors of Fed. Reserve Sys., 649 F.Supp.2d 262 (S.D.N.Y. 2009), *aff'd*, 601 F.3d 143 (2d Cir. 2010), *petition for cert. filed*, 79 U.S.L.W. 3271 (U.S. Oct. 26, 2010) (No. 10-543).

272. *Bloomberg*, 601 F.3d at 145.

273. *Id.* (parenthesis in original).

274. *Id.* at 145-46.

275. Jonathan Stempel, *Federal Reserve Loses Suit Demanding Transparency*, REUTERS, (Aug. 24, 2009, 8:39 PM), http://www.reuters.com/article/businessNews/idUSTRE57O03P20090825.

276. Chad Bray, *Fed Resists Identifying Loan Users*, WALL ST. J., Jan. 12, 2010, *available at* http://online.wsj.com/article/SB126325700903725517.html.

277. *Id.*

"banks would be less likely to use the Discount Window, which provides short-term loans to banks, or other last-resort lending programs if they knew their usage would be made public. Accessing the window carries a negative connotation, even when a healthy bank suffering a short-term liquidity issue does it."[278] However, because this case dealt with a Freedom of Information Act request, the district court found that Federal Reserve board had not shown that competitive harm was imminent by disclosing such records and ordered such records disclosed.[279]

The Second Circuit's decision to affirm the district court's opinion in *Bloomberg* drew sharp criticism from economists, with one stating that the "Federal Reserve might be facing the irrelevancy of one of its key emergency lending tools."[280] Even though the Court based its decision on the statutory mandate of the Freedom of Information Act,[281] "many economists agree with the [Federal Reserve's] view" that "the Discount Window would simply go untapped" if disclosure of its users was required.[282]

V. RECOMMENDATIONS

The proliferation of central bank activity, particularly in the Federal Reserve's expanded scope of operations under Section 13.3, has not been without criticism. This criticism has been shown through opposition to Ben Bernanke's eventual reconfirmation as Chairman of the Board of Governors of the Federal Reserve.[283] In addition, some observers opined that "[i]f we are going to have a [Federal Reserve] and a political class as reckless as we have, then we need a more comprehensive answer to financial risk."[284] Similarly, former United States President George W. Bush warned that increased government intervention, such as increased Federal Reserve actions in financial markets, will lead the economy away from free-market principles.[285]

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278. *Id.*

279. Bloomberg L.P v. Bd. of Governors of Fed. Reserve Sys., 649 F.Supp.2d 262, 280 (S.D.N.Y. 2009), *aff'd*, 601 F.3d 143 (2d Cir. 2010), *petition for cert. filed*, 79 U.S.L.W. 3271 (U.S. Oct. 26, 2010) (No. 10-543).

280. Michael S. Derby, *Discount-Window Future Darkens After Court Move*, WALL ST. J. REAL TIME ECON. BLOG (Mar. 19, 2010, 3:45 PM), http://blogs.wsj.com/economics/2010/03/19/discount-window-future-darkens-after-court-move/.

281. *Bloomberg*, 601 F.3d at 151.

282. Derby, *supra* note 280.

283. Op-Ed., *The Bernanke Record*, WALL ST. J., Dec. 4, 2009, at 10, *available at* http://online.wsj.com/article/SB10001424052748704107104574572160340353006.html.

284. Op-Ed., *Obama v. Wall Street*, WALL ST. J., Jan. 22, 2010, at A18, *available at* http://online.wsj.com/article/SB10001424052748703699204575017341468635052.html.

285. *Bush Warns of 'Temptation' to Abandon Free-Market System in Wake of Recession*, FOXNEWS.COM, (Nov. 13, 2009), http://www.foxnews.com/politics/2009/11/12/bush-warns-temptation-abandon-free-market-wake-recession/?test=economy.

However, Federal Reserve Chairman Ben Bernanke has vigorously defended the Federal Reserve against such criticism:

> In its making of monetary policy, the [Federal Reserve] is highly transparent, providing detailed minutes of policy meetings and regular testimony before Congress, among other information. Our financial statements are public and audited by an outside accounting firm; we publish our balance sheet weekly; and we provide monthly reports with extensive information on all the temporary lending facilities developed during the crisis. Congress, through the Government Accountability Office, can and does audit all parts of our operations except for the monetary policy deliberations and actions covered by the 1978 exemption. The general repeal of that exemption would serve only to increase the perceived influence of Congress on monetary policy decisions, which would undermine the confidence the public and the markets have in the [Federal Reserve] to act in the long-term economic interest of the nation.[286]

At first glance, the Federal Reserve appears to be in a contradictory position. The Federal Reserve believes transparency is a vital part of the modern economy.[287] However, the Federal Reserve advocates for secrecy when it feels that it is in the best interest of the market to do so.[288] Central bank transparency, in general, has helped the financial markets become more efficient by helping market participants make more informed decisions.[289] However, as the Northern Rock disclosure shows, there is the possibility that the market can receive too much information, or at least too much information at an improper time, causing market panic.[290]

According to the Bank of International Settlements, a "standing lending facility is a widely adopted central bank instrument for providing liquidity insurance against frictional problems in payment systems and overnight money markets. However, in the United States . . . the effectiveness of this instrument has been limited by banks' unwillingness to use it." [291] The Bank of International Settlements stated that this unwillingness to use the lender of last resort facility is because of the stigma

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286. Ben Bernanke, Op-Ed., *The Right Reform for the Fed*, WASH. POST, Nov. 29, 2009, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2009/11/27/AR2009112702322.html.

287. *Id.*

288. *See id.*

289. *See supra* Part III.B. (discussing increased central bank transparency).

290. *See supra* Part IV.A. (discussing how an accidental disclosure created a bank run and slowed liquidity in credit markets).

291. CGFS PAPERS NO. 31, *supra* note 226, at 20.

associated with using the lender of last resort facility.[292] "While stigma is most often associated with lending related to emergency liquidity assistance, it can also affect lending for more benign purposes . . . particularly when financial turmoil [generally] raises doubts about the soundness of financial institutions."[293]

Currently, the Federal Reserve's lending occurs through the Discount Window.[294] Therefore, a bank going to the Federal Reserve for overnight funds, or primary credit, receives money from the same facility as a bank needing serious financial assistance, or secondary credit.[295] Without knowing the details of each transaction, there is no way for an outside observer to know which type of credit a bank is receiving. The identification of all Discount Window borrowers, as currently required by the Dodd-Frank Wall Street Reform and Consumer Protection Act,[296] would likely create unwillingness by financial institutions needing primary credit to use the Federal Reserve's Discount Window since it is used for both primary and secondary credit lending.[297]

In order to increase the usage of the Federal Reserve's Discount Window and conform to the Dodd-Frank Wall Street Reform and Consumer Protection Act, the structure of the Discount Window should be altered so that there are two separate lending programs which are similar to the Bank of England's Operational Standing Facility and Discount Window Facility.[298] One of the two proposed lending programs would involve the use of the Federal Reserve as a backstop to the interbank lending market.[299] The Bank of England's Operational Standing Facility provides a model as a backstop to the interbank lending market because its main purpose is to help banks in times of unexpected payment shock.[300] This would be a benign or safe lending program since it would involve banks with a financially sound balance sheet. This lending program would ensure that commercial banks have immediate access to liquidity, even when there was "unexpected friction" in the market.[301]

In order to keep stigma away from this program, disclosure of financial institutions using the benign program would not be allowed. Non-

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292. *Id.*

293. *Id.*

294. *See supra* Part II.B.

295. *Id.*

296. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

297. Bray, *supra* note 276.

298. *See supra* Part II.C. (detailing the Bank of England's current lender of last resort structure).

299. *See supra* Part II.C. (discussing the Bank of England's current lender of last resort facilities).

300. *See supra* Part II.C.

301. *Operational Standing Facilities*, *supra* note 103.

disclosure for overnight lending should increase the willingness of financial institutions to use this new facility and thus, reduce any possibility for stigma to exist.[302] Instead of full disclosure, as currently mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Federal Reserve should only report aggregate statistics of usage, interest income generated, and losses. Disclosure of the names or financial details of users of this program should never be disclosed. Since institutions using this facility would be financially sound, there should be no worry from taxpayers or government officials that funds were being used unwisely. "If anonymity is not well preserved . . . then there is a greater risk that borrowing from standing facilities would be regarded as a sign of borrower weakness. When this occurs, the effectiveness of these facilities as a liquidity backstop is severely impaired."[303]

The second lending program, much like the Bank of England's Discount Window Facility, would be established to help banks acquire liquidity, but not capital, if they were in dire financial straits.[304] Due to the increased risk of this secondary lending program, the Federal Reserve should require prospective borrowers to post more collateral than necessary in order to protect the taxpayers from unnecessary loss. Additionally, like the Discount Window Facility, this program should require loan terms of 30 or 364 days in order to ensure that these riskier institutions do not rush loan repayment and end up with the same sort of risk that forced the institution to initially seek government assistance. Since these transactions are likely to be smaller in number but greater in scope than the transactions of the benign program, secrecy should be maintained, but only for as long as necessary. Disclosure should occur after the Federal Reserve determines that the market and the institution receiving funds could adequately handle disclosure without subsequent panic, or after two years, whichever occurs first.[305] This disclosure requirement falls in line with the current requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[306]

In times of financial crisis, this long-term lending program for risky institutions could be used in combination with Section 13.3 of the Federal Reserve Act to create innovative financial solutions to combat any future crises. The creative aspect of Section 13.3 was used in the current financial crisis with great success:

> Mr. Bernanke's [Federal Reserve] found new ways to pump

302. CGFS PAPERS No. 31, *supra* note 226, at 20.

303. *Id.*

304. *See supra* Part II.C. (discussing the Bank of England's Discount Window Facility).

305. *See supra* Part II.C.

306. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

> liquidity into the credit markets that were on the verge of a total freeze-up. This could only have happened because of the [Federal Reserve's] independence, experience in and understanding of the financial world, and its wide-ranging authority. No one could respond better than the [Federal Reserve] if the next crisis is anywhere near as severe as the last one.[307]

Therefore, this long-term lending program, in conjunction with the broad power of Section 13.3, would help the Federal Reserve act in an aggressive manner to control any subsequent financial crisis. For example, the Maiden Lane special purpose vehicles would receive their funding through the secondary lending program.

Provided that central banks make smart loans, even in a lender of last resort situation, increased central bank lending and activity in the market can be beneficial both to the market and to the central bank. The Federal Reserve saw "record profits in 2009 as its holdings of Treasury [bonds], mortgage-backed securities[,] and agency debt grew."[308] In 2009, profits at the Federal Reserve increased forty-seven percent from 2008.[309] "The windfall came as the [Federal Reserve's] balance sheet ballooned to more than $2.2 trillion and the [Federal Reserve] acquired billions of dollars in securities through unusual asset-purchase programs aimed at spurring economic growth."[310] Finally, "[o]f the 2009 earnings, $46.1 billion was generated through open-market operations and $5.5 billion was generated by [the Maiden Lane vehicles] it created as part of the Bear Stearns, AIG and other rescue operations."[311] If the Federal Reserve continues to make such loans to stressed corporations, it could end up making money that can be deposited in the United States Treasury, and as a result, save taxpayer money.

The Bank of England's lender of last resort facilities provide a real-life model for the Federal Reserve, and other similarly situated central banks, to follow in order to protect both taxpayers, through increased disclosure, and lender of last resort users, through non-disclosure of safe lending programs. In addition, the Bank of England's Sterling Monetary Framework proves that stigma can be eliminated in lender of last resort

307. Mortimer Zuckerman, Op-Ed., *Finding the Right Fix for 'Too Big to Fail'*, WALL ST. J., Nov. 25, 2009, *available at* http://online.wsj.com/article/SB10001424052748704888404574550570805868530.html.

308. Meena Thiruvengadam, *Fed Profits Set Record Last Year*, WALL ST. J., Jan. 14, 2010, at A7, *available at* http://online.wsj.com/article/SB126333721463026795.html?mod=WSJ_WSJ_US_News_5.

309. *Id.*

310. *Id.*

311. *Id.*

facilities.[312] In November 2009, the Bank of England disclosed emergency liquidity assistance it provided to Royal Bank of Scotland (RBS) and HBOS, two United Kingdom banks.[313] While there has been some backlash and controversy surrounding the terms of the assistance given to the banks, there was not any apparent negative connotation associated with the banks for receiving the liquidity assistance or a run on either bank.[314] The lack of market reaction to this disclosure proves that the Bank of England's model has eliminated some stigma associated with the use a central bank's lender of last resort facilities. Therefore, the United States' Federal Reserve should follow the same model.

CONCLUSION

When used properly, secrecy can be beneficial for a central bank in its lender of last resort operations. Individual institutions that experience financial friction value secrecy more than institutions that experience financial turmoil.[315] In this context, secrecy enables a central bank to ensure that financially sound banking institutions will not encounter unnecessary stress or negative publicity for using a central bank's lender of last resort facility.[316] This lack of negative publicity, in turn, keeps liquidity flowing through the interbank loan market, which is an important aspect to stability in the financial markets as a whole.[317]

A central bank should be able to provide long-term support as needed to banks, and at appropriate times, non-banks.[318] Such lending, however, is risky and akin to the Federal Reserve's secondary credit program or the Bank of England's Discount Window Facility.[319] Therefore, in order to help paint a more accurate picture of a central bank's balance sheet and risks, a central bank should disclose the names of risky firms to which it gives liquidity assistance only after a reasonable amount of time has passed, such as the timeframe required by the Dodd-Frank Wall Street Reform and

312. BANK OF ENG., ADDITIONAL INFORMATION PROVIDED TO THE TREASURY COMMITTEE BY THE BANK OF ENGLAND 1 (Nov. 24, 2009), *available at* http://www.bankofengland.co.uk/publications/other/treasurycommittee/financialstability/ela091124.pdf.

313. *Id.*

314. Louise Armitstead, *PAC Slams Treasury Over Bank Rescues During Financial Crisis*, TELEGRAPH, Feb. 9, 2010, *available at* http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/7191148/PAC-slams-Treasury-over-bank-rescues-during-financial-crisis.html.

315. Bray, *supra* note 276.

316. *Id.*

317. *See supra* Part IV.A. (discussing events leading to the recent financial crisis including the freezing of liquidity in the interbank loan market).

318. *See supra* Part IV.B. (discussing central bank activities during the recent financial crisis including extending loans to various insurance companies).

319. *See supra* Part II.B-C. (discussing the Federal Reserve's and Bank of England's lender of last resort facilities).

Consumer Protection Act.[320] Using the Dodd-Frank standard enables a central bank to balance the needs of secrecy in the financial markets with the need for transparency and openness of central bank operations.[321] The Bank of England's current lender of last resort facilities provide an example for the Federal Reserve and other similarly situated central banks to follow.

Therefore, the Federal Reserve should follow the Bank of England's lender of last resort model and create two lender of last resort facilities: one for relatively safe overnight loans and one for institutions in need of long-term assistance. Additionally, the new overnight program should deviate from the current disclosure requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Disclosure should not occur for the overnight facility but should occur for the long-term facility after the risk of market panic has passed. Having two lender of last resort programs would help strike a balance between transparency and secrecy and help eliminate the stigma associated with the Federal Reserve's lender of last resort operations.

The creation of two lender of last resort programs with different disclosure requirements fits within Federal Reserve Chairman Ben Bernanke's desire to "ensure that any disclosure of emergency borrowing, via the Discount Window or through another program, isn't interpreted to reflect poorly on the current state of the bank that drew the credit."[322] A long-term lender of last resort facility with mandatory disclosure provides financial market participants and taxpayers with an accurate assessment of the risky financial institutions using such government facilities. Perhaps more importantly, the elimination of stigma through the non-disclosure of financial institutions using a newly-created overnight lender of last resort facility should keep liquidity flowing in the credit markets and prevent a financial crisis similar to the recent, and crippling, financial crisis.

320. *See supra* Part III.B. (discussing the benefits of increased central bank transparency); *see also* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

321. *See supra* Part II.B.

322. Derby, *supra* note 280.