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PLEASE BE DELICATE WITH MY PERMANENT RECORD: THE PENDULUM INCHES TOWARDS ABSOLUTE PRIVILEGE IN MERKAM v. WACHOVIA

JOSEPH W. CATUZZI*

I. INTRODUCTION

“[I]t will go on your permanent record . . .[!]”1 For elementary school students the notion of an eternal “permanent record” is quite believable.2 Fortunately for unruly children, permanent records do not actually exist.3 At least not until they decide to work in the securities industry.4

Employers in the securities industry are required to state the reasons why an employee was fired in a Uniform Termination Notice for Securities Industry Registration (Form U-5).5 After completing an employee’s Form U-5, an employer files and stores it in the Financial Industry Regulatory

* J.D. Candidate, 2014, Villanova University School of Law. I would like to thank my colleagues on the Villanova Law Review for their diligent work and helpful comments. I would also like to thank my family, especially Bill and Deirdre Catuzzi, for their unwavering support, and my friends for their constant encouragement and advice.


2. See id. (providing examples of teachers’ use of permanent records to ensure students behave in school).


4. For a discussion of how Form U-5s operate as permanent records in the securities industry, see infra notes 5-7 and accompanying text.

5. See FINRA, FORM U5: UNIFORM TERMINATION NOTICE FOR SECURITIES INDUSTRY REGISTRATION 4 (2009), available at http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015113.pdf (describing requirements for employers after terminating registered professional). Employers must explain why an employee was fired if he or she was “permitted to resign,” “discharged,” or let go for other involuntary reasons. See id. (requiring employers to provide explanation if termination was involuntary).
Authority’s (FINRA’s) Central Registration Depository (CRD) where it is made accessible to all FINRA member firms.6 As if having a “permanent record” available for future bosses to see is not bad enough, FINRA requires employers to review each candidate’s Form U-5 as part of their hiring process.7 Not surprisingly, employees’ reputations are likely to suffer greatly from any negative statements in their Form U-5s.8

Although a major purpose of the Form U-5 is to alert regulators and other employers to unscrupulous broker-dealers, the potential for abuse is great.9 Form U-5s have been used as a weapon to punish and even blackmail ex-employees who might leave the firm and take clients with them.10


7. See Regulatory Notice 07-55, FINRA 1–4 (2007), available at www.finra.org/web/groups/industry/@ip/@reg/notice/documents/notices/p037480.pdf (re-minding firms of obligation to investigate business reputation of applicants as part of hiring process). The notice explained that checking the backgrounds of prospective employees ultimately protects customers because the searches will show if the candidate has a history of regulatory violations. See id. (discussing importance of background search); see also Richard G. Ketchum, About the Financial Industry Regulatory Authority, FINRA, http://www.finra.org/AboutFINRA/ (last visited Oct. 16, 2012) (stating that FINRA oversees about 4,345 firms including 163,410 branch offices).

8. See Baravati v. Josephthal, Lyon & Ross, Inc., 28 F.3d 704, 708 (7th Cir. 1994) (noting negative statements in Form U-5s can bar professionals from industry); cf. Dawson v. N.Y. Life Ins. Co., 135 F.3d 1158, 1164 (7th Cir. 1998) (“Any embellishment or exaggeration can only damage the agent’s professional reputation and make the job hunt more difficult.”); Glennon v. Dean Witter Reynolds, Inc., 83 F.3d 132, 138 (6th Cir. 1996) (observing difficulties experienced by professionals after being defamed in Form U-5s); Rosenberg v. MetLife, Inc., 866 N.E.2d 439, 446 (N.Y. 2007) (Pigott, J., dissenting) (“When a defamatory statement is made on such a Form, there is the danger of substantial harm to the individual about whom the statement is made.”); see also Jeffrey L. Liddle & Ethan A. Brecher, Form U-5 Defamation Claims: The End of the Line? Not So Fast, in SECURITIES ARBITRATION 2007 673, 690 (2007) (“A defamatory Form U-5 can ruin an individual’s career in the financial services industry.”); Vivek G. Bhatt, The Amended Form U-5: Two Proposals for Solving the Privilege Dilemma, 21 WHITTIER L. REV. 963, 964 (2000) (explaining how negative statements in Form U-5s can serve as scarlet letters in individual’s reputation and inhibit job searches).


10. See Eaton Vance Distrib., Inc. v. Ulrich, 692 So. 2d 915, 916-17 (Fla. Dist. Ct. App. 1997) (noting departing employee’s Form U-5 was allegedly used as baiting tool to obtain preferential settlement). In Eaton, the plaintiff claimed that
In one instance, an employee was fired after allegedly being told to ignore or participate in regulatory fraud. 11 Ironically, the employee’s Form U-5 explained that he was terminated for “failure to perform duties . . . .” 12 In a defamation suit, the employee was awarded $40,535 in compensatory damages and $100,000 in punitive damages. 13 However, if this outrageous conduct occurred in New York today, the employer would be completely immune from civil liability. 14

his employer told him that the wording in his Form U-5 would be modified if he accepted a certain severance package offer. See id. (discussing plaintiff’s claim); cf. Culver v. Merrill Lynch & Co., No. 94 Civ. 8124, 1995 WL 422203, at *1 (S.D.N.Y. July 17, 1995) (describing plaintiff’s claim that his ex-employer intentionally reported false statements in his Form U-5). In Culver, the plaintiff alleged that his employer used the Form U-5 to retaliate against him for reporting unethical activities to regulators. See Culver, 1995 WL 422203, at *1 (discussing plaintiff’s claim). However, the court held that regardless of the employer’s motive, statements made in Form U-5s are subject to absolute privilege making the employer immune from civil liability. See id. at *5 (stating Form U-5s are absolutely privileged); see also Scott Krady, You Have Recourse if Ex-Employer Defames You on U-5 Termination Form, EFINANCIAL CAREERS (Mar. 31, 2010), http://news.efinancialcareers.com/2603/you-have-recourse-if-ex-employer-defames-you-on-u-5-termination-form/ (listing situations where employees were defamed by former employers in Form U-5s and received large awards); Wright, supra note 6, at 1302 (“Indeed, it is widely acknowledged that false Form U-5 reporting has sometimes been used to retaliate against departing employees or threatened to gain concessions from such employees.” (footnote omitted)).

11. See Acciardo v. Millennium Sec. Corp., 83 F. Supp. 2d 413, 415 (S.D.N.Y. 2000) (discussing plaintiff’s defamation claim). The district court determined whether the arbitration panel acted with a manifest disregard for the law and awarded the plaintiff with punitive damages for his defamation claim. See id. (providing background information of case); see also Petitioner-Respondent’s Memorandum of Law in Support of Motion to Confirm Arbitration Award and in Opposition to Respondents-Cross-Petitioners’ Cross-Motion to Vacate Award, Acciardo v. Millennium Sec. Corp., 83 F. Supp. 2d 413 (S.D.N.Y. 2000) (No. 99 Civ. 3371), 1999 WL 33885589 (describing regulatory frauds taking place at firm). The plaintiff claimed that his ex-employer was intentionally failing to inform regulators of over forty-two customer complaints. See Petitioner-Respondent’s Memorandum, supra (describing employer’s misconduct). According to the plaintiff, he was fired after refusing to sign a legal document that stated the company had no customer arbitration claims, regulatory proceedings, and subordinate debt. See id. (noting plaintiff’s refusal facilitated fraud). The plaintiff’s replacement also testified that the defendant threatened to make unfavorable statements in her Form U-5 if she said anything negative about the firm. See id. (detailing replacement’s experience with defendant).


13. Id. at 416 (explaining arbitration award); see also Petitioner-Respondent’s Memorandum, supra note 11 (recounting reasoning for punitive award). The arbitration panel’s decision to award punitive damages was based on findings of malice. See Petitioner-Respondent’s Memorandum, supra note 11 (“The Panel apparently found that Millennium played the ‘U-5 game’ and intentionally sought to harm Acciardo as it had done with various other departing employees whose Form U-5s were admitted into evidence and who testified at the hearing.”).

14. For a discussion of the absolute privilege standard in New York, see infra note 17 and accompanying text. If this case were decided seven years later the employer would be completely immune from civil liability. See generally Acciardo, 83 F. Supp. 2d 413.
The issue of how much protection employers should receive for statements made in Form U-5s remains controversial and unsettled. A majority of courts have held that employers should receive qualified privilege, or protection that can be lost if the employer acts with malice or a reckless disregard for the truth. However, a call for absolute immunity has emerged. Weighing in on the dispute, a former commissioner of the Securities Exchange Commission (SEC) reasoned that the SEC should consider establishing a uniform qualified-privilege rule if “the pendulum begins to swing in favor of absolute immunity” because of the inequitable results which can occur when employees are maliciously defamed.

In the absence of any uniform rule, jurisdictions without laws requiring qualified privilege are likely to hear arguments favoring absolute privilege.
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lege.\textsuperscript{19} Pennsylvania, a state that is home to one of the largest populations of securities industry professionals, does not have a uniform standard regarding the degree of protection employers should receive.\textsuperscript{20} As a result, Pennsylvanian employees have obtained large defamation awards against former employers who inaccurately or maliciously filed their Form U-5s.\textsuperscript{21} 

Yet, according to the court in \textit{Merkam v. Wachovia Corp.},\textsuperscript{22} securities professionals in the Keystone state should not be able to sue employers for defamation \textit{under any circumstances}.\textsuperscript{23} The court explained that absolute immunity best promotes the candid flow of information from firms to regulators and, in effect, provides the best protection to investors.\textsuperscript{24} The court, however, refrained from addressing the clear potential for abuse or the significant damage employees might experience if employers draft Form U-5s with malicious or reckless intent.\textsuperscript{25} 

The \textit{Merkam} case is evidence that the call for absolute privilege has reached the trial court level and illustrates a likely trend in Form U-5 defamation litigation.\textsuperscript{26} Hence, if the pendulum continues to swing towards absolute privilege, the SEC should take action to protect employees’ repu-


\textsuperscript{21} See SAC Survey of SRO Defamation Awards, 8 SEC. ARB. COMMENTATOR, No. 8, 2007, at 5, 7–8, available at http://www.sacarbitration.com/pdf/Defamation%201989-1994.pdf (analyzing defamation awards from Form U-5 arbitration panels). The study demonstrates that Pennsylvania is traditionally among the top five states in terms of the number of Form U-5 defamation disputes and the size of awards. \textit{See id.} (comparing size of defamation awards in Pennsylvania to other states).


\textsuperscript{23} \textit{See id.} at *19 (concluding statements made in Form U-5s should be absolutely privileged).

\textsuperscript{24} \textit{See id.} at *18 (explaining absolute privilege promotes flow of information from employers to regulators).

\textsuperscript{25} For a discussion of the court’s reasoning, see \textit{infra} notes 115–44 and accompanying text.

\textsuperscript{26} See John P. Clarke & Mary Noe, \textit{Legal Actions for Defamation by Terminated Employees in the Financial Services Industry: Can a Required Filing Have an Unfair Effect on Some Terminated Employees}, 23 BANK ACCT. & FIN., Dec. 1, 2009, at 41 available at 2009 WLNR 26393944 (“[I]t is more likely that the absolute privilege rule will ultimately be the prevailing rule in the industry.”).
If absolute privilege becomes the law in Pennsylvania, securities professionals will be at the mercy of their employers, not regulators. This Note argues that the Merkam court reached the correct outcome, but that the court should not have extended absolute privilege to the Form U-5. Part II describes the regulatory role of the Form U-5, discusses the arguments for qualified and absolute privilege, and provides a brief history of absolute privilege in Pennsylvania. Part III provides an overview of the facts and the court’s reasoning in Merkam. Part IV argues that the Form U-5 reporting system should not be absolutely privileged because it is not part of a quasi-judicial process, and it does not definitively protect the general investing public. Finally, Part V concludes by explaining the significance of Merkam.

II. BACKGROUND

Generally, employers refrain from giving negative letters of recommendation regarding ex-employees to avoid defending costly defamation suits. Much to the distaste of cautious employers, regulators require them to provide “employee references” by completing a Form U-5. Thus, it should come as no surprise that the compulsory nature of Form U-5 reporting has sparked substantial debate over whether employers should be given qualified or absolute immunity. Reviewing the arguments for both types of immunity, as well as the conservative history of

27. See Hunt, supra note 9, at 5–6 (addressing importance of protecting vulnerable employees). Hunt explained that “regulators should proceed cautiously before establishing a system that would insulate intentional retaliatory conduct from review.” Id. at 5

28. See Baravati v. Josephthal, Lyon & Ross, Inc., 28 F.3d 704, 708 (7th Cir. 1994) (concluding that allowing employers to be absolutely immune from civil liability would allow employers to “blackball” former employees from the industry).

29. For a discussion of why the court in Merkam should not have extended absolute privilege to the Form U-5, see infra notes 164–73 and accompanying text.

30. For a further discussion of the regulatory role of Form U-5s in the securities industry, see infra notes 34–54 and accompanying text. For a discussion of the arguments for absolute privilege and qualified privilege, see infra notes 55–98 and accompanying text. For a discussion of the history of absolute privilege in Pennsylvania, see infra notes 99–114 and accompanying text.

31. For a further discussion of the facts and reasoning of the court in Merkam, see infra notes 115–44 and accompanying text.

32. For a critical analysis of the Merkam decision, see infra notes 164–73 and accompanying text.

33. For a further discussion of the impact of Merkam, see infra notes 184–86 and accompanying text.


35. For a description of the role of Form U-5s in the securities industry, see infra notes 44–49 and accompanying text.

36. For a discussion of how Form U-5s can potentially spark defamation suits, see infra notes 50–54 and accompanying text.
absolute immunity, reveals that extending absolute immunity to employers unfairly jeopardizes employees’ reputations and conflicts with its original purpose.\footnote{37}

A. The Role of Permanent Records in the Securities Industry

In the schoolyard of the securities industry, the SEC is the school board; FINRA is the principal; firms are teachers, and employees are students.\footnote{38} In much the same way that a school depends on its teachers to report problematic students to the principal, the securities industry relies on firms to inform regulators of employees’ unethical or illegal behavior.\footnote{39} At the heart of this self-regulatory system are the Form U-4 and Form U-5, which register and terminate professionals with FINRA, respectively.\footnote{40}

To “enroll” in the securities industry, individuals must register with FINRA by submitting a Form U-4.\footnote{41} By filing Form U-4s, individuals con-

\footnote{37. For a discussion of the arguments for qualified and absolute privilege and the history of absolute privilege, see infra notes 70–114 and accompanying text.}

\footnote{38. See Roberta S. Karmel, Should Securities Industry Self-Regulatory Organizations Be Considered Government Agencies? 1–8 (Mar. 2008), available at http://works.bepress.com/cgi/viewcontent.cgi?article=1087&context=roberta_karmel (providing overview of self-regulatory system in securities industry and discussing essential role played by SROs). Traditionally, SROs have been private membership organizations that promote regulatory and market functions. See id. at 1–5 (defining traditional roles of SROs). As regulators, SROs enforced their own standards and federal securities laws but in their private role SROs created exchanges where member firms could sell and trade securities. See id. at 5 (describing SROs’ functions). The most prominent SROs include the National Association of Securities Dealers (NASD) and the New York Stock Exchange (NYSE). See id. at 2 (identifying major SROs). In order to successfully perform regulatory functions, SROs depend on its member firms to voluntarily self-regulate and report violations. See id. at 13–14 (discussing self-regulation). In an effort to consolidate rules, improve SEC oversight, and to make self-regulation more efficient, the SEC approved the merger of the NASD and NYSE’s regulatory bodies into FINRA. See id. at 27–29 (discussing inclusion of NASD and NYSE); see also FINRA, GET TO KNOW US 1–3 (2012), available at http://www.finra.org/web/groups/corporate/@corp/@about/documents/corporate/p118667.pdf (describing FINRA’s principal duties). FINRA’s principal duties include licensing and monitoring industry professionals, ensuring that firms comply with industry and federal regulations, and administering the largest arbitration forum to resolve securities-related disputes. See Karmel, supra, at 27–29 (explaining FINRA’s principal duties).}

\footnote{39. See Rosenberg v. MetLife, Inc., 866 N.E.2d 439, 444 (N.Y. 2007) (explaining that information provided by firms to regulators is critical to effective self-regulatory system). The court emphasized that candid information provided by firms in Form U-5s enables FINRA to carry out its regulatory functions and sanction unethical brokers. See id. (noting benefits of Form U-5s).}

\footnote{40. See Liddle & Brecher, supra note 8, at 677 (describing regulatory significance of Form U-4 and Form U-5).}

\footnote{41. See FINRA, FORM U4: UNIFORM APPLICATION FOR SECURITIES INDUSTRY REGISTRATION OR TRANSFER 1 (2009), available at http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015111.pdf (explaining purpose of Form U-4). The official instructions of the Form U-4 provide that, “[r]epresentatives of broker-dealers, investment advisers, or issuers of securi-
sent to settle any disputes with their employers through FINRA’s arbitration system. Additionally, Form U-4s authorize employers to furnish information regarding an employee’s history at the firm and reasons for termination to prospective employers.

The Form U-5, or the “permanent record,” is the official filing used to terminate the association between securities professionals and FINRA. Employers must complete and submit an ex-employee’s Form U-5 within thirty days of termination. While the Form U-5’s primary function is to notify FINRA that an employee has left a firm, its higher purpose is to protect investors and employers from unscrupulous representatives by alerting regulators and other firms to problematic representatives.

Registered representatives must use this form to become registered in the appropriate jurisdictions and/or SROs.” Id. Registered representatives have a continual obligation to update their Form U-4s. See id. (noting individuals are under ongoing obligation to make sure information is accurate).

42. See Uniform Application for Securities Industry Registration or Transfer, FINRA 15 (May 2009), http://www.finra.org/web/groups/industry/@ip/@comp/@regs/documents/appsupportdocs/p015112.pdf (providing consent to settle disputes via FINRA arbitration). Part 5 of question 15A states, “I agree to arbitrate any dispute, claim or controversy that may arise between me and my firm, or a customer, or any other person, that is required to be arbitrated under the rules, constitutions, or by-laws of the SROs indicated in Section 4 . . . .” Id.

43. See id. (providing consent to disclose information to prospective employers). Part eight of question 15A states:

I authorize all my employers and any other person to furnish to any jurisdiction, SRO, designated entity, employer, prospective employer, or any agent acting on its behalf, any information they have, including without limitation my creditworthiness, character, ability, business activities, educational background, general reputation, history of my employment and, in the case of former employers, complete reasons for my termination. Id.

44. See FINRA, WHAT TO EXPECT FROM THE U4 AND U5 FILING PROCESS 3 (2010), available at http://www.finra.org/web/groups/industry/@ip/@edu/documents/education/p018907.pdf (stating that employers must complete Form U-5s when employees stop working at firm).


In a Form U-5, an employer must state his or her reasons for firing an employee and provide explanations if the ex-employee is undergoing any internal or criminal investigations.\textsuperscript{47} The Form U-5 is then filed in FINRA’s CRD, making individuals’ permanent records available to virtually all employers in the securities industry.\textsuperscript{48} Ideally, the flow of information from firms to regulators and other employers better positions regulators to sanction rogue brokers and helps employers make informed hiring and supervisory decisions.\textsuperscript{49}

In an era of highly publicized financial fraud, preventing rogue brokers from roaming recklessly through the industry has become a significant public interest.\textsuperscript{50} These rogue brokers include individuals who participate in Ponzi schemes, falsify customer documents, or convert client funds to their own use.\textsuperscript{51}

\textsuperscript{47} See \textit{Form U5: Uniform Termination Notice for Securities Industry Registration}, \textit{supra} note 5, at 5 (providing requirements for Form U-5 filing process). In section three, employers are required to state the reason why an employee was fired if the termination was involuntary. \textit{See id.} (describing requirements for completing reason of termination). In section seven, employers must provide a detailed explanation if they answer “yes” to any of the listed questions. \textit{See id.} at 6 (providing disclosure requirements when criminal or regulatory proceedings are pending or ongoing against employee); \textit{see also Uniform Termination Notice for Securities Industry Registration}, FINRA 7-8 (May 2009), http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015114.pdf (listing mandatory disclosure questions).

\textsuperscript{48} See \textit{Uniform Termination Notice for Securities Industry Registration}, \textit{supra} note 47, at 1 (requiring submission of Form U-5 to CRD). An individual’s Form U-5 is available to virtually the entire industry because FINRA regulates around 4,345 firms including 163,410 branch offices. \textit{See Ketchum, supra} note 7 (providing statistics).

\textsuperscript{49} See \textit{Cicconi}, 808 N.Y.S.2d at 607 (declaring significance of information flow from firms to regulators). The court stated, “[o]nly by clear descriptions of questionable conduct by brokers can we best ensure that any future employers and customers notice of any such conduct in their interactions with those brokers.” \textit{Id.}; \textit{see also Hunt, supra} note 9, at 2 (explaining Form U-5s ensure firms are aware of important risks employees pose).

\textsuperscript{50} See \textit{Fontani v. Wells Fargo Invs.}, 28 Cal. Rptr. 3d 833, 841 (Cal. Ct. App. 2005) (recognizing content of Form U-5s are matter of public interest). The court in \textit{Fontani} implied that disclosures in Form U-5s are a matter of public interest because broker misconduct can affect a significant amount of investors or even an entire market. \textit{See NASD Notice to Members 97-77, supra} note 20, at 662 (declaring that Form U-5s are matter of public interest). The notice explained that the “full disclosure of disciplinary problems on Forms U-4 and U-5 is in the public interest.” \textit{Id.}

\textsuperscript{51} See Nicholas J. Giuliano, \textit{FINRA Boots Broker for Misappropriating $100K, Stockbroker Fraud, Securities Arbitration, Investment Fraud Lawyers} (July 27, 2012), http://www.stockbrokerfraud.com/law-blog/finra-boots-broker-for-misappropriating-100k (describing case where broker converted clients’ funds to his own use). FINRA permanently barred a representative from the securities industry after he converted over $100,000 of his customers’ funds. \textit{See id.} (discussing broker’s misconduct); \textit{cf.} Bruce Kelly, \textit{Private Placements Cause Finra to Slam Eight Broker-Dealers}, \textit{InvestmentNews} (Dec. 4, 2011, 6:01 AM), http://www.investmentnews.com/article/20111204/REG/312049969 (providing examples of fraudulent practices and FINRA disciplinary actions); \textit{see also FINRA Lawyers on Ponzi Schemes in
ethical brokers is a worthy cause, employees that are far from “rogue” sometimes become the reporting system’s collateral damage.\footnote{See Baravati v. Josephthal, Lyon & Ross, Inc., 28 F.3d 704, 708 (7th Cir. 1994) (explaining how negative statements in Form U-5s can seriously impact employees’ reputations).} For example, negative remarks in the Form U-5 of an employee who was fired for mediocrate job performance or for personality mismatches can prevent the employee from reentering the industry.\footnote{See Tann, supra note 6, at 1019 (discussing fragile nature of securities professionals’ reputations).} Due to the serious impact of these negative statements, Form U-5s have become a hotbed for defamation disputes.\footnote{See Bhatt, supra note 8, at 964 (describing how embellishments in Form U-5s can have devastating effects on reputations); \textit{cf.} Tann, supra note 6, at 1025 (noting false statements in Form U-5s can prevent individuals from becoming employed in securities industry); \textit{see also} Kevin Burke, \textit{Breaking Up Is Hard to Do}, Inv. Adviser (Sept. 22, 2008), 2008 WLNR 17993329 (“In a highly competitive field, the mere appearance of impropriety is enough for a firm to pass on hiring you.”); Liddle & Brecher, supra note 8, at 690 (“A defamatory Form U-5 can ruin an individual’s career in the financial services industry.”).}

B. \textit{When Teachers Are not Delicate with Students’ Permanent Records}

In Pennsylvania, a person has an action for defamation if an opinion is vague and “implies the allegation of undisclosed defamatory facts.”\footnote{See Green v. Mizner, 692 A.2d 169, 174 (Pa. Super. Ct. 1997) (“A defamatory communication may consist of a statement in the form of an opinion but a statement of this nature is actionable only if it implies the allegation of undisclosed defamatory facts as the basis for the opinion.” (quoting \textit{Restatement (Second) of Torts} § 566 (1977))). The court cited comment (c) of section 566 of the Second Restatement of Torts that states:

A simple expression of opinion based on disclosed or assumed nondefamatory facts is not itself sufficient for an action of defamation, no matter how unjustified and unreasonable the opinion may be or how derogatory it is. But an expression of opinion that is not based on disclosed or assumed facts and therefore implies that there are undisclosed facts on which the opinion is based, is treated differently. \textit{Id.; see also \textit{Restatement (Second) of Torts} § 566 cmt. c (1977).}} The Third Circuit rationalized the importance of providing facts by explaining that when an opinion “draws upon unstated facts for its basis, the listener is unable to make an evaluation of the soundness of the opinion.”\footnote{Redco Corp. v. CBS, Inc., 758 F.2d 970, 972 (3d Cir. 1985).} On the other hand, if an individual clearly lays out facts to support
his or her opinion, the statement will not be defamatory.57 In effect, statements can be embarrassing or even detrimental to one’s reputation but not defamatory if enough supporting facts are provided.58

To defend against defamation, employers can argue that their statements were true or privileged.59 First, the truth is always an absolute defense to defamation.60 In Form U-5 disputes, employers will never be liable if they are honest and identify sufficient facts to support the basis of their statements.61 Although the degree of privilege in Pennsylvania is undetermined, employers, at a minimum, will receive qualified privilege.62

57. See Goralski v. Pizzimenti, 540 A.2d 595, 598 (Pa. Commw. Ct. 1988) (holding statements cannot be defamatory if they clearly lay out supporting facts). In Goralski, a teacher claimed that her former employer defamed her by publishing a letter documenting the reasons for her termination. See id. (describing plaintiff—teacher’s claims). However, the court explained that the letter was not defamatory because it contained facts including that the plaintiff failed to return calls and mistreated another employee. See id. (reasoning statements were not defamatory because facts were supplied).

58. See id. (“It is not sufficient, however, if the words are merely annoying or embarrassing to plaintiff.”).

59. See 42 Pa. Cons. Stat. Ann. § 8343(b)(1)-(2) (West 1978) (“In an action for defamation, the defendant has the burden of proving, when the issue is properly raised: (1) The truth of the defamatory communication[, and] (2) The privileged character of the occasion on which it was published.”).


61. See Tann, supra note 6, at 1025 (explaining truth is absolute defense in Form U-5 defamation); see also Dawson v. N.Y. Life Ins. Co., 135 F.3d 1158, 1168 (7th Cir. 1998) (noting employers are required to provide complete and accurate information in Form U-5s). The court observed that the NASD requires firms to provide “all relevant information available to the member, including facts that would lend support to or cast doubt on the truth of the allegations.” Dawson, 135 F.3d at 1168.

62. See Weiss, supra note 17, at 3–4 (explaining that in Pennsylvania statements made by employers on Form U-5s are subject to qualified privilege). The article cites 42 Pa. Cons. Stat. Ann. § 8340.1, which in relevant part states:

An employer who discloses information about a current or former employee’s job performance to a prospective employer of the current or former employee, upon request of the prospective employer or the current or former employee, is presumed to be acting in good faith and, unless lack of good faith is demonstrated by clear and convincing evidence is immune from civil liability for such disclosure or its consequences in any case brought against the employer by the current or former employee. The presumption of good faith may be rebutted only by clear and convincing evidence establishing that the employer disclosed information that: (1) the employer knew was false or in the exercise of due diligence should have known was false; (2) the employer knew was materially misleading; (3) was false and rendered with reckless disregard as to the truth or falsity of the information; or (4) was information the disclosure of which is prohibited by any contract, civil, common law or statutory right of the current or former employee.

Under qualified privilege, employers are protected unless they act with malice or a reckless disregard for the truth.\textsuperscript{63}

Despite two strong defenses to defamation, employers hesitate to disclose important details regarding an employee’s termination.\textsuperscript{64} This “chilling effect” results primarily from the possibility of civil liability.\textsuperscript{65} In other words, employers are keenly aware that they can find themselves in arbitration proceedings where “big money” can be at stake.\textsuperscript{66}

New York is the only state to uniformly provide employers with the ultimate assurance of absolute immunity.\textsuperscript{67} However, courts in California and Pennsylvania have also held that employers’ statements in Form U-5s should be absolutely privileged.\textsuperscript{68} In this debate over the degree of privilege, the arguments for and against qualified and absolute privilege are well documented.\textsuperscript{69}

1. The Pro-Student Rule: Qualified Privilege

Proponents of qualified privilege argue that it best balances the interests of employees, employers, regulators, and investors.\textsuperscript{70} First, qualified

\textsuperscript{63} See Corabi, 273 A.2d at 909 (“[I]f the privileged occasion is but a qualified one and it be shown that defendant was actuated by malice, the defense of qualified privilege is vitiated.”).

\textsuperscript{64} For a discussion of the defenses, see supra notes 60–63 and accompanying text.

\textsuperscript{65} See Wright, supra note 6, at 1300–01 (noting that some employers believe it is safer choice to issue clean Form U-5s regardless of whether it is warranted); see also Clarke, supra note 26 (“While truth is an absolute defense in defamation complaints, the employer’s high cost of defending those actions could have an adverse influence on setting forth the full basis for termination.”); SEC Has No Evidence U-5 Defamation Claims Hurt Firms, WEALTHMANAGEMENT.COM (Oct. 1, 2000), http://wealthmanagement.com/archive/sec-has-no-evidence-u-5-defamation-claims-hurt-firms (explaining that regulators are concerned employers’ fear of defamation claims has reduced informational value of Form U-5s).

\textsuperscript{66} See Martin Harris, Defamation on Form U-5: Caught Between a Rock and a Hard Place, SEC. INDUSTRY EMP. LITIG. ALERT (Drinker, Biddle & Reath L.L.P, Chicago, Ill.), Oct. 2008, at 1, available at http://www.drinkerbiddle.com/resources/publications/2008/defamation-on-form-u-5—caught-between-a-rock-and-a-hard-place (“In a number of recent cases, negative information on a U-5 has triggered lawsuits for defamation in which the plaintiffs won millions of dollars.”); see also Liddle & Brecher, supra note 8 (listing NASD and NYSE defamation awards).


\textsuperscript{69} See Weiss, supra note 17, at 1–5 (reciting arguments for absolute and qualified privilege).

\textsuperscript{70} See Dawson v. N.Y. Life Ins. Co., 135 F.3d 1158, 1164 (7th Cir. 1998) (holding that qualified privilege protects interests of all parties); see also Tann, supra
privilege protects employees by allowing them to hold employers accountable for false or misleading statements made in Form U-5s. Given the serious consequences that Form U-5 disclosures can have on an individual’s career, qualified privilege can be viewed as more equitable because it enables employees to be fairly compensated for damages that arise when employers misuse Form U-5s to intentionally damage reputations. Under an absolute privilege standard, however, defamed employees can only clear their names through expensive expungement proceedings.

Second, qualified privilege protects employers because they retain immunity as long as they tell the truth and refrain from recklessly drafting Form U-5s. Moreover, the threat of liability can deter employers from exaggerating or drafting misleading statements in Form U-5s. As a result, regulators and the general investing public benefit because more accurate information is transmitted from firms to regulators.

Acknowledging that qualified privilege provides benefits to all parties, a majority of courts have held in favor of qualified privilege. Several states have even enacted statutes requiring qualified privilege. Finally, note 6, at 1033 (asserting that qualified privilege balances interests of employees and employers).

71. See Baravati v. Josephthal, Lyon & Ross, Inc., 28 F.3d 704, 708 (7th Cir. 1994) (discussing how qualified privilege protects employees). The court explained that insulating employers would allow them to “blackball” former employees from the entire industry. See id.

72. See Tann, supra note 6, at 1037 (providing instances of Form U-5s being used to retaliate against employees). In one instance, an employer changed the statements in an employee’s Form U-5 after discovering that the employee was switching to a competitor. See id. (detailing facts of dispute); see also Svigos v. Merrill Lynch Pierce Fenner & Smith Inc., No. 93-04516, 2000 WL 1808278, at *3 (Oct. 6, 2000) (describing arbitration award for defamation). In Svigos, Merrill Lynch was held liable for $1,025,000 in compensatory damages and $250,000 in punitive damages for intentionally defaming an ex-employee in his Form U-5. See Svigos, 2000 WL 1808278, at *3.

73. See Tann, supra note 6, at 1042–43 (asserting that expungement proceedings are expensive and defamed employees are left to bear cost); see also Burke, supra note 54 (describing expungement process as herculean task).

74. See Dawson, 135 F.3d at 1164 (explaining employers are not liable for defamation if their disclosures are true); see also Tann, supra note 6, at 1038–39 (arguing qualified privilege provides adequate protection for employers).

75. See Hunt, supra note 9, at 5 (“[A]bsent safeguards, such as civil liability, the risks of broker-dealer abuse are too great and the consequences for associated persons too onerous to provide absolute immunity for Form U-5s.”); see also Tann, supra note 6, at 1039 (asserting that absolute privilege removes incentive for employers to act in good faith).

76. See Tann, supra note 6, at 1040 (“[Q]ualified privilege benefits the securities industry by encouraging employers to give complete and accurate references.”).

77. See Weiss, supra note 17, at 2–3 (stating qualified privilege is majority rule).

78. See id. at 2 (listing states that have enacted qualified privilege statutes). A prime example is Hawaii’s qualified privilege statute, which states:
prominent regulatory officials in the industry have also called for a uniform qualified privilege rule to be adopted.79

2. The Pro-Teacher Rule: Absolute Privilege

Proponents of absolute privilege argue that it best supports the regulatory objectives of the Form U-5 and protects employers who are compelled to make the statements as part of a quasi-judicial proceeding.80 First, removing civil liability eliminates the main reason why employers issue “clean” Form U-5s.81 Second, the mandatory submission of Form U-5s to FINRA can be viewed as part of a quasi-judicial proceeding.82 Finally, Form U-5s should be absolutely privileged because their content is a matter of general public concern (i.e., unethical brokers can seriously harm the investing public).83

In response to the argument that employers might abuse their immunity, supporters of absolute privilege argue that there are safeguards in the

A broker-dealer, agent, investment adviser, federal covered investment adviser, or investment adviser representative shall not be liable to another broker-dealer, agent, investment adviser, federal covered investment adviser, or investment adviser representative for defamation . . . unless the person knew, or should have known at the time that the statement was made, that it was false in a material respect or the person acted in reckless disregard of the statement’s truth or falsity.


79. See Wright, supra note 6, at 1328 (“[R]egulators generally have supported according broker-dealers a qualified privilege for Form U-5 reporting that is defamatory and untrue.”); cf. Tann, supra note 6, at 1043–45 (noting efforts to create qualified privilege standard). In 1998, the NASD proposed a uniform qualified immunity rule to protect employees from misleading or false statements made in Form U-5s. See Tann, supra note 6, at 1043–45 (describing proposed qualified privilege rule). However, the proposal never became law due to concerns over whether the NASD had the authority to impose a uniform rule that differed from state law. See id. (explaining failure of proposal to become effective). Four years later in 2002, Commissioners of the Uniform Securities Act proposed a model qualified privilege rule for states to adopt. See id. (noting that several states have adopted model qualified privilege statutes); see also UNIFORM SECURITIES ACT, § 507 (2002) (“A broker-dealer . . . is not liable . . . unless the person knew, or should have known at the time that the statement was made, that it was false in a material respect or the person acted in reckless disregard of the statement’s truth or falsity.”).


81. See Tann, supra note 6, at 1040–41 (describing employers reluctance to provide more information without absolute immunity); see also Hunt, supra note 9, at 3 (“[A] widely-held belief is that some firms supply ’clean’ Forms U-5 to avoid possible defamation exposure.”).


83. See Fontani v. Wells Fargo Invs., 28 Cal. Rptr. 3d 833, 842 (Cal. Ct. App. 2005) (holding statements in Form U-5s should be absolutely privileged because they concern conduct capable of affecting large numbers of people).
reporting system to protect employees. As a general matter, all FINRA member firms are under an obligation to act in good faith when completing and updating Form U-5s. Employers that purposely report inaccurate or misleading information on a Form U-5 can be subjected to fines and other administrative penalties. To ensure compliance, FINRA routinely investigates Form U-5s for accuracy. Finally, employees can find relief within the system by commencing expungement proceedings to clear their records.

The most significant decision in favor of absolute privilege comes from the New York Court of Appeals in Rosenberg v. MetLife, Inc. In Rosenberg, the court classified the submission of Form U-5s as being part of a quasi-judicial process. The court reasoned that NASD is a quasi-govern-

84. See Jeffery Zuckerman, New York Court Finds Absolute Immunity Applies to Broker-Dealer U-5 Termination Statements, MONDAQ BUS. BRIEFING (Apr. 5, 2007), available at 2007 WLNR 6492222 (describing safeguards in Form U-5 reporting system that protect employees).

85. See id. (explaining that FINRA requires firms to complete accurate disclosures); see also FINRA, FORM U4 AND U5 INTERPRETIVE QUESTIONS AND ANSWERS 1-13 (2013), available at http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p119944.pdf (acknowledging employers’ continuing obligation to provide accurate and complete information in Form U-5s).

86. See REGULATORY NOTICE 10-39, supra note 45, (explaining that firms can face administrative and civil penalties for not providing complete and accurate information in Form U-5s); see also Melanie Waddell, FINRA’s Top 5 Enforcement Issues of 2011, ADVISORONE (Mar. 12, 2012), http://www.advisorone.com/2012/03/12/finras-top-5-enforcement-issues-of-2011?page=2 (listing FINRA’s top enforcement issues). In 2011, there were four cases where an employer was fined over $600,000 for not reporting material information in a Form U-5. See Waddell, supra (discussing violations for inaccurate Form U-5s).

87. See id. (noting regulators often check accuracy and completeness of Form U-5s).

88. See Rosenberg v. MetLife, Inc., 866 N.E.2d 439, 445 (N.Y. 2007) (explaining that defamed employees can commence arbitration proceedings to clear their records). But see Tann, supra note 6, at 1042–43 (discussing realities of expungement proceedings). Expungement proceedings are expensive and a defamed employee’s reputation may be damaged too greatly before the proceeding can provide a result. See Tann, supra note 6, at 1043 (“If a broker is in fact successful in getting a statement expunged, he may be out of work for years until the expungement actually occurs, and the harm at that point may be irreparable.”).

89. 866 N.E.2d 439, 445 (N.Y. 2007); see also Weiss, supra note 17, at 5 (discussing Rosenberg’s significance).

90. See Rosenberg, 866 N.E.2d at 443–44 (comparing Form U-5 reporting to other quasi-judicial proceedings). The court analogized Form U-5 reporting to absolutely privileged complaints made to a New York bar association’s grievance committee. See id. (noting complaints to bar association were absolutely privileged). But see id. at 446 (Pigott, J., dissenting) (rejecting majority’s position that Form U-5 reporting is quasi-judicial). The dissent stated that the Form U-5 system is not a quasi-judicial proceeding because “statements made on a Form U–5 are not intended to be part of any court proceeding nor are they presented to a committee having attributes similar to a court.” Id. at 445 (Pigott, J., dissenting). The dissent also distinguished employers’ statements in Form U-5s from complaints made to the bar association’s grievance committee by noting that the complaints
mental agency because it has been delegated authority to enforce federal laws and is the “primary regulator of the broker-dealer industry.” Further, the court explained that the NASD performs quasi-judicial functions by investigating complaints from member firms and administering disciplinary proceedings.

The court also emphasized that Form U-5s promote a significant public interest by protecting investors and other employers from unethical brokers. Assuming that absolute privilege would be more likely to promote accurate disclosures, the court explained that the NASD could more efficiently investigate brokers. Additionally, the availability of Form U-5s to prospective employers aids them in researching the background of potential employees and ultimately helps the industry maintain high standards.

Outside of New York, only a few cases have held that employers are subject to absolute privilege. Nonetheless, Rosenberg has a substantial impact on the industry as a significant number of these disputes arise in New York. The decision is also likely to serve as persuasive authority in states that have yet to determine whether Form U-5s are absolutely privileged.

to the bar association were made confidentially and were not disseminated across the legal industry. See id. (distinguishing Form U-5 statements from complaints to bar association).

91. Id. at 443. The court explained that the compulsory nature of Form U-5s in the self-regulating system could be viewed as the first step of a quasi-judicial process. See id. at 444 (discussing quasi-judicial qualities of Form U-5 reporting system).

92. See id. (describing quasi-judicial functions performed by NASD).

93. See id. (noting significant public interest of investor protection). But see Liddle & Brecher, supra note 8, at 688 (“While investor protection is a worthy public policy, the Court’s conclusion in Rosenberg is based on the faulty premise that brokerage firms always act in the public’s interest and will be even more likely to do so with an absolute privilege.”).

94. See Rosenberg, 866 N.E.2d at 444 (implying that absolute privilege is more likely to promote accurate disclosures to regulators).

95. See id. (noting accurate Form U-5 disclosures assist other employers in researching employee backgrounds).


97. See Tann, supra note 6, at 1028 (describing impact of New York law on securities industry). The article explained that:

New York City accounts for 90% of all securities jobs in the state and more than 22% of securities jobs in the nation. In fact, the New York metropolitan area provided 230,000 jobs in the securities industry in 2006, far more than any other city. Wall Street alone accounted for 41% of the jobs gained in New York City between 2003 and 2006.

Id. (footnote omitted).

98. For a discussion of the significance of Rosenberg, see infra note 174 and accompanying text.
C. Today’s History Lesson: Absolute Privilege in Pennsylvania

In Pennsylvania, absolute privilege provides immunity from civil liability regardless of “occasion or motive.”99 Such privilege has primarily been reserved for statements made during the course of judicial or quasi-judicial proceedings as well as statements made by high public officials acting in their official capacity.100 In these settings absolute privilege is necessary to promote candid discourses in areas of public interest.101

In the employment context, Pennsylvania courts have held that absolute privilege can extend to statements made by employers regarding a former employee’s history at the firm.102 However, this extension of absolute privilege narrowly applies to an individual who consented to publish and receive potentially defamatory statements.103 In addition, the Pennsylvania Superior Court in Baker v. Lafayette College104 held that “an em-

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100. See Post v. Mendel, 507 A.2d 351, 355 (Pa. 1986) (“[T]he protected realm has traditionally been regarded as composed only of those communications which are issued in the regular course of judicial proceedings and which are pertinent and material to the redress or relief sought.”); cf. Barto v. Felix, 378 A.2d 927, 929 (Pa. Super. Ct. 1977) (holding that public officials enjoy absolute immunity when making statements pursuant to their official duties); see also Milliner v. Enck, 709 A.2d 417, 419 (Pa. Super. Ct. 1998) (explaining statements made during quasi-judicial proceedings are absolutely privileged); Moses v. McWilliams, 549 A.2d 950, 956 (Pa. Super. Ct. 1988) (recounting Pennsylvania’s traditional application of absolute privilege to statements made in judicial proceedings). The court in Barto explained that public officials need the protection of absolute privilege to act freely in areas of public interest. See Barto, 378 A.2d at 929 (“The threat of a potential civil suit for damages would unquestionably dampen a public official’s enthusiasm to act in certain situations . . . .”).


103. See Frymire v. Painewebber, Inc. (In re Frymire), 87 B.R. 856, 859 (Bankr. E.D. Pa. 1988) (reviewing Pennsylvania case law concerning absolute privilege in employment contexts). The court explained, “if no consent of the employee to the publication of his evaluation by his employer has been established, by a collective bargaining agreement or otherwise, no absolute privilege should attach.” Id.

employer should not be subject to a defamation suit by an employee based on statements the employer is contractually compelled to make . . . .”

In Baker, the plaintiff-professor claimed that a co-worker and his superior defamed him by exchanging letters that were critical of his job performance. The plaintiff alleged that the letters were biased, false, and ultimately led to his termination. Despite the plaintiff’s claims, the court held that the superior’s letters were subject to absolute privilege because the plaintiff consented to such written evaluations in the employee handbook.

Relying on section 583 of the Restatement (Second) of Torts, the Baker court stated that if consent is given to an employer to publish potentially defamatory matters, then the employer enjoys absolute privilege. However, the plaintiff’s co-worker was not entitled to absolute privilege because the handbook only stated that department heads would make written evaluations. Although the court recognized the possibility that an evaluation could be recklessly or maliciously drafted, it stated that as long as employees consented to having written evaluations published, they must have assumed the risk that the evaluations might be unfavorable.

On the other hand, the dissent emphasized that the plaintiff only consented to honest evaluations, and there was substantial evidence showing

105. Id. at 249.

106. See id. at 248 (describing allegedly defamatory letters). The letters focused on the plaintiff’s teaching ability, relationship with co-workers, and the presence of his wife in his classes. See id. at 260 (“Professor Gluhman wrote a letter to Provost Sause complaining of the ‘extraordinary, peculiar, and academically deplorable arrangement’ of [plaintiff’s] wife’s ‘habitual’ presence in [plaintiff’s] classes.”).

107. See id. at 249 (discussing plaintiff’s claim).

108. See id. (describing manner in which plaintiff consented). The court looked at the plaintiff’s employment contract and the university’s handbook to determine if plaintiff gave consent. See id. (discussing contents of handbook). The employee handbook provided for “annual written evaluations by the department head.” Id.

109. See id. (quoting Restatement (Second) of Torts § 583). The court quoted comment (f) that states:

The privilege conferred by the consent of the person about whom the defamatory matter is published is absolute. The protection given by it is complete, and it is not affected by the ill will or personal hostility of the publisher or by any improper purpose for which he may make the publication.

Id.; see also Restatement (Second) of Torts § 583 cmt. f (1977).

110. See Baker, 504 A.2d at 250 (finding co-worker’s letter not subject to absolute privilege on consent grounds). The employee handbook only provided for formal evaluations by department heads. See id. at 249 (discussing conditions in handbook).

111. See id. at 250 (reasoning that when employees agree to be evaluated they risk criticism might be unfavorable or negative). The court stated, “[t]he person who agrees to submit his work to criticism or evaluation assumes the risk that the criticism may be unfavorable.” Id.
that his superior’s evaluations were dishonest.\footnote{See id. at 268 (Spaeth, J., dissenting) (asserting consent only provides absolute privilege for honest statements). Baker relied on comment d in Section 583 of the Second Restatement of Torts, which states, “one who agrees to submit his conduct to investigation knowing that its results will be published, consents to the publication of the honest findings of the investigators.” Id. at 250 (majority opinion); see also \textit{RESTATEMENT (SECOND) OF TORTS} § 583 cmt. d (1977).} The dissent also added that “where one does \textit{not} know that a statement exists but \textit{does} know that in the course of an investigation of one’s conduct it may be made and published . . . one’s consent to publication is consent only to publication of honest findings.”\footnote{See Baker, 504 A.2d at 269 (Spaeth, J., dissenting).} Applying this reasoning to Form U-5 defamation disputes, it would be inequitable to allow employers to avoid civil liability when they use Form U-5s to retaliate or intentionally injure an ex-employee’s career.\footnote{See Matthew W. Finkin & Kenneth G. Dau-Schmidt, \textit{Solving the Employee Reference Problem: Lessons from the German Experience}, 57 \textit{AM. J. COMPL. L.} 387, 399 (2009) ("It is doubtful that we should be prepared to allow an employer to escape legal scrutiny altogether when . . . it knowingly asserts a completely baseless accusation of malfeasance as the ground of discharge, uses the reference as a retaliatory device, or uses the threat of a malicious reference . . . ." (footnotes omitted)).}

\section*{III. School Is in Session: Merkam v. Wachovia}

Gal Merkam, a former financial specialist at Wachovia, was fired for violating the company’s code of conduct by accepting loans from a third party and entering them into Wachovia’s computer system without first notifying the customer.\footnote{See Merkam v. Wachovia Corp., No. 2397, 2008 Phila. Ct. Com. Pl. LEXIS 85, at *1 (Pa. Ct. C.P. Apr. 8, 2008) (noting Merkam’s role as financial specialist in Wachovia’s Code). Merkam violated Wachovia’s Code of Conduct by entering an application for a loan into Wachovia’s computer system without first speaking to the car-dealership. \textit{See id.} (describing Merkam’s violation).} Merkam appealed his dismissal by filing a termination appeal request.\footnote{See id. at *2 (noting Merkam’s appeal).} In the appeal letter, Merkam admitted to violating Wachovia’s code of conduct on at least one occasion.\footnote{See id. (describing Merkam’s appeal letter). The court stated, “[i]n his letter, [Merkam] expressly conceded that, on one occasion, he had received a faxed application for an auto loan from Tri State Auto and entered the application into Wachovia’s computer system without first speaking to the customer.” Id.} After reviewing the appeal, Wachovia upheld its decision to terminate Merkam.\footnote{See id. at *3 (noting Wachovia upheld its decision to terminate Merkam).}

Following his departure, Dawn Lang, Merkam’s former supervisor, prepared a report for an unemployment compensation hearing to determine Merkam’s eligibility for benefits.\footnote{See id. (describing Dawn Lang’s involvement with Merkam’s unemployment compensation hearing).} At this hearing, Lang recited the specific code of conduct violation that led to Merkam’s termination.\footnote{See id. (“At the hearing, Ms. Lang testified and corroborated the facts as set forth in her [r]eport.”). In her report, Lang identified the exact company
few days after the hearing, Wachovia filed Merkam’s Form U-5 with the NASD.\textsuperscript{121}

In the Form U-5, Wachovia stated that Merkam was “[t]erminated by Wachovia Bank, for violation of Wachovia Bank’s code of conduct.”\textsuperscript{122} Wachovia went on to explain that, “[n]o Wachovia Bank or Wachovia Securities Clients were affected by the code of conduct violation.”\textsuperscript{123} After reviewing Wachovia’s statements in Merkam’s Form U-5, the NASD decided to investigate Merkam.\textsuperscript{124} However, the NASD quickly ended its investigation after Wachovia identified all of the relevant facts to support its opinion that Merkam violated its code of conduct.\textsuperscript{125}

Merkam proceeded to sue Wachovia and Lang, claiming that he was defamed by the statements made by Lang in the unemployment compensation hearing and by Wachovia in his Form U-5.\textsuperscript{126} Among other things, Merkam alleged that the negative statements in his Form U-5 tarnished his business reputation.\textsuperscript{127} In response, Wachovia filed preliminary objections and the court dismissed the claim for legal insufficiency.\textsuperscript{128}

On appeal, the Court of Common Pleas affirmed that Merkam failed to show that Wachovia’s statements at the unemployment compensation hearing and in the Form U-5 were defamatory.\textsuperscript{129} The Superior Court of Pennsylvania affirmed the lower court’s ruling in an unreported memorandum opinion.\textsuperscript{130} In its opinion, the Superior Court refrained from dis-
cussing whether Wachovia’s statements in the Form U-5 were subject to absolute or a qualified privilege.131

The Court of Common Pleas began its discussion by identifying the burdens of proof for defamation in Pennsylvania.132 First, the court analyzed whether Lang or Wachovia’s statements could be capable of a defamatory meaning.133 Focusing on the amount of supporting facts provided by Lang and Wachovia in their statements, the court concluded that none of the statements were capable of a defamatory meaning.134 The court recognized that Lang’s statements clearly laid out all of the relevant facts to support her opinion that Merkam violated Wachovia’s Code of Conduct.135 Similarly, the court explained that Wachovia provided all of the supporting facts through its disclosures in the Form U-5 and its statements to the NASD during the investigation.136

The second half of the court’s analysis focused on whether Wachovia and Lang’s statements were protected by the truth and if they were absolutely privileged.137 First, the court determined that Wachovia’s statements were true because Merkam admitted to violating the company’s code of conduct in his letter to appeal termination.138 Although not necessary, the court proceeded to discuss whether absolute privilege applied to Wachovia’s communications in the unemployment compensation hearing and statements on the Form U-5.139

After reviewing Pennsylvania case law regarding the purpose of absolute privilege, the court concluded that Wachovia’s communications to

131. See id. at 4–5 (discussing Form U-5 privilege). The superior court did not classify the degree of privilege provided to Form U-5s as absolute or qualified. See id. at 5 (“[W]e conclude the trial court did not err in finding this communication was privileged.” (emphasis added)).


134. See id. at *6–7 (concluding Lang and Wachovia’s statements were incapable of defamatory meaning).

135. See id. at *15 (explaining that Lang clearly laid out relevant facts to support her opinion).

136. See id. at *12 (“The Form U-5 submitted to NASD and the NASD correspondence . . . conclusively establish that Wachovia informed the NASD of its opinion that Plaintiff had violated Wachovia’s Code of Conduct and specifically identified all of the facts supporting its opinion.”).

137. See id. (analyzing Lang and Wachovia’s burden of proof).

138. See id. at *13 (“Plaintiff admitted in his appeal letter that he did, on at least one occasion, receive a faxed loan application from Tri State Auto and entered the application into Wachovia’s computer system without first speaking with the customer.”).

139. See id. (discussing applicability of absolute privilege). At this point, the court already determined that Lang and Wachovia’s statements were not capable of a defamatory meaning and were protected under the absolute defense of the truth. See id.
the unemployment compensation referee were absolutely privileged.\textsuperscript{140} The court explained that absolute privilege applied because unemployment compensation hearings are “judicial” and Lang’s statements were relevant and material to the proceedings.\textsuperscript{141}

Relying on New York case law, the court explained that Wachovia’s statements in Merkam’s Form U-5 were subject to absolute privilege.\textsuperscript{142} In reaching its conclusion, the court emphasized that without the threat of civil liability, employers would be more likely to provide more accurate information on Form U-5s.\textsuperscript{143} However, the court did not acknowledge that the majority rule outside of Pennsylvania is qualified privilege.\textsuperscript{144}

\section*{IV. Critical Analysis}

The Court of Common Pleas correctly held that Wachovia and Lang were not liable for defamation because the statements were true but should not have extended absolute privilege to Merkam’s Form U-5.\textsuperscript{145} First, making Form U-5s immune from all liability under any circumstance is inconsistent with the purpose of absolute privilege.\textsuperscript{146} Second, the court did not definitively show that the public interest is actually protected by providing absolute privilege.\textsuperscript{147} Finally, if absolute privilege becomes the law in Pennsylvania, employees’ reputations will be left at the mercy of their employer.\textsuperscript{148}

\begin{itemize}
\item \textsuperscript{140} See id. at *17 (“Since Ms. Lang’s alleged statements were relevant and material to the judicial proceedings before the Unemployment Compensation Referee, they are protected by an absolute privilege.”). In its review of the original purpose of absolute privilege, the court cited the Supreme Court of Pennsylvania in \textit{Binder} to show that absolute privilege was initially deployed to promote the free administration of justice in judicial proceedings. See id. at *16.
\item \textsuperscript{141} See id. at *17 (citing \textit{Milliner v. Enck}, 709 A.2d 417, 419 (Pa. Super. Ct. 1998)) (implying unemployment compensation hearings are judicial proceedings protected by absolute privilege).
\item \textsuperscript{142} See id. at *18 (relying on New York case law applying absolute privilege to statements made on Form U-5s). The court was persuaded by the reasoning of the New York Court of Appeals in \textit{Rosenberg}. See id.
\item \textsuperscript{143} See id. (citing \textit{Cicconi v. McGinn, Smith & Co.}, 808 N.Y.S.2d 604, 607–08 (N.Y. App. Div. 2005)) (noting that Form U-5s protect investors “by assuring brokerage firms that they will not be liable in tort for statements in their mandatory U-5 filings, [thus] avoid[ing] the possibility that they will hesitate to clearly state the exact grounds for an employee’s termination”).
\item \textsuperscript{144} See generally id. (avoiding discussion of majority view of courts that statements made in Form U-5s are subject to qualified privilege).
\item \textsuperscript{145} For a discussion of why the court should not have extended absolute privilege, see infra notes 149–90 and accompanying text.
\item \textsuperscript{146} For a further discussion of how the Form U-5 is not part of a quasi-judicial proceeding, see infra notes 149–63 and accompanying text.
\item \textsuperscript{147} For a further discussion of how absolute privilege for Form U-5s does not necessarily benefit the investing public, see infra notes 164–73 and accompanying text.
\item \textsuperscript{148} For a further discussion of the potential impact of \textit{Merkam’s} holding, see infra notes 174–90 and accompanying text.
\end{itemize}
A. The Form U-5 Reporting System Lacks the “Judicial” Part of a Quasi-Judicial Proceeding

When employers file Form U-5s, they are not participating in a typical quasi-judicial process worthy of absolute privilege. In some respects, the Form U-5 reporting system administers quasi-judicial functions because it enables regulators to investigate brokers and allows FINRA to enforce federal securities laws. On the other hand, the reporting system reaches outside the scope of the quasi-judicial process by creating a massive database of “employee references” for its member firms. To address this conundrum, it is important to review the purpose of absolute privilege.

The Court of Common Pleas correctly identified that the original purpose of absolute privilege was to promote the free administration of justice by judges and to promote the participation of litigants and witnesses in trials. While Pennsylvania has extended absolute privilege to quasi-judicial proceedings like unemployment compensation hearings, those proceedings retain essential elements of a traditional judicial process. Unlike an unemployment compensation hearing, the Form U-5 reporting system lacks fundamental “judicial” characteristics. For example, em-

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150. See Baravati, 28 F.3d at 708 (explaining NASD performs quasi-judicial functions). The court explained that the NASD performs quasi-judicial functions by requiring member firms to self-report violations, conducting investigations, and imposing sanctions. See id.

151. See id. (stating that disseminating Form U-5s across securities industry is not quasi-judicial).

152. For a discussion of the purpose of absolute privilege, see infra notes 153–63 and accompanying text.


154. See Shortz v. Farrell, 193 A. 20, 22 (Pa. 1937) (holding proceedings before unemployment compensation hearing board are quasi-judicial). The Pennsylvania Supreme Court explained that the proceeding was of a judicial character because the unemployment compensation board had the power to issue subpoenas, apply legal rules, administer oaths, require attendance of witnesses, and adjudicate disputes. See id. (explaining that proceeding possessed fundamental characteristics of typical courtrooms); see also Milliner v. Enck, 709 A.2d 417, 421 (Pa. Super. Ct. 1998) (noting other instances where absolute privilege was extended to quasi-judicial proceedings).

155. See Glennon v. Dean Witter Reynolds, Inc., 83 F.3d 132, 137 (6th Cir. 1996) (finding submission of Form U-5s to be formality that is not part of NASD’s
employees lack a meaningful opportunity to dispute potentially defamatory or false statements, FINRA regulators are not necessarily weighing evidence and resolving disputes, and investigations do not accompany all Form U-5 filings.156

The Merkam court also emphasized that absolute privilege applies to all pleadings pertinent to a judicial proceeding.157 However, unlike traditional pleadings in which both parties submit statements to be evaluated by a judge, employers truly dominate the Form U-5 reporting system.158 Moreover, under an absolute privilege standard, employees can only challenge an employer’s statements through an expensive expungement process.159 Recognizing this issue, the dissent in Rosenberg stated that “[i]f the Form U–5 were part of a quasi-judicial process, then an expungement action would be entirely unnecessary.”160

Finally, the Merkam court did not explain how Form U-5’s role of providing “employee references” falls within the gambit of a “quasi-judicial” process that deserves absolute privilege.161 On the contrary, the Pennsylvania legislature has stated in Section 8340.1 of the Pennsylvania Code that when employers provide employee references they are presumed to be acting in good faith unless it can be shown that the employer knew its statements were false, materially misleading, or made with reckless disregard for the truth.162 Given the serious impact Form U-5s can have on a quasi-judicial regulatory process); cf. Rosenberg v. MetLife, Inc., 866 N.E.2d 439, 445 (N.Y. 2007) (Pigott, J., dissenting) (“[S]tatements made on a Form U–5 are not intended to be part of any court proceeding nor are they presented to a committee having attributes similar to a court.”); see also Tann, supra note 6, at 1036 (comparing formality of filing Form U-5s to filing police reports). The court noted that a majority of states only provide police reports with a qualified privilege to protect the reputation interest of individuals. See Tann, supra note 6, at 1036 (“Although there is a vital public interest in ensuring that individuals report crimes to the police, there must also be sufficient protection of the accused’s reputational interest.”).

156. See Rosenberg, 866 N.E.2d at 445 (Pigott, J., dissenting) (explaining why Form U-5s are not quasi-judicial). The dissent emphasized that the employee did not have an opportunity to challenge the statements made on his Form U-5. See id. at 446.

157. See Binder, 275 A.2d at 56 (“[S]tatements by a party, a witness, counsel, or a judge cannot be the basis of a defamation action whether they occur in the pleadings or in open court.”).

158. See Rosenberg, 866 N.E.2d at 446 (Pigott, J., dissenting) (implying employers have too much control over Form U-5 reporting system).

159. See id. at 446 n.3 (“Indeed, a costly expungement action is often the only means by which an employee may challenge defamatory statements made on a Form U-5.”); see also Tann, supra note 6, at 1042–43 (arguing that expungement proceedings do not provide adequate protection to employees).

160. Rosenberg, 866 N.E.2d at 446 n.3 (Pigott, J., dissenting).


professional’s reputation, the court in Merkam did not adequately explain how the widespread dissemination of Form U-5s across the securities industry is sufficiently judicial in character.163

B. Absolute Privilege for Form U-5 Reporting Is not “Absolutely Necessary” to Protect the Public

Merkam serves as evidence that the regulatory objectives of the Form U-5 can be satisfied without absolute privilege.164 According to the court’s reasoning, Merkam’s defamation claims would have failed under a qualified privilege standard because Wachovia was acting in good faith and telling the truth.165 In effect, regulators and other employers would have received the same information about Merkam’s employment history.166

At the time Wachovia completed Merkam’s Form U-5, the company did not believe that its statements were absolutely privileged.167 Despite believing that it could be held liable for defamation, Wachovia was honest and gave Merkam a “negative reference.”168 Accordingly, Wachovia’s conduct demonstrates that the “chilling effect” of defamation might not be as strong as proponents of absolute privilege suggest.169

Further, it is not entirely clear how disseminating the reasons for Merkam’s termination to prospective employers would better protect investors.170 Merkam’s violation had no negative effect on Wachovia’s clients.171 The behavior was not illegal, and regulators did not believe it was

163. For a discussion of Merkam’s explanation, see supra notes 132–44 and accompanying text.

164. See Tann, supra note 6, at 1040–41 (“[Q]ualified privilege benefits the securities industry by encouraging employers to give complete and accurate references.”). To deter the submission of “clean” Form U-5s, states that have enacted qualified privilege statutes protect employers unless actual malice can be proven. See id. at 1041.

165. See Brief of Appellees at 21–22 n.2, Merkam v. Wachovia Corp., 947 A.2d 839 (Pa. Super. Ct. May 23, 2008) (No. 230 EDA 2007), 2007 WL 2858008 (“[E]ven if this Court were to hold that a qualified, rather than absolute, privilege attaches to Wachovia’s statements to the NASD, the Complaint and attached exhibits, taken together, fail [sic] to establish Wachovia’s abuse of a qualified privilege . . . .”).

166. For a description of the negative content of Merkam’s Form U-5, see supra notes 126–27 and accompanying text.

167. See Brief of Appellees, supra note 165, at 21–22 (citing majority of case law supporting qualified privilege and explaining absolute privilege does not apply outside of New York).


169. See Dawson v. N.Y. Life Ins. Co., 135 F.3d 1158, 1164 (7th Cir. 1998) (acknowledging firms are under pressure to provide clean Form U-5s but holding firms can still satisfy regulatory reporting under qualified privilege).

170. See Liddle & Brecher, supra note 8, at 691 (arguing that public interest is not advanced by making statements in Form U-5s absolutely privileged).

even worthy of sanctions.\textsuperscript{172} In the words of the Seventh Circuit, applying absolute privilege to situations like Merkam’s is “strong medicine.”\textsuperscript{173}

C. Absolute Privilege Could Become a Reality in Pennsylvania

The Merkam court’s adoption of Rosenberg illustrates how states without a mandatory qualified privilege standard are likely to react to new arguments for absolute privilege.\textsuperscript{174} Although not binding in Pennsylvania, Merkam laid a foundation for future arguments supporting absolute privilege.\textsuperscript{175}

One avenue by which this might occur is an employer arguing that its statements are absolutely privileged because the employee at issue consented to the employer publishing the reasons for the employee’s termination.\textsuperscript{176} According to the Pennsylvania Superior Court in Baker, absolute privilege can be conferred by consent.\textsuperscript{177} Further, the court in Baker explained that employers should not be liable for defamation when they are contractually compelled to make certain statements.\textsuperscript{178} Applying Baker to Form U-5s, employers could argue that employees confer consent by signing their Form U-4, which expressly provides consent for employers to make the Form U-5 disclosures.\textsuperscript{179} Employers may also argue that they deserve protection because they are obligated by FINRA to submit Form U-5s after firing an employee.\textsuperscript{180}

Conversely, securities professionals can argue that application of Baker should be limited to internal evaluations.\textsuperscript{181} Recognizing the serious risks to an individual’s reputation, the dissent in Baker reasoned that individuals only consent to the publication of honest statements.\textsuperscript{182} Applying this rea-

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\textsuperscript{172.} See \textit{id.} at *4 (stating that NASD chose to take no action against Merkam).
\textsuperscript{173.} Baravati v. Josephthal, Lyon & Ross, Inc., 28 F.3d 704, 708 (7th Cir. 1994).
\textsuperscript{174.} See Weiss, \textit{supra} note 17, at 5 (predicting that \textit{Rosenberg’s} holding will influence jurisdictions outside of New York).
\textsuperscript{175.} See \textit{generally} Merkam v. Wachovia, No. 230 EDA 2007, 1, 4 (Mem. Op.) (Pa. Super. Ct. May 23, 2008). The fact that the Superior Court of Pennsylvania avoided discussing whether absolute privilege applies to Form U-5s might suggest that the court was not ready to address the issue. \textit{See id.}
\textsuperscript{176.} For a further discussion of this potential reality, see \textit{infra} notes 177–80 and accompanying text.
\textsuperscript{178.} See \textit{id.} (stating employers should not be liable for defamation based on statements they are contractually compelled to make).
\textsuperscript{179.} For a discussion of Form U-4’s consent aspect, see \textit{supra} note 42 and accompanying text.
\textsuperscript{180.} For an explanation of how employers are obligated by FINRA to submit Form U-5s after firing employees, see \textit{supra} notes 44–45 and accompanying text.
\textsuperscript{181.} See Baker, 504 A.2d at 253 (noting significance that evaluation was limited to internal members of college).
\textsuperscript{182.} See \textit{id.} at 268–69 (asserting that consent only applies to publication of honest remarks).
soning to Form U-5 disclosures, employers would only be protected if their statements were honest. As former SEC Commissioner Isaac C. Hunt, Jr. argued, if absolute privilege becomes the law in Pennsylvania and other states, the SEC should enact a regulation mandating a qualified privilege. Such action would be necessary to protect employees who would be left at the mercy of their employers. Moreover, the need for a qualified privilege rule becomes especially apparent in certain egregious circumstances where employers use Form U-5s to retaliate against employees.

One alternative to providing employers with absolute privilege, which Mr. Hunt and others have floated, could be to give employees an opportunity to challenge the content of their Form U-5 in front of a FINRA arbitration panel before the Form U-5s are published. This option allows employees to dispute the language they claim is defamatory and holds employers accountable for the statements they make. Having a FINRA arbitration panel determine whether a statement is defamatory before it is published may also provide employers with some assurance that they will not be held liable for defamation down the road. Ultimately, this type of proposal provides benefits to both employees and employers, shifts responsibility to FINRA regulators to determine the defamatory nature and truthfulness of statements, and makes the reporting system more judicial in character.

183. See id. (explaining only honest evaluations are privileged).

184. See Hunt, supra note 9, at 6 (advocating SEC might need to act if absolute privilege becomes law). The former commissioner of the SEC believed that a qualified privilege rule might be necessary if the New York Court of Appeals ruled in favor of absolute privilege. See Jacob H. Zamansky, Form U-5: Unequal Justice in State, U.S. Courts, INVESTMENTNEWS (May 30, 2006), http://www.investmentnews.com/article/20060530/SUB/605300701 (stating SEC should enact qualified immunity rule to protect reputations of honest brokers).


186. For examples of employees maliciously defamed by employers, see supra notes 9–14 and accompanying text.

187. See Hunt, supra note 9, at 7 (presenting qualified privilege rules that can be considered by SEC). The commissioner detailed a proposal from the Vice Chairman of Merrill Lynch that calls for arbitration to settle disputes before Form U-5s are submitted to the CRD. See id. ("The arbitrator could affirm or modify the U-5 language, and the decision would preclude seeking other redress based upon the original or modified language.").

188. See id. (explaining potential benefits for employees). Employees could have the language in their Form U-5 modified if they believe it is defamatory or untrue. See id. (describing employees’ ability to challenge language in Form U-5 in front of FINRA arbitrators).

189. See id. (describing potential benefits for employers).

190. See id. (discussing advantages and drawbacks of proposal).
V. Conclusion

Perhaps the most important aspect of the *Merkam* decision lies in its potential to demonstrate how *Rosenberg*’s reasoning can spread to states with unsettled law.191 The decision also comes at a time when arguments for absolute privilege are likely to increase as FINRA demands more information from employers.192 Therefore, if absolute privilege eventually becomes the law in Pennsylvania or other states, the SEC should take action to protect employees’ reputations.193

191. *See* Anne Marie Estevez, *Absolute Privilege Protects Employers’ Statements*, Law360 2–3 (Apr. 2, 2007), http://www.morganlewis.com/pubs/Estvez_Employ-Law360.pdf (“The Rosenberg decision is likely to be used as support for extending the absolute privilege not only to Form U-5 reporting in other states but also to other similar forms of mandatory regulatory reporting designed to protect the public.”); *see also* Weiss, *supra* note 17, at 5 (discussing influence of Rosenberg decision).

192. *See* Regulatory Notice 10–39, *supra* note 45, at 3 (“[A] firm may be required to provide an affirmative answer to a question even if the matter is not securities-related.”); *see also* Chris Kentouris, *Finra Wants More Details When Someone Gets Canned, OnWallStreet* (Oct. 1, 2010), (“[T]he firm must also disclose if it fired an employee for ‘misconduct,’ even if the firm was not making the allegations, and even if the misconduct did not involve a customer of the firm.”); Edward Beeson, *FINRA Warns on U5 Shortcomings, Compliance Rep.* (Sept. 17, 2010), available at 2010 WLNR 19689664 (“Industry officials cautioned that complying with FINRA’s demands will ratchet up pressure on firms and likely spark lawsuits from aggrieved former workers.”).

193. *See* Hunt, *supra* note 9, at 6 (“If the pendulum begins to swing in favor of absolute immunity, the Commission may need to consider whether to act.”).
A PREFERENCE FOR DEFERENCE: THE BENEFITS OF THE FIRST CIRCUIT’S CUSTOMIZED STANDARD OF REVIEW FOR COLLECTION DUE PROCESS APPEALS IN 
DALTON v. COMMISSIONER

ADAM M. COLE*

“It is not our role . . . to determine whether the IRS applied the correct rule of law. . . . [W]e need only determine whether the IRS applied a reasonable view of what the law is or might be.”

I. INTRODUCTION

Typical hardworking Americans pay their taxes on time and in full. Some citizens even do so because they view paying taxes as a civic duty. Unfortunately, not all people pay the tax they owe, which places a higher burden on the law-abiding, compliant taxpayers. A significant portion of

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2. See 1 INTERNAL REVENUE SERV., NATIONAL TAXPAYER ADVOCATE: 2006 ANNUAL REPORT TO CONGRESS 6 (2006) [hereinafter 2006 TAXPAYER ADVOCATE REPORT], available at http://www.irs.gov/pub/irs-utl/2006arc_vol_1_cover_section_1.pdf (noting over 95% compliance rate for taxpayers whose income is reported to IRS on Form W-2 wage withholding or other comparable schedules). In 2009, approximately 116 million tax returns were filed with reported income from salaries and wages. See INTERNAL REVENUE SERV., ESTIMATED DATA LINE COUNTS INDIVIDUAL INCOME TAX RETURNS 9 (2009), available at http://www.irs.gov/pub/irs-soi/09inlinecount.pdf (showing estimated number of tax returns filling out selected line items on return).

3. See Kevin Drawbaugh, Taxes Not Just Certain, They’re Right Thing To Do-Survey, TAX BREAK (Jan. 31, 2012), http://blogs.reuters.com/taxbreak/2012/01/31/taxes-not-just-certain-theyre-right-thing-to-do-survey/ (“Most Americans believe strongly that it’s a civic duty to pay their ‘fair share’ in taxes, that cheating on taxes is wrong and that cheaters should be held accountable . . . .’); see also INTERNAL REVENUE SERV., IRS OVERSIGHT BOARD: 2011 TAXPAYER ATTITUDE SURVEY 1 (2011), available at http://www.treasury.gov/irsob/reports/2012/IRSOB-Taxpayer%20Attitude%20Survey%202012.pdf (noting 84% of public feels it is “not at all acceptable to cheat on one’s income taxes,” while 72% feel it is their civic duty to pay taxes).

4. See 2006 TAXPAYER ADVOCATE REPORT, supra note 2, at 6 (noting each compliant taxpayer was assessed effective subsidy of $2,200 because of costs from noncompliant taxpayers). The subsidy amount was calculated by dividing the estimated uncollected tax amount by the number of individual income tax returns filed. See id. (calling “surtax” on compliant taxpayers “an extraordinary burden to expect the average taxpayer to bear”).
uncollected tax is attributable to businesses failing to pay the payroll taxes they withheld from employees. Every uncollected tax dollar adds to the already rising federal deficit. As a result, politicians have called for some Americans to pay their “fair share” of income tax to help reduce the deficit. Furthermore, the Internal Revenue Service (IRS) is under pressure to collect more tax during periods of budget deficits. The current uncollected amount is substantial: at the end of 2010, there was approximately $359 billion of uncollected tax.


7. See, e.g., Editorial, The State of the Union in 2012, N.Y. TIMES, Jan. 25, 2012, at A28. President Obama has called for wealthy Americans to pay their “fair share” in taxes. See id. (describing President Obama’s state of union address stating that “any credible plan to wrestle down the deficit must include the wealthy paying a fairer share of taxes”). Republican presidential candidate Mitt Romney disagrees with President Obama’s definition of fairness. See Michael D. Shear, Obama vs. Romney: Battles of Fairness Doctrines, THE CAUCUS (Apr. 27, 2012, 7:26 AM), http://thecaucus.blogs.nytimes.com/2012/04/27/obama-vs-romney-battle-of-the-fairness-doctrines/ (describing definition of fairness in various contexts as key campaign issue). This Note argues that a fairness distinction should be drawn between compliant and delinquent taxpayers, and delinquent taxpayers who owe the government taxes should pay their “fair share.” For a discussion of the distinction between these two groups, see infra note 12. This Note argues that judicial review of tax collection should be configured to allow the government to collect the “fair share” of taxes owed from all citizens if it uses reasonable methods. For a discussion of how a de novo standard of review can create unfairness in tax collection, see infra notes 153–62 and accompanying text.

8. See 1 Internal Revenue Serv., National Taxpayer Advocate: 2008 Annual Report to Congress viii (2008), available at http://www.irs.gov/pub/irs-utl/08tas_arc_intro_toc_msp.pdf (“On the other hand, as the budget deficit grows, the IRS comes under subtle pressure to collect more federal revenue and close the tax gap.”); Marilyn E. Phelan, Taxpayers’ Procedural Rights Can Clash With Aggressive Tax Enforcement, 82 Prac. Tax Strategies 149, 149 (2009) (“A concern with the tremendous and ever-increasing federal budget deficit (estimated to be in the trillions given the enormous projected costs of the recently enacted financial rescue and economic stimulus plans) may lend continuing support for the Treasury Department’s current more aggressive tax enforcement policy.”).

Given the importance of tax collection in periods of budget deficits, a well-functioning tax collection system must be fair and efficient. A fair tax system treats similarly situated taxpayers the same, a concept known as horizontal equity. To treat everyone fairly in the collection context, the IRS must try to collect from delinquent taxpayers, otherwise law-abiding, compliant taxpayers would be at a disadvantage. An efficient tax system collects taxes as quickly and inexpensively as possible. However, collecting unpaid tax is not cheap: the IRS spent over $5 billion on enforcement in 2011.

Because collecting tax revenue is of great importance, Congress historically allowed the IRS to collect taxes with no court interference prior to 2003.
to collection. However, some members of Congress grew concerned about the IRS’s “nearly unlimited collection discretion.” This prompted Congress to pass the IRS Restructuring and Reform Act of 1998 ("RRA"), which gave taxpayers limited pre-collection rights. These rights are referred to as the Collection Due Process ("CDP") rights.

CDP provides taxpayers with the right to a pre-collection administrative hearing to raise challenges to the proposed IRS collection action.

15. See Danshera Cords, How Much Process Is Due? I.R.C. Sections 6320 and 6330 Collection Due Process Hearings, 29 VT. L. Rev. 51, 56 (2004) [hereinafter Cords, How Much Process Is Due?] ("Historically, due process has not entitled a taxpayer to pre-deprivation review of IRS decisions to collect assessed, unpaid taxes."). Before 1998, a taxpayer generally had no right to protest collection actions until after collection. See id. at 57 (describing no pre-assessment review as justified “because of the significant hardship the government would suffer without the ability to promptly collect taxes owed”). Judicial review over tax collection was traditionally limited to post-collection refund claims in either the United States District Court or the Court of Federal Claims. See id. at 58 (explaining how administrative request for refund needed to be made and denied before filing refund suit).


18. Hereinafter referred to as “CDP,” “CDP rights,” or “CDP regime.” See I.R.C. §§ 6320, 6330 (2006) (providing rights for notice of federal tax lien and rights for notice of intent to levy). Some commentators have criticized the CDP regime for unnecessarily slowing collection. See Bryan T. Camp, The Failure of CDP, Part 2: Why It Adds No Value, 104 TAX NOTES 1567, 1569–70 (2004) (describing collection process as deciding whether delinquent taxpayer is classified as “can’t pay” or “won’t pay” and arguing CDP does not generate any new information to help with that decision); see also Book, supra note 16, at 1188–89 (arguing CDP is too broad because it allows taxpayers too many opportunities to challenge underlying tax liability); Cords, How Much Process Is Due?, supra note 15, at 99–100 (arguing CDP hearing procedures should be revised to create uniformity). This Note does not take a position on the merits of the CDP regime, but rather argues that the standard of review for subsidiary determinations should be for reasonableness in order for the current CDP regime to work as well as possible. For an argument as to how a deferential standard of review benefits the tax system, see infra notes 127–76 and accompanying text.

19. See I.R.C. § 6330(c)(2) (allowing taxpayer to raise spousal defenses, raise challenges to collection action, and propose collection alternatives). The taxpayer can also challenge the underlying tax liability if the taxpayer did not have a previous opportunity to do so. See id. § 6330(c)(2)(B) (providing opportunity for challenge if taxpayer did not receive “statutory notice of deficiency for such tax liability”).
Taxpayers can also make an offer-in-compromise to settle the tax debt. These CDP rights also include the ability to appeal unfavorable collection decisions to the Tax Court. Since 2003, appeals from collection due process hearings are one of the most commonly litigated issues in Tax Court.

In *Dalton v. Commissioner*, the First Circuit dealt with an issue of first impression: whether subsidiary determinations made during a CDP hearing—such as legal ownership of an asset—should be reviewed de novo or under a more deferential standard of review. In a typical case, an appellate court reviews all questions of law de novo, giving no deference to legal conclusions made by lower courts. *Dalton* held the opposite to be true, stating that in CDP appeals, all subsidiary determinations are reviewed for reasonableness, not correctness.

This Note analyzes how the *Dalton* standard of review departs from the Tax Court’s previous de novo approach, and argues that the deferential review benefits the tax system because it treats taxpayers fairly and allows the IRS proper deference to collect taxes in an efficient manner.

Part II provides a brief background of the CDP process, with an emphasis on the offers-in-compromise issue discussed in *Dalton*. Part II also describes the standard of review that past courts have used in CDP appeals.
as well as how the standard has been applied to subsidiary legal determinations. Part III describes the factual and procedural background of the *Dalton* case and analyzes the First Circuit’s reasoning. Part IV argues that the First Circuit reached the correct result because the *Dalton* standard of review increases efficiency and fairness, and is consistent with the purpose of CDP. Part V concludes by urging Congress to expressly incorporate this standard into the CDP statutes because of the likelihood that the Tax Court will not apply the standard in cases appealable to the other circuits.

II. A Peculiar Process: A Brief Overview of CDP and its Traditional Abuse of Discretion Standard of Review

CDP gives taxpayers the right to an administrative hearing to dispute a proposed collection action. An important part of the regime is the ability to appeal unfavorable administrative decisions to the Tax Court, which generally uses an abuse of discretion standard of review. The Tax Court has also used a de novo review of certain subsidiary determinations that are made before the final CDP determination.

A. CDP: What Are Your “Rights” Before Collection?

The IRS can assess a tax liability in one of two ways: (1) through an underpayment, when a taxpayer files a tax return showing a balance due and does not pay; and (2) through the deficiency process, when the IRS claims that the taxpayer should have paid more tax than was paid on the finalized return. Once the IRS properly assesses a tax liability, it can

29. For a discussion of the standard of review the Tax Court uses in CDP cases and how it has been applied in certain circumstances, see infra notes 50–62 and accompanying text. For a discussion of the standard of review the Tax Court used to review subsidiary determinations in prior CDP cases, see infra notes 63–75 and accompanying text.

30. For a discussion of *Dalton* and an analysis of the First Circuit’s decision, see infra notes 76–106 and accompanying text.

31. For a discussion how the *Dalton* standard increases efficiency in the tax system, see infra notes 131–52 and accompanying text. For a discussion of how it increases fairness in the tax system, see infra notes 153–62 and accompanying text. For a discussion of how the standard adheres to CDP’s purpose, see infra notes 163–76 and accompanying text.

32. For a discussion of why Congress should codify the *Dalton* standard of review, see infra notes 177–82 and accompanying text.

33. For a discussion of judicial review of CDP decisions, see infra notes 50–62 and accompanying text.

34. For a discussion of the standard of review the Tax Court used in past cases involving subsidiary determinations, see infra notes 65–75 and accompanying text.

35. See Book, *supra* note 16, at 1150 (explaining how IRS properly assesses tax liabilities). If a taxpayer does not pay after a valid assessment, an automatic lien in favor of the IRS arises on all of a taxpayer’s property. See id. (explaining lien is in amount of tax liability and includes potential interest and penalties).
exercise its “powerful administrative collection powers.”\textsuperscript{37} The IRS has two main collection powers affected by CDP: tax liens and tax levies.\textsuperscript{38} After an assessment of liability and demand for payment, the IRS can levy a taxpayer’s property to satisfy the debt if the tax remains unpaid.\textsuperscript{39}

Under CDP, after the IRS files a Notice of Intent to Levy or a Notice of Federal Tax Lien, it must inform a taxpayer of their right to request a CDP hearing with the IRS Office of Appeals.\textsuperscript{40} At the hearing, the taxpayer can propose collection alternatives.\textsuperscript{41} One common collection alter-

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\textsuperscript{37} Id. at 150–52 (providing background on tax liens and levies); see also Cords, \textit{How Much Process Is Due?}, supra note 15, at 54 (describing assessment as “first step” in collection process).

\textsuperscript{38} See I.R.C. § 6331(b) (2006) (“The term ‘levy’ as used in this title includes the power of distraint and seizure by any means.”); see also Bryan T. Camp, \textit{Failure of Collection Due Process, Pt. 1: The Collection Context}, 104 Tax Notes 969, 970 (2004) [hereinafter Camp, \textit{Collection Context}] (providing explanation of all three collection powers but noting ability to offset liabilities with refunds not relevant to CDP because RRA did not address it). Tax liens arise automatically after the IRS assesses a tax liability. See I.R.C. § 6321 (providing lien arises “upon all property and rights to property, whether real or personal, belonging to such person”); see also Camp, \textit{Collection Context}, supra, at 970 (describing lien as “virtual sticky note[] claiming ‘Pay Me’ on all property the taxpayer has or acquires”). The lien is misunderstood because the IRS does not file for a lien like a typical creditor would, but instead files the notice of the lien. See id. (explaining lien already exists because of automatic trigger from Code). The IRS must file a Notice of Federal Tax Lien to give notice of the lien to third parties. See id. (explaining lien is effective tool for real property because lien is paid off when property is sold). Although only one lien exists, the IRS can file multiple notices of the lien depending on where the taxpayer has assets. See id. (noting IRS can enforce lien through “either inquisitorial process (levy) or adversarial process (court action)” if lien is not paid off when property sold).

\textsuperscript{39} See I.R.C. § 6331(a) (delegating authority to Secretary of Treasury to collect tax through levy power). The IRS must give thirty day notice before levying property. See id. § 6331(d)(2) (providing notice must be in person, left at dwelling or usual place of business, or sent by certified mail); see also Camp, \textit{Collection Context}, supra note 38, at 971 (describing levy as another misunderstood tool and as statutory power to take property to settle tax debt). The levy must be asserted against a specific piece of property, unlike a lien that “attaches to all future acquired property as well as current property.” Id. (noting liens and levies can be used together even though they are separate collection tools).

\textsuperscript{40} See I.R.C. §§ 6320(a)(1), 6330(a)(1) (providing for tax liens and tax levies). The hearing must be conducted by an IRS agent with no previous connection to the taxpayer’s case. See id. § 6330(b)(3) (allowing taxpayer to waive impartial officer requirement). The hearing is informal in nature. See Cords, \textit{How Much Process Is Due?}, supra note 15, at 65–70 (describing various ways hearings are conducted, including telephone, face-to-face, correspondence only, or combination of all three). Taxpayers must submit a request for a hearing in writing, and are encouraged to use Form 12153 “Request for a Collection Due Process Hearing.” See Treas. Reg. § 301.6320-1(c)(2) (as amended in 2006) (describing alternative steps to properly request CDP hearing and detailing written requirement important for evidentiary purposes to ensure timely request).

\textsuperscript{41} See I.R.C. § 6330(c)(2)(A)(iii) (allowing taxpayer to raise “offers of collection alternatives, which may include the posting of a bond, the substitution of other assets, an installment agreement, or an offer-in-compromise”). Although the Code lists these issues that can be raised, it is not a fully inclusive list. See Cords,
native is the offer-in-compromise ("OIC"), a procedure in which a taxpayer offers to settle a tax liability for less than the full amount.\textsuperscript{42} Before deciding whether to accept or reject an OIC, the IRS first calculates a taxpayer’s reasonable collection potential ("RCP"), or what it expects the taxpayer could reasonably pay in tax.\textsuperscript{43} The IRS calculates the RCP by analyzing the taxpayer’s expected income, estimated living expenses, assets, and liabilities.\textsuperscript{44} The IRS’s initial conclusions on the tax-

\begin{quote}
\textit{How Much Process Is Due?}, supra note 15, at 89 (explaining legislative history of RRA shows list was not meant to be limited). Taxpayers are generally excluded from raising any issue that was “raised in a prior proceeding in which the taxpayer meaningfully participated . . . .” Id.
\end{quote}

\textsuperscript{42} See I.R.C. § 7122(a) (2006) (authorizing Secretary of Treasury to "compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense"). A taxpayer must submit Form 656: Offer in Compromise, describing the taxpayer’s circumstances and why the IRS should accept, along with at least a 20% payment of the offer amount. See Shu-Yi Oei, \textit{Getting More by Asking Less: Justifying and Reforming Tax Law’s Offer-In-Compromise Procedure}, 160 U. PA. L. REV. 1071, 1077–81 (2012) (describing OIC procedure in detail); see also Michael I. Saltzman & Leslie Book, \textit{IRS Practice and Procedure} ¶¶ 15.07[3][a]-[b] (2010) (listing advantages and disadvantages to taxpayer of making offer-in-compromise); see generally I. Jay Katz, \textit{An Offer in Compromise You Can’t Confuse: It Is Not the Opening Bid of a Delinquent Taxpayer to Play Let’s Make a Tax Deal with the Internal Revenue Service}, 81 MISS. L.J. 1673, 1681 (2012) (offering detailed history of development of OIC process and analyzing major developments in law). The regulations provide three reasons why the IRS would exercise its discretion and accept an OIC: (1) doubt as to liability; (2) doubt as to collectability; and (3) the promotion of effective tax administration. See Treas. Reg. § 301.7122-1(b)(iii) (2002) (prohibiting compromise if it would "undermine compliance by taxpayers with the tax laws"); see also Oei, supra, at 1078–80 (describing all three grounds for compromise and circumstances in which IRS would accept OIC under each). The OIC procedure has several policy goals:

- Effect collection of what can reasonably be collected at the earliest possible time and at the least cost to the government.
- Achieve a resolution that is in the best interests of both the individual taxpayer and the government.
- Provide the taxpayer a fresh start toward future voluntary compliance with all filing and payment requirements.
- Secure collection of revenue that may not be collected through any other means.

Oei, supra, at 1078. The IRS most often accepts an OIC because of doubt as to collectability. See id. (detailing IRS’s procedure for determining taxpayer’s ability to pay).

\textsuperscript{43} See Oei, supra note 42, at 1078 (commenting that IRS must calculate RCP to "determine the taxpayer’s ability to pay"). The Internal Revenue Manual, a non-binding guide for IRS employees, defines RCP as “the amount that can be collected from all available means, including administrative and judicial collection remedies.” IRM 3.8.4.3(2) (June 1, 2010).

\textsuperscript{44} See Oei, supra note 42, at 1079 ("Essentially, in determining whether a doubt-as-to-collectability offer should be accepted, the IRS has to analyze the taxpayer’s assets, expenses, and liabilities."). The RCP calculation accounts for the “taxpayer’s expected future income after taking into account necessary living expenses.” Id. (commenting that IRS uses national and local standards for calculating living expenses). The RCP calculation considers the “net realizable equity” in assets. See id. at 1079 n.24 (noting net realizable equity is calculated using “quick
payer’s financial circumstances—such as whether the taxpayer owns certain assets—can be referred to as subsidiary determinations. They are subsidiary determinations because the IRS must make these decisions before making the final determination of whether to accept the OIC.

Although the IRS has complete discretion to accept or reject an OIC, the IRS will almost always reject an OIC if it calculates a RCP that is higher than the taxpayer’s offer. The Appeals Officer issues a final written determination as to whether the collection action can proceed after the officer reviews the proposed action and any proposed collection alternatives. The taxpayer then has thirty days to appeal an unfavorable CDP determination to the Tax Court.

sale value,” or value if taxpayer had to sell within ninety days). The calculation also includes a taxpayer’s “income or assets that are available to the taxpayer but beyond the reach of the IRS, such as property held abroad.” Id. at 1079.

45. See Dalton v. Comm’r, 682 F.3d 149, 152 (1st Cir. 2012) (describing IRS’s conclusions as to taxpayer’s legal ownership of certain assets before deciding whether to accept OIC as subsidiary determinations). Although these issues could be referred to as underlying legal or factual issues, for the purposes of this Note they will be called subsidiary determinations to be consistent with the First Circuit’s language in Dalton. See id. (describing IRS’s decision on underlying ownership issue as “subsidiary determination”). Whether a taxpayer wrongly dissipated an asset prior to making an OIC is another example of a subsidiary determination. See, e.g., Tucker v. Comm’r, 101 T.C.M. (CCH) 1307, 1315 (2011) (affirming IRS’s decision to include value of taxpayer’s stock trading losses in RCP because it determined taxpayer disregarded tax liability and could have used money to pay outstanding taxes), aff’d, 676 F.3d 1129 (D.C. Cir. 2012). If the IRS determines the taxpayer wrongly dissipated an asset without regard to an outstanding tax liability, it will include the asset’s value in the RCP. See id. at 1314 (noting that although inclusion of dissipated assets does not increase actual collection potential, inclusion rule deters “delinquent taxpayers from wasting money that they owe and should pay as taxes”). Therefore, an asset dissipation issue is a subsidiary determination because the IRS must first determine whether the dissipated asset should be included in the RCP before deciding whether to accept or reject the OIC. See IRM 5.8.5.16 (Oct. 16, 2010) (giving instructions to IRS employees to consider asset dissipation prior to ruling on OIC). Another example of a subsidiary determination is when the IRS determines whether a taxpayer’s liabilities were discharged in bankruptcy before ruling on a proposed collection action. For a discussion of the Tax Court’s standard of review of subsidiary determinations for bankruptcy issues, see infra notes 63–75 and accompanying text.

46. See Oei, supra note 42, at 1078 (explaining OIC requires IRS to first determine taxpayer’s RCP to facilitate comparison with offer amount).

47. See IRM 5.8.4.3(2) (June 1, 2010) (“[T]he decision to accept or reject usually rests on whether the amount offered reflects the reasonable collection potential (RCP).”); Oei, supra note 42, at 1074 (“The taxpayer must meet certain requirements and conditions in order to qualify, and the IRS has the discretion to accept or deny the offer.”).

48. See I.R.C. § 6330(c)(3) (2006) (requiring officer to consider valid issues raised by taxpayer before making final determination). The Appeals Officer must also consider whether the “proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary.” Id. § 6330(c)(3)(C).

49. See id. § 6320(d) (1) (giving Tax Court exclusive jurisdiction for appeals). The Tax Court is an Article I court of record that only has jurisdiction over cases
B. Judicial Review of CDP Appeals

The Internal Revenue Code (the “Code”) does not set the standard of review for collection due process appeals. Instead, the Tax Court looks to the legislative history of the RRA for guidance on the proper standard. The Tax Court uses an abuse of discretion review when the underlying tax liability is not in dispute. Under the abuse of discretion standard, the Tax Court will only reverse the IRS’s final determination if it finds the decision “arbitrary, capricious[, or without sound basis in fact or law.”

While the final IRS decision is reviewed for abuse of discretion, in Robinette v. Commissioner the Tax Court held that it could consider new evidence that was not part of the administrative record to determine whether the IRS abused its discretion.

Congress specifically assigns to it by statute. See Saltzman, supra note 42, at 1.06[1] (explaining history of Tax Court and noting that it “adjudicates cases in the same manner as a federal district court judge sitting without a jury”). The Tax Court is a single court located in Washington D.C. that travels around the country in designated cities to conduct trials. See About the Court, U.S. Tax Court (last updated May 25, 2011), http://www.ustaxcourt.gov/about.htm (giving general background of Tax Court). It is comprised of nineteen judges that are appointed by the President. See id. (explaining appointed judges are experts in tax law).

50. See I.R.C. §§ 6320, 6330 (presenting provisions for CDP, but not judicial review).


52. See id. at 610 (“Where the validity of the tax liability is not properly part of the appeal, the taxpayer may challenge the determination of the appeals officer for abuse of discretion.”).


54. See Schwartz v. Comm’r, 348 F. App’x 806, 808 (3d Cir. 2009) (noting parties did not dispute that rejection of OIC was reviewed for abuse of discretion); Salazar v. Comm’r, 338 F. App’x 75, 77–78 (2d Cir. 2009) (finding IRS did not abuse discretion in rejecting OIC); Keller v. Comm’r, 568 F.3d 710, 716 (9th Cir. 2009) (“Like the Tax Court, our review of the decision by the Commissioner whether to accept an offer-in-compromise is for an abuse of discretion.”); Poindexter v. Comm’r, 321 F. App’x 771, 773 (10th Cir. 2009) (applying abuse of discretion review to IRS administrative determinations); Marshall v. United States, 300 F. App’x 636, 638 (11th Cir. 2008) (applying abuse of discretion review to IRS decision that taxpayer’s ability to pay exceeded OIC); Murphy v. Comm’r, 469 F.3d 27, 32 (1st Cir. 2006) (holding abuse of discretion review of administrative determination appropriate in collection due process appeal when underlying tax liability not in dispute); Orum v. Comm’r, 412 F.3d 819, 820 (7th Cir. 2005) (citing Jones and noting “[j]udicial review of [IRS determinations] is deferential”); Living Care Alts. of Utica, Inc. v. United States, 411 F.3d 621, 625–26 (6th Cir. 2005) (looking to legislative history for guidance on applying abuse of discretion review when tax liability is not in dispute); Jones v. Comm’r, 338 F.3d 463, 466 (5th Cir. 2003) (stating courts review IRS administrative determinations for abuse of discretion).

55. 123 T.C. 85 (2004), rev’d, 439 F.3d 455 (8th Cir. 2006).

56. See id. at 95–96 (holding Administrative Procedure Act not applicable and therefore court could consider new evidence in abuse of discretion review).
under an abuse of discretion standard of review is referred to as a de novo scope of review. The Tax Court stated that it reviewed the IRS’s final decision for abuse of discretion, but effectively held a trial de novo by considering new evidence. The de novo scope of review allowed the Tax Court to substitute its judgment for that of the IRS because the court considered evidence that the IRS did not, creating a standard of review that was similar to de novo. Under the rule of Golsen v. Commissioner, the Tax Court follows the law of the circuit court to which an appeal would follow. Therefore, although the Eight Circuit expressly overturned the Robinette decision, the Tax Court continues to follow Robinette in cases appealable to circuits that have not yet ruled on the issue.

**C. The Decision Before the Decision: Standard of Review for Subsidiary Determinations in Past Tax Court Cases**

Whereas the final CDP determination is reviewed using an abuse of discretion standard of review, the IRS must first make several subsidiary determinations. See Porter v. Comm’r, 130 T.C. 115, 122–23 (2008) (discussing intersection and differences of scope of review and standard of review). The standard of review refers to the level of deference an appellate court will give to a lower court’s findings; the scope of review refers to whether the court will consider new evidence or not. See id. (explaining standard of review and scope of review). If a reviewing court considers new evidence, it is referred to as a de novo scope of review. See id. (referring to admission of new evidence as holding “de novo trial”).

Nevertheless, the Robinette court purported to review the IRS decision for abuse of discretion. See Robinette, 123 T.C. at 105 (“Where, as here, the validity of the underlying tax liability is not at issue, we review the determination for abuse of discretion.”). See Cords, Administrative Law, supra note 10, at 445 (describing Tax Court’s standard of review as “more closely resembl[ing] de novo review” and arguing Tax Court applies de novo standard “because of its limited experience with abuse of discretion review”); see also Book, supra note 16, at 1173–74 (describing Tax Court’s approach as “taxpayer friendly” because it holds “trials de novo in situations where an abuse of discretion standard applies”).

See Porter v. Comm’r, 130 T.C. 115, 122–23 (2008) (discussing intersection and differences of scope of review and standard of review). The standard of review refers to the level of deference an appellate court will give to a lower court’s findings; the scope of review refers to whether the court will consider new evidence or not. See id. (explaining standard of review and scope of review). If a reviewing court considers new evidence, it is referred to as a de novo scope of review. See id. (referring to admission of new evidence as holding “de novo trial”).

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57. See Golsen v. Commissioner, 34 T.C. 54 (1960) (discussing intersection and differences of scope of review and standard of review). The standard of review refers to the level of deference an appellate court will give to a lower court’s findings; the scope of review refers to whether the court will consider new evidence or not. See id. (explaining standard of review and scope of review). If a reviewing court considers new evidence, it is referred to as a de novo scope of review. See id. (referring to admission of new evidence as holding “de novo trial”).

58. See Med. Practice Solutions, L.L.C. v. Comm’r, 99 T.C.M. (CCH) 1392, 1395 (2010) (describing Robinette as providing for “de novo trial”). Nevertheless, the Robinette court purported to review the IRS decision for abuse of discretion. See Robinette, 123 T.C. at 105 (“Where, as here, the validity of the underlying tax liability is not at issue, we review the determination for abuse of discretion.”).

59. See Golsen v. Commissioner, 34 T.C. 54 (1960) (discussing intersection and differences of scope of review and standard of review). The standard of review refers to the level of deference an appellate court will give to a lower court’s findings; the scope of review refers to whether the court will consider new evidence or not. See id. (explaining standard of review and scope of review). If a reviewing court considers new evidence, it is referred to as a de novo scope of review. See id. (referring to admission of new evidence as holding “de novo trial”).

60. See Med. Practice Solutions, L.L.C. v. Comm’r, 99 T.C.M. (CCH) 1392, 1395 (2010) (describing Robinette as providing for “de novo trial”). Nevertheless, the Robinette court purported to review the IRS decision for abuse of discretion. See Robinette, 123 T.C. at 105 (“Where, as here, the validity of the underlying tax liability is not at issue, we review the determination for abuse of discretion.”).

61. See id. at 757 (“[W]e think that where the Court of Appeals to which appeal lies has already passed upon the issue before us, efficient and harmonious judicial administration calls for us to follow the decision of that court.”). See id. at 757 (“[W]e think that where the Court of Appeals to which appeal lies has already passed upon the issue before us, efficient and harmonious judicial administration calls for us to follow the decision of that court.”). See id. at 757 (“[W]e think that where the Court of Appeals to which appeal lies has already passed upon the issue before us, efficient and harmonious judicial administration calls for us to follow the decision of that court.”).

62. See, e.g., Med. Practice Solutions, L.L.C., 99 T.C.M. (CCH) 1395 (2010) (discussing intersection and differences of scope of review and standard of review). The standard of review refers to the level of deference an appellate court will give to a lower court’s findings; the scope of review refers to whether the court will consider new evidence or not. See id. at 757 (“[W]e think that where the Court of Appeals to which appeal lies has already passed upon the issue before us, efficient and harmonious judicial administration calls for us to follow the decision of that court.”). See id. at 757 (“[W]e think that where the Court of Appeals to which appeal lies has already passed upon the issue before us, efficient and harmonious judicial administration calls for us to follow the decision of that court.”).
factual and legal determinations before making the final CDP determination and the issue of which standard of review applies to these determinations has arisen in past Tax Court decisions. In Swanson v. Commissioner, the Tax Court held that if the IRS committed an error of law, it was an automatic abuse of discretion. The court, analyzing a subsidiary bankruptcy law issue, never stated under which standard of review it would analyze the subsidiary determination of law. Nevertheless, the standard of review resembled de novo because the Tax Court performed its own analysis of the law and substituted its own view without any mention of the IRS’s interpretation.

The Tax Court addressed the issue again in Kendricks v. Commissioner, stating that the outcome regarding the subsidiary determination of law was the same—whether reviewed de novo or for abuse of discretion—because erroneous views of the law cannot stand under either standard. The Tax Court relied on its previous decision in Swanson and the

63. For a discussion of the subsidiary decisions that the IRS must make before deciding whether to accept or reject an OIC, see supra notes 45–46 and accompanying text. For a discussion of cases addressing the issue of the standard of review for subsidiary determinations, see infra notes 64–75 and accompanying text.

64. 121 T.C. 111 (2003).

65. See id. at 119 (“If [the IRS]’s determination was based on erroneous views of the law . . . then we must reject [the IRS]’s views and find that there was an abuse of discretion.”); see also Freje v. Comm’r, 125 T.C. 14, 36 (2005) (holding that IRS error of law was “accordingly an abuse of discretion”).

66. See Swanson, 121 T.C. at 119 (declaring that it would be abuse of discretion if IRS determination was erroneous view of law, but not stating how appellate court would review that determination). In Swanson, the taxpayer argued that the collection action should not proceed because the taxpayer’s liabilities were discharged in a bankruptcy proceeding. See id. at 120–25 (analyzing whether taxpayer’s tax liability was “dischargeable debt” under bankruptcy law). Under bankruptcy law, all of a debtor’s debts are generally discharged. See id. at 120 (describing general rule for debts incurred prior to filing). Although the bankruptcy court’s order discharged the debtor from all “dischargeable debts,” the order did not address whether the debtor’s tax liabilities were discharged. See id. at 121 (commenting that record was unclear whether specific tax liabilities were included in bankruptcy court discharge order).

67. See id. at 125 (“Accordingly, we hold that pursuant to [the Bankruptcy Code], the U.S. Bankruptcy Court for the Northern District of Texas did not discharge petitioner from his unpaid liabilities . . . .”). The court did not discuss the IRS’s determination, but merely declared its own judgment—a review similar to de novo. See id. at 120–25 (analyzing bankruptcy law issue without reference to IRS’s conclusions).

68. 124 T.C. 69 (2005).

69. See id. at 75 (“When faced with questions of law . . . the standard of review makes no difference. Whether characterized as a review for abuse of discretion or as a consideration ‘de novo’ (of a question of law), we must reject erroneous views of the law.”). In Kendricks, the question of law turned on whether the taxpayer had an opportunity to contest the tax liability at the taxpayer’s bankruptcy proceeding. See id. at 73 (describing taxpayer’s request for CDP hearing to dispute underlying tax liability). The court analyzed the Bankruptcy Code, the Tax Code, and case law to hold that the taxpayer did have the opportunity to dispute the liability in
Supreme Court’s decision in *Cooter & Gell v. Hartmarx Corp.* for the principle that errors of law cannot stand under an abuse of discretion review. The *Hartmarx* Court noted that an abuse of discretion would always occur if the ruling was based “on an erroneous view of the law or on a clearly erroneous assessment of the evidence.”

*Swanson* and *Kendricks* consistently support the proposition that a clearly erroneous view of the law is an abuse of discretion. However, neither court addressed the issue of how an appellate court should review subsidiary determinations of law for unsettled legal areas—where any view of the law is unlikely to be clearly erroneous. The First Circuit addressed exactly that scenario in *Dalton*.

III. *Dalton*: The First Circuit Creates a Customized Standard of Review for CDP Appeals

The First Circuit in *Dalton* ruled on the issue of how to review subsidiary determinations in CDP appeals. The reasonableness of the IRS’s final collection determination turned on the subsidiary issue of whether the taxpayer’s primary residence should be considered in the Daltons’ reason-
able collection potential.\textsuperscript{77} In ruling for the IRS, the First Circuit created a deferential, customized standard of review for CDP appeals.\textsuperscript{78}

A. Telling the IRS That You Do Not Own Your Home to Escape a Tax Liability: Background and Procedural History of Dalton

The Daltons were married taxpayers whose former business—like many other businesses—owed the IRS payroll taxes withheld from their employees’ paychecks, but never paid to the IRS.\textsuperscript{79} The Daltons were personally liable for $400,000 of unpaid tax from their business.\textsuperscript{80} The IRS filed a notice of intent to levy, seeking the Daltons’ equity interest in their primary residence (the “Property”).\textsuperscript{81} Before the Daltons’ tax trouble started, legal title in the Property was transferred to a trust for little consideration.\textsuperscript{82} The Daltons did not request a CDP hearing to dispute the amount of tax owed, but to propose an offer-in-compromise (OIC) to settle their debt for pennies on the dollar.\textsuperscript{83}

At the hearing, the Daltons argued that they would never be able to pay their full tax debt because they did not own the Property and had insufficient income.\textsuperscript{84} The Daltons made an OIC to settle their $400,000

\textsuperscript{77. For a discussion of the facts and procedural background of the Dalton case, see infra notes 79–93 and accompanying text.}
\textsuperscript{78. For an analysis of the Dalton decision and a discussion of why the court held for the IRS, see infra notes 95–106 and accompanying text.}
\textsuperscript{79. See Dalton v. Comm’r, 682 F.3d 149, 152–53 (1st Cir. 2012) (describing tax debt that arose from unpaid payroll taxes from taxpayer’s former business). Unpaid payroll taxes represent a significant portion of the total unpaid, assessed tax. See T. Keith Fogg, In Whom We Trust, 43 CREIGHTON L. REV. 357, 361 (2010) (acknowledging small businesses account for higher portion of unpaid payroll taxes than large businesses and how concentration is problematic because of high failure rate for small businesses); Fogg, supra note 5, at 7–9 (giving example of how companies usually “borrow” payroll taxes withheld for current cash needs instead of paying to IRS).}
\textsuperscript{80. See Dalton, 682 F.3d at 153 (noting taxpayers were personally liable for company’s tax debt under Code provision).}
\textsuperscript{81. See id. (noting taxpayers had substantial equity interest in residence).}
\textsuperscript{82. See id. at 152 (giving background of trust transaction). In 1983, the Daltons sold the Property to Mr. Dalton’s father for $1, who then transferred the Property to a trust. See id. The father was originally the trustee before his death, when Mr. Dalton named his brother-in-law, Robert Pray, the successor trustee. See id. at 152–53 The Daltons’ children were the primary beneficiaries of the trust; however, the Daltons acted as the Property’s owners. See id. at 152 (noting Daltons granted mortgage interest in Property and signed mortgage documents as owner). Certain legal formalities associated with trusts were not observed, such as legal paperwork being forwarded to the Daltons instead of the trustee. See id. at 153 (calling efforts to comply with legal formalities “less than scrupulous”). In addition, the Daltons also used the Property as their primary residence and paid all of its expenses. See id. at 152–53 (noting trustee Pray claimed to control trust Property).}
\textsuperscript{83. See id. (noting hearing requested under Section 6330(b)).}
\textsuperscript{84. See id. at 153 (noting that “based on their assets and income, [the Daltons] could never come close to satisfying their total tax liability”). For a dis-
debt for $10,000.85 The IRS calculated that the Daltons’ reasonable collection potential was higher than the $10,000 OIC because it considered the Property among the Daltons’ assets, and therefore rejected the offer.86 The IRS analyzed federal nominee law to conclude that the Daltons legally owned the Property, not the trust.87 The Daltons appealed the determination to the Tax Court, which held that the IRS abused its discretion by not considering state nominee law and remanded the case back to the IRS.88 On remand, the IRS analyzed Maine law and again concluded that the Daltons owned legal title and therefore rejected the OIC a second time.89

Hearing the case again, the Tax Court reviewed the subsidiary ownership issue de novo, but reviewed the IRS’s final decision to reject the OIC for abuse of discretion.90 The Tax Court performed a lengthy analysis of state and federal nominee law and held that the Daltons did not own the Property.91 Therefore, the court held that the IRS abused its discretion by rejecting the OIC.92 The IRS appealed the decision to the First Circuit.93

85. See Dalton, 682 F.3d at 153 (noting Daltons asserted OIC should be accepted because of doubt as to collectability). The offer represented less than 3% of the total liability. See id. (stating that total liability was $400,000 and Daltons’ offer was $10,000).
86. See id. at 153–54 (commenting that taxpayer’s equity interest in Property could be liquidated to provide more funds than current $10,000 offer).
87. See id. (noting IRS determined “trust . . . held naked legal title purely for [the taxpayers’] convenience” and therefore trust was nominee for taxpayer). A nominee is “an ‘individual who holds legal title to property of a taxpayer while the taxpayer enjoys full use and benefit of that property.’”94 Stephanie Hoffer et al., To Pay or Delay: The Nominee’s Dilemma Under Collection Due Process, 82 TUL. L. REV. 781, 807 (2008) (quoting IRM 5.17.2.5.7.2(1) (Mar. 27, 2012)) (explaining that nominee determination requires “facts and circumstances analysis[,]” with no one factor being determinative). Among the factors listed in the Internal Revenue Manual are whether the taxpayer retains possession or control of the property, whether the nominee paid little or no consideration for the property, and whether the taxpayer pays all or most of the property’s expenses. See id. (noting “federal tax lien extends to property ‘actually’ owned by the taxpayer even though a third party holds ‘legal’ title to the property as nominee” (quoting IRM 5.17.2.5.7.2(1) (Mar. 27, 2012))).
88. See Dalton v. Comm’r, 96 T.C.M. (CCH) 3, 8 (2008) (reasoning court could not conclude whether IRS abused discretion because it did not consider nominee issue under state law); Saltzman, supra note 42, ¶ 14.15 (noting that state law can decide whether nominee exists and listing factors courts consider).
89. See Dalton, 682 F.3d at 154 (explaining IRS concluded Maine court would look to federal law for nominee issue and therefore it followed its original legal conclusion under federal law).
90. See id. (“Reviewing the IRS’s ownership finding de novo, the [Tax] court determined that the trust was not a nominee of the taxpayers under Maine law.”).
92. See id. at 423 (concluding trust not taxpayer’s nominee under federal law).
93. See Dalton, 682 F.3d at 154 (“This timely second-tier appeal ensued.”). The IRS issued a Chief Counsel Advisory disagreeing with the Tax Court’s decision...
B. The First Circuit: “One Size Does Not Fit All” for CDP Standards of Review

The court first noted that the proper standard of review for subsidiary determinations the IRS makes during a CDP hearing was an issue of first impression. To resolve the issue, the court created a two-step, customized standard of review for CDP: first, a reviewing court must determine whether the IRS’s subsidiary determinations were reasonable using evidence in the administrative record; second, it must determine whether the final determination constituted an abuse of discretion.

The court gave three reasons for its decision. First, the deferential standard of review carried out the purpose of CDP: to ensure that IRS collection decisions are not arbitrary. CDP was meant as an oversight of IRS decisions, not as a means to adjudicate individual collection actions. The court stated that erroneous views of the facts or law would be unreasonable and therefore always constitute an abuse of discretion. A de novo review was inappropriate because it “would result in the courts inevitably becom[ing] involved on a daily basis with tax enforcement details that judges are neither qualified, nor have the time, to administer.”

Second, the court found that the customized, deferential standard of review in *Dalton* and directed agents to look at the decision to see “how complex the [nominee] question may become.” I.R.S. Chief Couns. Advisory 201211023 (Mar. 16, 2012).

94. *Dalton*, 682 F.3d at 154 (“In the exercise of powers of judicial review, one size does not fit all.”).

95. See id. at 151–52 (“[N]o court has had the occasion to parse that standard and analyze how it plays out with respect to subsidiary factual and legal determinations made by the IRS during the CDP process. We grapple with that issue today.”). Although past courts “had the occasion” to analyze how the standard applied to subsidiary determinations, the First Circuit was the first to explicitly rule on the issue. For a discussion of past Tax Court cases addressing this issue, see supra notes 63–75 and accompanying text.

96. See *Dalton*, 682 F.3d at 156 (summarizing new standard of review). Both components of the two-step, customized standard of review will hereinafter be referred to collectively as the “*Dalton* standard.” The first part of the standard—review of subsidiary determinations—when referred to alone will be called the “reasonableness standard.” The second part of the standard—review of the final CDP determination—when referred to alone will be called the “abuse of discretion standard.”

97. See id. at 154–56 (justifying decision that courts should use deferential standard of review over subsidiary determinations).

98. See id. at 155 (explaining judicial review must be “tailored” to CDP’s purpose of ensuring IRS decisions are not arbitrary).

99. See Book, supra note 16, at 1195–96 (arguing de novo review “tends to become more of a judicial substitution of judgment, rather than a mechanism for external control of agency practice—the very rationale for CDP in the first place”).

100. See *Dalton*, 682 F.3d at 159 n.6 (“Of course, an absurd factual determination or a legal determination that flies in the face of settled precedent will never be reasonable and, thus, will always constitute an abuse of the IRS’s discretion.”).

101. *Id.* at 155 (quoting Olsen v. United States, 414 F.3d 144, 150 (1st Cir. 2005)).
view made sense because of the informal nature of CDP hearings and the likelihood the administrative record would be incomplete.\footnote{102 See id. at 155–56 (explaining that because Congress knew of possibility of limited record to review, it never intended for courts to “undertake de novo review of subsidiary determinations made during that process”).} Lastly, the court noted that a de novo standard of review would create judicial inefficiencies by allowing the taxpayers “two bites at the cherry.”\footnote{103 See id. at 156 (noting if taxpayers lost, Commissioner would have to litigate the ownership issue at proceeding with trust joined as party). In this case, the “cherry” was the issue of who owned the property. See id. (explaining that deciding ownership issue would adjudicate rights of third party).}

Once the court established the customized, deferential standard of review, it ruled that the IRS did not abuse its discretion by rejecting the Daltons’ OIC.\footnote{104 See id. at 158 (concluding IRS’s view of nominee law was reasonable—because IRS reasonably concluded Daltons legally owned property and could afford to pay more—and therefore IRS did not abuse discretion by rejecting Daltons’ offer).} The court found that the IRS took a reasonable view of state and federal nominee law—a complex and unsettled area of law—to determine the Daltons legally owned the property.\footnote{105 See id. at 157–59 (“In this instance, we believe that the IRS acted reasonably in looking to case law from other jurisdictions to fill the void and illuminate Maine’s nominee doctrine.”). The court agreed with the IRS’s adoption of a balancing test that weighed several factors to analyze the nominee issue. See id. at 158 (“Viewed against this backdrop, the IRS’s decision to apply a balancing test to resolve the nominee question appears reasonable.”). The court further agreed that the IRS’s application of the test to conclude the Daltons legally owned the property was reasonable. See id. (discussing various nominee factors and noting most factors weighed against Daltons). The court noted that the application of nominee law was not an easy decision. See id. at 159 (commenting that some factors weighed in favor of Daltons, but true question was not who owned property, but “whether the IRS’s determination, correct or not, falls within the wide universe of reasonable outcomes”). For a further discussion of nominee law and the relevant factors, see supra note 87.} The IRS therefore did not abuse its discretion by rejecting the OIC because it reasonably determined the Daltons had the ability to pay more than their offer.\footnote{106 See Dalton, 682 F.3d at 158 (implying that IRS included Property in Daltons’ RCP, and therefore Daltons’ $10,000 offer fell well below their RCP). For a discussion on what information the IRS uses to calculate a taxpayer’s RCP, see supra note 44.}

IV. UNDERSTANDING DALTON’S CUSTOMIZED STANDARD OF REVIEW AND HOW IT BENEFITS THE TAX SYSTEM

The First Circuit’s customized standard of review for CDP benefits the tax system for several reasons.\footnote{107 For a discussion of how a deferential review of subsidiary determinations made during a CDP hearing benefits the tax system, see infra notes 127–76 and accompanying text.} The Dalton standard of review departs from the Tax Court’s previous de novo review of subsidiary determina-
tions, which essentially gave taxpayers a new trial. The First Circuit's more deferential standard of review benefits the tax system because it (1) increases efficiency for both the government and courts; (2) promotes fairness for taxpayers; and (3) is consistent with the purpose of CDP.

A. Saying "No" to De Novo: How the Dalton Standard Differs From the Tax Court's Approach

The Dalton decision provided new guidance for the Tax Court because it explicitly analyzed the proper standard of review in CDP appeals when the IRS decides subsidiary questions of law and fact. Specifically, Dalton dealt with a subsidiary question involving an unsettled area of law. The First Circuit and the Tax Court previously agreed that erroneous views of the law constituted a per se abuse of discretion. This principle found support in Dalton. Dalton, however, provided further guidance by holding that a reasonable view of the law should be affirmed under its customized reasonableness standard, not analyzed de novo.

The decision in Dalton departs from the Tax Court’s unarticulated de novo standard used in prior cases because it held that a subsidiary legal issue is reviewed for reasonableness. It also implicitly conflicts with the Tax Court’s assertion that the standard of review for subsidiary legal ques-

108. For a discussion of how the First Circuit’s decision departed from the Tax Court’s previous approach for subsidiary determinations in CDP hearings, see infra notes 110–26 and accompanying text.

109. For a discussion of the efficiencies promoted by the Dalton standard, see infra notes 131–52 and accompanying text. For a discussion of how the standard increases fairness in the tax system, see infra notes 153–62 and accompanying text. For a discussion of how the standard reinforces CDP’s purpose, see infra notes 163–76 and accompanying text.

110. For a discussion of how Dalton presented an issue of first impression for the First Circuit, see supra note 24 and accompanying text.

111. See Dalton, 682 F.3d at 159 (“Whether an IRS determination reached during the CDP process rests upon a purely factual question, a purely legal question, or a mixed question of fact and law, a reviewing court’s mission is the same: to evaluate the reasonableness of the IRS’s subsidiary determination.”). The court implies that the nominee issue was an unsettled issue of law, and therefore it was unlikely that any view of the law could be erroneous. See id. at 157 (noting IRS acted reasonably to look at other jurisdictions for law to fill “void” in Maine law).


113. See Dalton, 682 F.3d at 159 n.6 (acknowledging erroneous views of law would be unreasonable and therefore constitute abuse of discretion).

114. See id. at 156 (“[A] court’s job is not to review the IRS’s CDP determinations afresh.”).

115. See, e.g., Swanson, 121 T.C. at 125 (reviewing subsidiary bankruptcy law issue “afresh” by giving no deference to IRS conclusions, but failing to state exact standard of review). For a discussion of the Dalton reasonableness standard of review for subsidiary determinations, see supra note 96 and accompanying text.
tions “makes no difference.” Undeniably, if the IRS took an erroneous view of the law, it should be reversed under either standard of review. Conversely, if the IRS took a reasonable view of the law—albeit a view with which the Tax Court disagreed—it would be upheld under the Dalton reasonableness standard, but reversed in a de novo review.

Dalton is also consistent with the Supreme Court’s general guidance in Hartmarx because the Dalton standard of review also gives the original reviewing body, the IRS, proper deference. The IRS is in a better position to make collection decisions and carry out policy goals than the Tax Court. Just as in Hartmarx, Dalton allows for the opportunity for an appellate court to overturn “absurd” legal or factual conclusions under an abuse of discretion standard.

The Dalton court avoided turning an abuse of discretion review of the final determination into a de novo trial. A de novo review of subsidiary determinations, paired with an abuse of discretion review of the final determination, would convert the analysis into a de novo trial because the court’s review would give no deference to the IRS’s judgment.

116. Kendricks v. Comm’r, 124 T.C. 69, 75 (2005) (“Whether characterized as a review for abuse of discretion or as a consideration ‘de novo’ (of a question of law), we must reject erroneous views of the law.”).

117. See, e.g., Dalton, 682 F.3d at 159 n.6 (discussing in dicta that absurd views of law would always be unreasonable and constitute abuse of discretion); Kendricks, 124 T.C. at 75 (rejecting erroneous views of law under either de novo or abuse of discretion standard).

118. Compare Dalton, 682 F.3d at 159 (“[T]he IRS acts within its discretion as long as it makes a reasonable prediction of what the facts and/or the law will eventually show.”), with infra note 123 (discussing courts taking independent view and substituting their judgment in place of IRS under de novo review).

119. See Cooter & Gell v. Hartmarx Corp., 496 U.S. 384, 404 (1990) (deciding proper standard of review for Rule 11 determinations). In Hartmarx, the Supreme Court noted that the district court was in a better position to make decisions on Rule 11 than an appellate court, and therefore it should be afforded more deference, even on legal issues. See id. (noting deference would conserve court resources). Similarly, Dalton recognized that the IRS, not courts, should be making collection decisions, and therefore the IRS should be afforded more deference. See Dalton, 682 F.3d at 155 (finding stricter standard of review would result in courts, not IRS, enforcing collection actions that “judges are neither qualified, nor have the time, to administer” (quoting Olsen v. United States, 414 F.3d 144, 150 (1st Cir. 2005))).

120. See Cords, Administrative Law, supra note 10, at 467 (arguing that courts should give deference because it is IRS’s responsibility to make collection decisions).

121. See Dalton, 682 F.3d at 159 n.6 (stating “absurd” legal or factual determination would be unreasonable and therefore is de facto abuse of discretion).

122. For a discussion of how the Dalton decision avoided de novo trials by providing a deferential standard of review, see infra notes 123–26 and accompanying text.

123. See Book, supra note 16, at 1194–97 (arguing that when Tax Court substitutes its judgment for IRS in abuse of discretion review, it resembles de novo review). A de novo review of subsidiary determinations and Robinette’s de novo scope of review that allows new evidence both allow courts to substitute their judgment for that of the IRS. See supra notes 55–62 and accompanying text (discussing Robi-
tively, the de novo review of subsidiary determinations would swallow the abuse of discretion standard because it would allow courts to substitute their judgment for the IRS’s. In *Dalton*, the entire question of whether the IRS abused its discretion in rejecting the Daltons’ OIC turned on the subsidiary issue of whether the Property should be included in the Daltons’ reasonable collection potential. Therefore, the de novo review of the subsidiary ownership issue would effectively usurp an abuse of discretion review of the final decision of rejecting the OIC.

B. A Preference for Deference: The Benefits of Dalton’s Customized Standard of Review

The *Dalton* standard benefits the tax system for three reasons. First, it increases both collection efficiency and judicial efficiency because it reduces delay in collection and allows the IRS to be the primary decision-maker. Second, it promotes fairness in collection by discouraging noncompliance. Third, it is consistent with the purpose of CDP because deferential review is sufficient to ensure the IRS’s collection actions are reasonable.

1. Efficiency: Let the IRS, Not Courts, Handle Day-To-Day Tax Collection

The *Dalton* standard of review benefits the tax system because it promotes two types of efficiency: collection efficiency and judicial efficiency.
First, the standard increases efficiency in tax collection for both the government and taxpayers because it reduces delay. Second, the standard increases efficiency for courts by entrusting the day-to-day collection responsibilities to the IRS.

a. Collection Efficiency: How Dalton’s Deferential Standard Reduces Collection Costs

A de novo review of subsidiary determinations would result in delayed collection, costing both taxpayers and the government. A de novo review of subsidiary factual and legal decisions delays collection because it could result in more litigation. For example, in Dalton, if the court performed a de novo review of the ownership issue and found that the taxpayer owned the property, the IRS would need to re-litigate the issue in another proceeding with the trust. Giving taxpayers such as the Daltons a second "bite at the cherry" through de novo review further delays collection because of the lengthy nature of adjudicating issues in court. CDP cases already represent one of the most litigated issues in tax court, and judicial review that potentially creates more litigation only further burdens the IRS.

Collection that is further delayed through additional layers of judicial review also costs the government money because of the decreased likelihood of collection.

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131. For a discussion of how the Dalton standard enhances efficiency in the tax collection system, see infra notes 134–52 and accompanying text.
132. For a discussion of how the Dalton standard of review reduces delay and increases efficiency for taxpayers and the government, see infra notes 134–44 and accompanying text.
133. For a discussion of how the Dalton standard of review increases judicial efficiency, see infra notes 145–52 and accompanying text.
134. For a discussion of how de novo review of subsidiary determinations delays collection and how that costs taxpayers and the government, see infra notes 135–44 and accompanying text.
135. See Dalton v. Comm’r, 682 F.3d 149, 156 (1st Cir. 2012) (explaining that de novo review would give Daltons multiple opportunities to contest ownership issue).
136. See id. (“Such a duplication of effort would both undermine the significant public interest in the speedy and efficient resolution of disputes and open the door to inconsistent decisions.”).
137. Id. See also I.R.C. § 6330(e)(1) (2006) (suspending collection during CDP hearing and ensuing appeals pending). Resolving CDP cases in court can take up to “300–400 days or more.” Bryan T. Camp, The Costs of CDP, 105 Tax Notes 1445, 1446 (2004) (analyzing sample of Tax Court cases to determine length of time between CDP notice and final court decision). In Dalton, the IRS first issued a CDP notice in 2004; the final court decision was filed in 2012. See Dalton, 682 F.3d at 153 (detailing history of case and notice of intent to levy sent in 2004). The original tax liability was from 1996. See id. (explaining that tax liability increased with accrued interest).
138. See 2011 Taxpayer Advocate Report, supra note 14, at 619 (“Since 2005, CDP has been one of the federal tax issues most frequently litigated in the federal courts . . . .”); FY 2013 Budget, supra note 14, at 9 (requesting over $4.8 billion for enforcement activities).
hood of collection the longer the process is prolonged. A de novo review of subsidiary determinations could add years in litigation before a final court decision. Those years of litigation increase the chance that, even if the IRS eventually proves its collection action was reasonable, it could collect nothing.

Delay also hurts the delinquent taxpayer because of accumulated interest and penalties that must be paid if the IRS eventually wins. In some cases, the accumulated interest can exceed the original tax liability. A de novo standard of review that encourages more litigation and delay could lead to taxpayers unnecessarily owing more money to the government.

b. Judicial Efficiency: Easing the Burden on the Tax Court’s Already Heavy Docket

A deferential review of subsidiary determinations promotes efficiency because it allows for minimal court interference in tax collection. A de novo review of IRS subsidiary determinations would place an even higher hurdle on collecting taxes, risking courts becoming “involved on a daily basis with tax enforcement details that judges are neither qualified, nor have the time, to administer.” CDP cases already clog the Tax Court’s

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140. For a discussion of how de novo review adds time to CDP cases, see supra note 137 and accompanying text.


142. See Camp, Failure of Adversarial Process, supra note 139, at 105 (“For every day that taxpayers delay collection, they owe additional interest and possible penalties on their taxes.”); see also Dalton, 682 F.3d at 153 (noting interest accumulation on original tax liability).

143. See Camp, Failure of Adversarial Process, supra note 139, at 105 (commenting that National Taxpayer Advocate has noted “accumulation of interest and penalties on those taxpayer accounts not resolved during the Notice stage will often equal or exceed the original delinquencies”).

144. See id. (describing that extended CDP process leads most taxpayers “further and further into debt”).

145. See Cords, Administrative Law, supra note 10, at 464 (“Significant limits on judicial interference with tax collection are necessary to prevent the tax collection system from screeching to a halt.”).

146. Living Care Alts. of Utica, Inc. v. United States, 411 F.3d 621, 631 (6th Cir. 2005). A de novo review of subsidiary determinations would create the same judicial inefficiencies as the Robinette de novo scope of review that allows the court to consider new evidence during appellate review because both standards require courts to substitute their judgment for the IRS and become the primary collection decision-maker. See Lane, supra note 16, at 160 (noting de novo scope of review on appeal would “require an enormous amount of time”). Lane argues that “the Tax Court simply does not have the time, resources, or energy to admit new evidence
docket.\textsuperscript{147} A more burdensome review is inefficient because it diverts limited court resources away from other cases.\textsuperscript{148}

In addition to the increased burden on scarce judicial resources, a de novo standard of review would shift tax collection decisions away from the experts, the IRS, and to the judiciary.\textsuperscript{149} A de novo review of subsidiary determinations would require the courts to substitute their judgment for the IRS's.\textsuperscript{150} The IRS is best suited to make decisions about the most efficient and effective way to collect taxes because it has resources and expertise that the judiciary does not, such as the ability to analyze and verify a taxpayer's information.\textsuperscript{151} Accordingly, judicial review should give deference to the IRS's judgments and expertise.\textsuperscript{152}

2. \textit{Fairness: Applying the Principle of Horizontal Equity to CDP's Standard of Review}

Dalton's deferential standard of review of subsidiary determinations promotes horizontal equity in tax collection because it discourages tax evasion.\textsuperscript{153} A tax system with horizontal equity requires that similarly situated of the kind admitted in Robinette." \textit{Id. See also Cords, Administrative Law, supra note 10, at 464 ("Significant limits on judicial interference with tax collection are necessary to prevent the tax collection system from screeching to a halt."). Likewise, a de novo review of subsidiary legal and factual conclusions would consume the same, if not greater, judicial resources. \textit{See Dalton}, 682 F.3d at 156 (noting de novo scope would create inefficiency because "[s]uch a duplication of effort would both undermine the significant public interest in the speedy and efficient resolution of disputes and open the door to inconsistent decisions").\textsuperscript{147}

\textit{147. See 2011 TAXPAYER ADVOCATE REPORT, supra note 14, at 619 (discussing CDP appeal as one of most litigated issues in Tax Court since 2003).}

\textit{148. See Lane, supra note 16, at 160 (arguing de novo scope of review "may slow the court's ability to efficiently manage an already voluminous caseload").}

\textit{149. See Cords, Administrative Law, supra note 10, at 467 (noting that IRS is "charged with collecting taxes and making decisions about the most appropriate way to collect taxes[,]" which does not "require the substitution of the court's judgment for the Service's judgment"); see also Robinette v. Comm'r, 439 F.3d 455, 459 (8th Cir. 2006) ("We see merit in the observation of these courts that Congress likely contemplated review for "a clear abuse of discretion in the sense of clear taxpayer abuse and unfairness by the IRS," lest the judiciary become involved on a daily basis with tax enforcement details that Congress intended to leave with the IRS." (quoting Olsen v. United States, 414 F.3d 144, 150 (1st Cir. 2005)).}

\textit{150. See Lane, supra note 16, at 160–61 (arguing responsibility to make determinations in CDP cases rests with IRS, not Tax Court).}

\textit{151. See Camp, Failure of Adversarial Process, supra note 139, at 97 ("[T]o allow taxpayers to introduce new evidence at the judicial review stage would make courts assume the agency's role and work the cases. . . . Not only do courts lack the expertise of the agency employees to make a fair evaluation of the information, they also lack the resources to verify the information presented.").}

\textit{152. See Cords, Scope and Nature of Judicial Review, supra note 124, at 1041 (arguing courts should rarely overturn IRS's collection judgments because IRS has more experience dealing with tax collection).}

\textit{153. For a discussion of how the Dalton standard promotes fairness by discouraging tax evasion, see infra notes 154–62 and accompanying text.}
taxpayers be treated the same. Allowing de novo review of subsidiary determinations could lead to similarly situated taxpayers having different tax burdens, depending on whether a taxpayer has “the time, energy, and persistence to fight the Service into submission.” Delinquent taxpayers are given favorable treatment with de novo review because of their ability to further delay reasonable collection actions, while compliant taxpayers pay their taxes on time and in full. A delinquent taxpayer that can extend court review through a de novo examination of subsidiary determinations can delay paying a tax liability, leaving compliant taxpayers to foot the bill.

A de novo standard of review for subsidiary determinations could also encourage taxpayers to practice tax evasion, further slowing collection and creating inequity in the tax system. Allowing courts to second-guess the IRS through de novo review of subsidiary determinations could lead to the

154. For a discussion of the concept of horizontal equity, see supra note 11. Lane, supra note 16, at 171. Lane argues that an expanded scope of review would lead to more taxpayers trying to evade taxes, but the same logic applies to an expanded review of subsidiary determinations because both situations allow the Tax Court to substitute its judgment for the IRS. See id. (“[T]he system will operate rewarding those who are less-honest and willing to fight, while punishing those who are more-honest or less inclined to fight.”). Lane notes that compliant taxpayers are hurt by delinquent taxpayers in two ways: first, they pay their fair share while delinquent taxpayers do not; second, as a result of increasing delinquency, taxes are likely to increase because of the inability to collect revenues. See id. at 171–72 (arguing de novo scope of review would also “significantly drive-up overall costs of collecting taxes by increasing the Service’s time spent litigating cases”).

155. See Camp, Failure of Adversarial Process, supra note 139, at 110 (arguing against CDP partly because of a “won’t pay” taxpayer’s ability to delay collection “at the expense of compliant taxpayers”).

156. See Camp, supra note 139, at 116 (examining select CDP appeals and noting that early on CDP was “a ‘boon to tax protestors and a pain to everyone else’” (quoting Bryan T. Camp, Tax Administration as Inquisitorial Process and the Partial Paradigm Shift in the IRS Restructuring and Reform Act of 1998, 56 FLA. L. REV. 1, 122 (2004))). Professor Camp noted that frivolous claims decreased with more court-imposed sanctions. See id. (noting direct correlation between lower frivolous claims and increased sanctions); see also Nick A. Zotos, Service Collection Abuse of Discretion: What Is the Appropriate Standard of Review and Scope of the Record in Collection Due Process Appeals?, 62 TAX L. 223, 237 (2008) (noting IRS can assess $5,000 penalty for frivolous arguments and Tax Court can assess $25,000 penalty). Zotos notes that “the Tax Court has demonstrated an increased willingness to impose sanctions as a means of dealing with frivolous claims.” Id.
IRS settling more cases before court review. In turn, taxpayers would then be encouraged to avoid paying taxes, fight the IRS through CDP, and hope to secure a lower tax liability through an OIC. Taxpayers might sense unfairness in a system that allows some to avoid liabilities through CDP, and those individuals are then less likely to comply with tax laws in the future. Ultimately, if courts allowed a de novo review of subsidiary determinations, compliant taxpayers would lose while delinquent taxpayers would win—the definition of unfairness.

3. Sticking to the Point: De Novo Review of Subsidiary Determinations Is Inconsistent with the Purpose of CDP

Judicial review is a critical part of the CDP regime because CDP is intended to ensure the IRS’s collection actions are reasonable through third party oversight. To be consistent with CDP’s purpose, courts only need to decide whether the IRS’s collection action is reasonable, not nec-
164. See Dalton, 682 F.3d at 156 (explaining appellate court’s purpose is to ensure “factual and legal conclusions reached at a CDP hearing are reasonable”). The Dalton court noted that the “CDP process presents no occasion for a reviewing court to demand incontrovertibly correct answers to subsidiary questions, whatever their nature.” Id. at 159. The Tax Court traditionally functions as a trial court, not as an appellate court. See Book, supra note 16, at 1195–96 (explaining Tax Court’s history as court of original jurisdiction and holding de novo trials in context of deficiencies cases to determine taxpayer’s true liability). Because the Tax Court is accustomed to reviewing matters de novo in order to find the correct answer, it is not as familiar with true abuse of discretion review. See id. at 1196 (explaining Tax Court’s de novo record rule approach as “fail[ing] to appreciate that review of collection determinations is intended as a means to provide oversight to IRS activities and is not about identifying agency error on an individualized basis”); see also Cords, Administrative Law, supra note 10, at 463 (observing that “district courts have more experience conducting abuse of discretion review than does the Tax Court”). The Tax Court’s de novo approach in CDP review where abuse of discretion is appropriate fails to consider that different standards of review apply in different circumstances. See Cords, Administrative Law, supra note 10, at 463 (explaining Tax Court has justified its de novo approach in CDP cases by pointing to its approach in deficiency cases); Lane, supra note 16, at 168 (“While the motivation to ‘get the right answer’ may be noble . . . it likely is not what Congress intended for the Tax Court in reviewing CDP cases.”).

165. See Woodral v. Comm’r, 112 T.C. 19, 23 (1999) (describing abuse of discretion standard); Book, supra note 16, at 1196 (describing de novo review in CDP context as one in which “court is concerned with the right answer, regardless of the agency action preceding the court review”); Lane, supra note 16, at 168 (stating “purpose of a de novo review is to get to the right answer[,]” but that “it likely is not what Congress intended for the Tax Court in reviewing CDP cases.”); Richard H. W. Maloy, “Standards of Review”—Just a Tip of the Icicle, 77 U. Det. Mercy L. Rev. 605, 609 (2000) (noting that de novo review is “intended to produce the correct substantive result”).

166. See Book, supra note 16, at 1195 (arguing that limiting IRS’s ability to offer post-hearing justification for actions in de novo review would create incentives for IRS to act reasonably during administrative hearing). But see Eliza Mae Scheibel, Note, Mixing It Up: The Tax Court Pairs a De Novo Scope of Review with an Abuse of Discretion Standard of Review Under Section 6330(D) in Robinette v. Commissioner, 58 Tax Law. 941, 953–54 (2005) (arguing de novo scope of review carries out purpose of CDP to protect taxpayers because limited scope of review would not be sufficient to curb abuse). For the argument that abuse of discretion review of subsidiary determinations is sufficient to protect taxpayers from IRS error, see infra notes 175–76 and accompanying text.

167. See Camp, Collection Context, supra note 38, at 975–76 (describing earlier version of CDP passed by Senate as having provisions that would make collection “full-blown shift to adversarial process and would have severely restricted IRS collection activity”). The provisions allowed taxpayers to obtain court review of “each and every collection decision made by the IRS in their individual case,” as well as “contest the merits of an assessment in all CDP hearings.” Id. at 975 (arguing these
court properly recognized that the deferential reasonableness review of subsidiary determinations carries out CDP’s purpose. 168

While the Dalton standard will likely result in more courts affirming the IRS’s judgments, lopsided results would not mean the standard of review is ineffective. 169 Although it seems counterintuitive, it would be beneficial to taxpayers as a whole if the IRS frequently prevailed on appeal because it would mean the IRS’s proposed collection action was reasonable—the entire purpose of CDP. 170 There is also concern that a deferential review of subsidiary determinations could provide an incentive for the IRS to develop an insufficient record to increase the chances a reviewing court will affirm its determination. 171 However, this concern is addressed by the Tax Court’s policy to remand cases where the administrative record is insufficient to review the IRS’s determination. 172

provisions would undermine automatic nature of bulk collection and effectively abolish long-standing rule that taxpayers pay liability in full before contesting it). These provisions were even too extreme for the Clinton administration. See id. (describing argument against provisions was that they would effectively give taxpayers “multiple bites at the apple[,]” with apple being opportunity to contest tax liability). The Dalton court also expressed this concern about de novo review of subsidiary determinations, using a cherry metaphor instead of an apple. See Dalton, 682 F.3d at 156 (“De novo review would also give the taxpayers two bites at the cherry.”).

168. See Dalton, 682 F.3d at 155 (“We conclude, therefore, that judicial review must be tailored to effecting the purpose of the CDP process; that is, to ensuring that the IRS’s determinations, whether of fact or of law, are not arbitrary.”); see also Murphy v. Comm’r, 469 F.3d 27, 32 (1st Cir. 2006) (declining to find abuse of discretion in order to avoid “transform[ing] CDP hearings from a shield against invasive government conduct into a taxpayer’s tool to delay the timely collection of delinquent tax liabilities by seeking endless extensions”); Olsen v. United States, 414 F.3d 144, 151 (1st Cir. 2005) (“While Congress clearly wanted to prevent mere bureaucratic harassment, we do not understand it to have intended to strip the IRS of effective and reasonable tax collection procedures.”).

169. See Zotos, supra note 158, at 228–29 (explaining high rate of success for IRS when its determinations are appealed); 2011 TAXPAYER ADVOCATE REPORT, supra note 14, at 624 (showing IRS success rate from 2003 through 2011, with lowest success rate for any year at 89% and highest success rate at 96%). For a discussion of why lopsided results would not necessarily show that the system is ineffective, see infra note 170 and accompanying text.

170. See Book, supra note 16, at 1205 (suggesting “success of [CDP] should not be based on the number of reversals . . . but rather on the broader effects that [CDP] would create, thereby improving IRS collection procedures”); Zotos, supra note 158, at 236 (examining reasons IRS wins majority of appeals and explaining one reason is IRS has “cleaned up its act so to speak, and the CDP provisions have been successful in preventing the very institutional abuses the statute was intended to prevent”).

171. See, e.g., Dalton v. Comm’r, 135 T.C. 395, 423 n.30 (2010) (acknowledging taxpayer’s argument that IRS purposely failed to create sufficient administrative record but ruling for taxpayer on other grounds), rev’d, 682 F.3d 149 (1st Cir. 2012).

172. See Robinette v. Comm’r, 123 T.C. 85, 126 (2004) (“In the event the administrative record of such an informal proceeding is insufficiently developed, ‘the proper course, except in rare circumstances, is to remand to the agency for additional investigation or explanation.’” (quoting Fla. Power & Light Co. v. Lo-
Supporters of de novo review could argue the deferential *Dalton* standard does not sufficiently ensure that the IRS’s collection actions are reasonable.\textsuperscript{173} Put another way, the *Dalton* standard of review is only appropriate if the risk of IRS error is low and no other relief is available for the taxpayer.\textsuperscript{174} However, the *Dalton* standard properly protects taxpayers from IRS abuse because it catches egregious agency errors while allowing the IRS to carry out its collection function without unnecessary intrusion.\textsuperscript{175} Further, as the *Dalton* court noted, there are usually alternative avenues of relief available to taxpayers when a CDP hearing is inadequate.\textsuperscript{176}

V. CONCLUSION

At the end of fiscal year 2011, the IRS Office of Appeals had over 32,000 CDP cases pending before it.\textsuperscript{177} The question of the proper standard, 470 U.S. 729, 744 (1985)); Lane, supra note 16, at 162 (detailing “well-established” rule that remand back to IRS is appropriate if record is insufficiently developed). But see Carlton M. Smith, *The Tax Court Keeps Growing Its Collection Due Process Powers*, TAX NOTES TODAY, Nov. 17, 2011, at 222–11 (questioning whether Tax Court has power to remand CDP cases and arguing Tax Court has inherent power to order IRS to accept OIC).

173. See Zotos, supra note 158, at 237–38 (questioning whether abuse of discretion is proper standard of review in CDP cases).

174. See, e.g., Smith, supra note 172 (“A robust Tax Court review proceeding is necessary to effectuate what I believe was Congress’s intent in setting up the CDP in the first place—preventing the IRS from overreaching in the collection process.”). 175. See Cords, Administrative Law, supra note 10, at 468–69 (arguing “de novo review is not necessary to protect taxpayers” in collection decisions); Zotos, supra note 158, at 237–38 (arguing that abuse of discretion standard protects against “overreaching Service practices while at the same time providing [IRS] agents with the discretion necessary to carry out their day-to-day functions, which is precisely the result the statute was intended to produce”). Professor Cords argues that de novo review would shift some tax collection decisions to the Tax Court, “which does not have the experience or expertise to efficiently make these decisions.” See Cords, Administrative Law, supra note 10, at 468 (arguing shift of decision making power to Tax Court would “hamper the functioning of the tax collection system”); see also Book, supra note 16, at 1203 (arguing “even highly deferential judicial review of agency action provides incentives for better agency practice, increases public confidence in agency practice, and is an integral part of our system of checks and balances . . . .”).

176. See Dalton v. Comm’r, 682 F.3d 149, 156 n.4 (1st Cir. 2012) (noting “deferential standard of review by no means leaves a taxpayer at the mercy of the IRS”). The *Dalton* court notes that the Daltons could seek a court order to remove the attachment of the Property, or the trust itself could attempt to remove the attachment through either wrongful levy or quiet title actions. See id. (“There are almost always other legal channels through which a taxpayer may develop a complete record and secure a definitive legal ruling on a contested point of law or fact.”).

177. See SOI Tax Stats—Appeals Workload, By Type of Case, I.R.S., http://www.irs.gov/uac/SOI-Tax-Stats—Appeals-Workload-by-Type-of-Case, IRS-Data-Book-Table-21 (last updated Aug. 3, 2012) (providing IRS statistics for Appeals Office workload by year). The source of potential CDP cases is also massive: only approximately 1.2% of taxpayers that receive a CDP notice request a hearing. See
standard of review of subsidiary determinations made during a CDP hearing is likely to arise again because a significant number of CDP cases are appealed to the Tax Court.\textsuperscript{178} The Tax Court is unlikely to apply Dalton’s customized standard of review in future cases that are not appealable to the First Circuit because of the Golsen rule.\textsuperscript{179} Therefore, Congress should amend the CDP statutes to codify Dalton’s customized standard of review.\textsuperscript{180} If Congress does not amend CDP, other circuits should adopt the Dalton standard because of its benefits in providing tax efficiency, tax fairness, and consistency with the purpose of CDP.\textsuperscript{181} In the current period of rising budget deficits, courts should not make it more difficult for the IRS to collect taxes when it uses reasonable methods.\textsuperscript{182}
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TREATING A CHRONIC CASE OF DISCRIMINATION: THE NINTH CIRCUIT’S PRESCRIPTION FOR MENTAL HEALTH PATIENTS’ RIGHTS IN HARLICK v. BLUE SHIELD

MEGAN LAGRECA*

“In a society where millions must hide debilitating diseases for fear of prejudice, where potentially life-saving health care is routinely denied to a disfavored class, where states have policies requiring parents to give up custody of mentally ill children as a condition of treating them, there are plenty of opportunities to strike a blow for justice. At the heart of this cause is ‘mental health parity’ legislation to end health insurance discrimination against those with mental illness.”

I. PREEXISTING CONDITIONS: MENTAL HEALTH COVERAGE IN THE AMERICAN HEALTH CARE SYSTEM

In June 1999, Anna Westin was diagnosed with anorexia. At the time of her diagnosis, Anna weighed eighty-two pounds, had an abnormal echocardiogram, a malfunctioning liver, and a below normal body temperature. Anna’s doctor ordered hospitalization, but told the Westins they would need their insurance company to certify the treatment. Anna’s mother thought “it was just a matter of a phone call.” Anna’s insurance company paid for a two-day hospital stay, then informed Anna that “her treatment was no longer medically necessary[,] and they would not pay any additional costs.” Unable to receive treatment, Anna Westin contin-

* Villanova University School of Law, J.D. Candidate 2014. This Note is dedicated to the memories of Joseph and Helen Lagreca, who taught me the importance of hard work and perseverance. None of this would have been possible without the support of my friends and family, especially John and Barbara Smith, who continue to teach me the importance of having strength in one’s convictions. Lastly, I would like to thank the editorial staff of the Villanova Law Review, especially Megan Pownall and Kathleen Dapper, whose insights and comments were integral to the completion of this article.


3. See id. (describing medical complications from anorexia nervosa).

4. See id. (detailing conflicts with insurance company over coverage of anorexia treatment).

5. Id.

6. Id.
ued to suffer from anorexia and ultimately committed suicide at her home on February 17, 2000, when she was twenty-one years old.7

Almost two thousand miles away in San Mateo, California, Jeanene Harlick had been suffering from anorexia for over twenty years.8 In 2006, Jeanene checked into Castlewood Treatment Center in St. Louis, Missouri.9 At the time of her admission, she was thirty-five percent below her ideal body weight and had to use a feeding tube to receive vital nutrients.10 When Blue Shield of California refused to cover her treatment at Castlewood, Jeanene’s parents borrowed hundreds of thousands of dollars against their home to pay for the treatment.11 After suing Blue Shield in district court, the Ninth Circuit held in a landmark ruling that California’s Mental Health Parity Act (“Parity Act”) required insurance companies to cover medically necessary treatments for severe mental illnesses even if the plan excluded such coverage.12

This Note argues that the Ninth Circuit’s interpretation of the Parity Act correctly addresses the case-specific needs of mental health patients and allows physicians to pursue all medically necessary treatment without a concern that the patient’s insurance company may deny such care.13 Part II provides an overview of mental health parity legislation since the introduction of managed care organizations into the American health care system, focusing on the federal system’s early statutory framework.14 Part III examines the history and text of the Parity Act, and discusses the state and federal courts’ interpretations of it.15 Part IV discusses the facts of the Ninth Circuit’s recent decision in Harlick v. Blue Shield of California16 and

7. See id. (testifying to Congress on family struggles with anorexia).
9. See id. (providing background of Jeanene Harlick’s claims against insurance company).
10. Id. (explaining Harlick’s medical status at time of admission to residential treatment center).
11. See id. (acknowledging financial hardships caused by expenses of residential treatment when coverage is denied by insurers).
12. See Harlick v. Blue Shield of Cal., 686 F.3d 699, 719 (9th Cir. 2012) (holding that all non-exempt California insurance plans must cover medically necessary treatments for severe mental illnesses even if plan excluded such coverage).
13. See Victoria Colliver, Eating-Disorder Patients Battle Insurers Over Care, S.F. CHRON. (Sept. 10, 2011), http://www.sfgate.com/news/article/Eating-disorder-patients-battle-insurers-over-care-2310184.php (interviewing doctor who remarked that, “[H]is patients have to be ‘literally on the verge of death’ to get hospitalized and then their insurance coverage often dictates how much care or what kind of care comes next”).
14. For a discussion of mental health coverage in employee health benefit plans, see infra notes 20–54 and accompanying text.
15. For a discussion of the Parity Act and lower federal courts’ interpretations prior to the Ninth Circuit’s holding, see infra notes 55–96 and accompanying text.
16. 686 F.3d 699 (9th Cir. 2012).
the court’s application of the Parity Act.\textsuperscript{17} Part V analyzes the Ninth Circuit’s reasoning and argues that Harlick successfully shifted the dialogue from one of stringent parity to a broader, more flexible definition of parity that remains sensitive to the case-specific needs of mental health patients.\textsuperscript{18} Finally, Part VI discusses implications of the Ninth Circuit’s holding for patients who, like Jeanene Harlick, are denied medically necessary treatment.\textsuperscript{19}

\section{II. Placing Parity in Context: Federal Approaches to Mental Health Parity}

The stories of Anna Westin’s denial of care or the Harlicks’ crippling debt demonstrate the failure of a health care system that, despite federal mental health parity reform, allowed insurance companies to deny or limit medically necessary treatment to mental health patients.\textsuperscript{20} This section provides a brief overview of the complex health care system that the Westins and Harlicks navigated in order to receive treatment for their daughters.\textsuperscript{21} As denials of care for mental health patients continued to rise in the 1990s, so did the saliency of mental health parity, which resulted in two stages of federal mental health parity reform.\textsuperscript{22} This section explains the genesis of that legislation and its failure to comprehensively address the needs of mental health patients.\textsuperscript{23}

\subsection{A. Mental Health Care Under Managed Care Settings}

Today, most Americans obtain health care coverage through the workplace.\textsuperscript{24} Most private insurers under employee benefit plans have his-
torically limited mental health benefits due to fear of “high costs associated with long-term and intensive psychotherapy and extended hospital stays.”

In an effort to limit these benefits, insurers increased deductibles, reduced the number of annual outpatient visits, and lowered the lifetime or annual limits on mental health care.

As a reaction to the rising health care costs of the 1970s and 1980s, many employers switched their health benefits to a managed care setting.

Through methods of cost containment, many managed care organizations were able to obtain mental health benefits at “relative equality” with physical health benefits.

Still, as the managed care organizations’ share of the employee benefit market expanded and health costs rose, such organizations freely increased deductibles, reduced outpatient or inpatient visits, and decreased lifetime or annual limits on care.

These annual limits and increased out-of-pocket costs have become particularly detrimental for mental illnesses such as anorexia nervosa, both in terms of the treatment’s duration and cost.

That eighty-four percent of Americans receive health benefits through employee benefit plans, and that fifty-six percent of Americans are enrolled in managed care organizations.

25. Id. at 418. Insurance companies justified limiting mental health coverage by citing the health economic principles of moral hazard and adverse selection. See Tovino, supra note 20, at 9–10 (explaining impact of moral hazard and adverse selection on mental health coverage). Tovino explains that “[i]n the context of mental health care, moral hazard refers to the concern that individuals who do not pay for 100% of the cost of their own mental health care will use more mental health services because they do not value these services at their full cost.” Id. In addition, adverse selection reflects the concern that, if a plan offers “generous mental health benefits,” it “will attract individuals with greater mental health care needs . . . .” Id. at 11.

26. See Tovino, supra note 20, at 9–11 (explaining measures taken by insurance companies to limit mental health care coverage).

27. See Aviv Shamash, Note, A Piecemeal, Step-By-Step Approach Toward Mental Health Parity, 7 J. HEALTH & BIOMEDICAL L. 273, 277 (2011) (discussing mental health parity in context of growing popularity of managed care organizations); SURGEON GENERAL REPORT, supra note 24, at 422. According to the Surgeon General Report, fifty-six percent of Americans were covered under some type of managed care organization by 1999. See id. (emphasizing importance of managed care organizations in providing mental health care). Unlike traditional private insurance, managed care organizations use various financial incentives to control costs. See id. at 423 (analyzing managed care organizations’ cost-control methods). For example, most managed care organizations shift inpatient treatment to an outpatient setting, negotiate discounted hospital and doctor’s fees, and use a utilization review process to certify a patient’s treatment to decide whether such treatment is necessary. See id. (enumerating examples of cost-cutting strategies used by managed care organizations).

28. See Shamash, supra note 27, at 277.

29. See id. (explaining how popularity of managed care organizations led to lower quality mental health care).

Jeanene Harlick, a patient faces a losing choice when insurance companies cap mental health benefits. The patient’s family must incur debt to help the patient complete the treatment, or the patient must stop treatment before achieving their ideal body weight and risk relapsing.

B. Federal and State Legislative Impetus: The Federal Mental Health Parity Act of 1996

In the 1990s, federal and state legislatures began to consider mental health parity legislation in order to equalize the disparity between physical and mental health coverage. One commentator has argued that the legislative movement toward mental health parity was the product of three factors. First, developments in medical research shifted the dialogue around mental illness from one of stigmatization to one of understanding, as new research revealed biological bases for these illnesses. Second, as biopsychosocial issues that require an integrated approach to treatment, including “medical, nutritional, and mental health professionals.” Applying the American Psychiatric Association guidelines to most insurance companies’ restrictions on hospital stays, Brunnalli stated that “restoration of ideal body weight . . . cannot be achieved in ten to fifteen days unless the patient’s ideal body weight is forty pounds.” Insurance companies’ limitations of mental health coverage do not only inhibit the duration of treatment that a patient may need, but they also impose prohibitive costs on patients.

31. See id. at 597 (noting that anorexia is “[a] perpetuating cycle of illness” because insurance companies’ coverage limitations frustrate complete treatment).

32. See id. (“Not surprisingly, the rate of relapse or readmission has more than doubled since the proliferation of mental illness limitations.”).


34. See id. at 328–29 (discussing factors leading to passage of parity legislation). For a full discussion of these factors, see infra notes 35–37 and accompanying text.

35. See Kaplan, supra note 33, at 328 (enumerating factors that led to influx of mental health parity legislation in 1990s). The clinical community uses two main classification systems to define mental illness. See Marcia C. Peck & Richard M. Scheffler, An Analysis of the Definitions of Mental Illness Used in State Parity Laws, 53 PSYCHIATRIC SERVICES 1089, 1089–90 (2002), available at http://ps.psychiatryonline.org/data/Journals/PSS/4351/1089.pdf (finding that definitions of mental health in state parity laws can influence access, cost, and insurance reimbursement). The first classification comes from the American Psychiatric Association’s Diagnostic and Statistical Manual of Mental Disorders (“DSM”). See id. (explaining different clinical classification systems for mental illnesses). The DSM defines mental illness as a “clinically significant behavioral or psychological syndrome or pattern that occurs in an individual . . . is associated with present distress . . . or disability . . . or with a significant increased risk of suffering.” Id. (alterations in original). The second main classification views mental illnesses as brain disorders,
a result of these new findings, mental health advocacy rose in the 1990s.\textsuperscript{36} Lastly, the passage of the federal Mental Health Parity Act of 1996 ("MHPA") influenced states to create their own mental health parity legislation.\textsuperscript{37}

Although the MHPA spurred state legislators to consider their own mental health parity legislation, the effect of the MHPA remained negligible.\textsuperscript{38} Rather than mandate mental health coverage on an equal basis among all insurers, the MHPA only regulated insurers who already pro-

and is built on premise that "disruptions in brain function lead to mental illness." \textit{Id.} Clinicians view this second classification as "too limiting, because no single gene or underlying brain lesion has been found for any disorder except Alzheimer’s disease." \textit{Id.} Despite its criticism, this second classification is used by biopsychiatrists who define mental illness by heredity or genetic makeup. \textit{See id.} (describing use of classification systems by clinicians). Despite the differing classifications in the clinical community, both definitions of mental illness suggest that the bases of such disorders "are now considered physical, or biological, rather than ‘mental.’" Richard E. Gardner, Comment, \textit{Mind Over Matter? The Historical Search for Meaningful Parity Between Mental and Physical Health Care Coverage}, 49 EMORY L.J. 675, 683 (2000) (discussing how advances in brain science show biological components to mental illnesses). For example, researchers have found that in the brains of those patients who suffer from major depression, there is a decrease in neural activity. \textit{Id.} at 684. In addition, panic disorders are now thought to have a biochemical basis because of patients’ positive responses to chemical treatments, like antidepressants. \textit{Id.} at 685.

36. \textit{See Kaplan, supra} note 33, at 329 (noting that as of 2005, there were over 360 organizations that support mental health parity). Support for mental health parity legislation expanded beyond professional organizations to include federal legislators. \textit{See Melissa M. McGow, Comment, A Plan for Recovery: Steps to Finally Provide Adequate Insurance Coverage for Those Starving for it the Most, 15 ROGER WILLIAMS U. L. REV. 583, 607–09 (2010) (discussing federal support for comprehensive federal parity statute). Representative Patrick Kennedy of Rhode Island, who suffered from periods of depression, remarked that federal parity legislation was "one more step in the long civil rights struggle to ensure that all Americans have the opportunity to reach their potential." \textit{Id.} at 609. Representative Kennedy’s father, the late United States Senator Edward Kennedy, also remarked that insurance companies’ limitations on mental health benefits were "senseless discrimination." \textit{Id.} at 606.


38. \textit{See, e.g.,} Tovino, \textit{supra} note 20, at 35–38 (discussing "incomplete development" of mental health parity laws on federal level).
vided mental health coverage. While this minimal mandate isolated many insurance plans from the law’s effects, two additional exemptions limited the law’s impact. Small employers were entirely exempt from the MHPA’s requirements. Moreover, group health plans were exempt from the law’s requirements if compliance with the MHPA increased the costs under the plan.

In addition to these exemptions, Congress’s failure to define “mental health benefits” within the MHPA contributed to the law’s inefficacy, as it gave insurance companies the discretion to define and limit the range of mental illnesses that it would cover. Eating disorders, for example, were not expressly mentioned in the MHPA. Congress’s failure to close this discretionary gap was most likely a political decision, as one study has found that legislators’ decisions to define mental illness are influenced by “ideologies of advocacy groups and parity opponents, cost, and political necessity,” rather than “needs-based studies and clinical judgment.”

C. A Second Federal Attempt at Achieving Mental Health Parity

In 2008, President Bush signed into law the Mental Health Parity and Addiction Equity Act (“MHPAEA”), which addressed the continuing issue

39. See 29 U.S.C. § 1185a(1),(2) (2006) (stating that MHPA only regulates lifetime and annual spending limits of those insurance plans that cover both physical and mental health benefits).

40. See McGow, supra note 36, at 588–94 (discussing limitations of MHPA).

41. See Mental Health Parity Act of 1996, Pub. L. No. 104-204, § 712(c)(1)(A), 110 Stat 2874, 2944 (“This section shall not apply to any group health plan (and group health insurance coverage offered in connection with a group health plan) for any plan year of a small employer.”). Further, the MHPA defined a small employer as one “who employed an average of at least 2 but not more than 50 employees on business days during the preceding calendar year and who employs at least 2 employees on the first day of the plan year.” Id. § 712(c)(1)(B).

42. See id. § 712(c)(2) (“This section shall not apply with respect to a group health plan . . . if the application of this section to such plan . . . results in an increase in the cost under the plan . . . of at least 1 percent.”).

43. See id. § 712(e)(4) (“‘[M]ental health benefits’ means benefits with respect to mental health services, as defined under the terms of the plan or coverage (as the case may be), but does not include benefits with respect to treatment of substance abuse or chemical dependency.”); Shamash, supra note 27, at 282 (discussing limitations of MHPA).

44. See McGow, supra note 36, at 592 (“Although the MHPA did not exclude eating disorders from the list of mental illnesses, it also did not explicitly include them; rather, the employer was allowed to define what constitutes mental illnesses and easily excluded eating disorders.”).

45. Peck & Scheffler, supra note 35, at 1091. The authors of the study noted that while federal legislation has not defined mental illness to date, the term’s use in federal legislation has nevertheless been interpreted “to include all disorders in DSM [Diagnostic and Statistical Manual of Mental Disorders].” Id. at 1090. For a full discussion of the two main classifications of mental illness among the clinical community, see supra note 35.
of disparate mental health coverage by private insurers. The MHPAEA was more comprehensive than the MHPA because it expanded the MHPA’s mandate to include substance use disorders. Moreover, the MHPAEA broadly prohibited insurance companies from imposing unequal financial or coverage restrictions on mental health care. This language extended beyond the MHPA, which only prohibited the imposition of disparate annual and lifetime limits. In addition, insurers could not place more restrictive limitations on mental health beneficiaries in terms of deductibles, copayments, coinsurance, out-of-pocket expenses, number of doctor’s visits, or days of coverage.

Although the MHPAEA was more comprehensive than the MHPA, the law suffered similar setbacks in terms of its limited scope. Much like the MHPA, exemptions for small employers and group health plans that would experience cost increases severely limited the law’s reach. Moreover, the law’s mandating power extended only to those insurance plans that already covered mental health benefits. Under the MHPAEA, it was possible that insurers could choose not to cover mental health benefits and remain exempt from federal mental health parity legislation entirely.

46. See Paul Wellstone and Pete Domenici Mental Health Parity and Addiction Equity Act of 2008, 29 U.S.C. § 1185a(a)-(g) (2006) (requiring non-exempt insurance companies to provide equal mental health and physical health services).
47. See id. § 1185a(a)(1)(A) (“If the plan or coverage does not include an aggregate lifetime limit on substantially all medical and surgical benefits, the plan or coverage may not impose any aggregate lifetime limit on mental health or substance use disorder benefits.”).
48. See id. § 1185a(a)(3)(A)(i)-(ii) (stating that group health plans that cover both medical and mental health benefits must ensure that financial requirements and treatment limitations are no more restrictive than predominant limitations placed on medical care).
49. See id. § 1185a(a)(1)(A)-(B), (2)(A)-(B) (barring imposition of lifetime or annual limits for health plans that offer medical and surgical benefits, as well as mental health and substance abuse benefits).
51. See Tovino, supra note 20, at 38 (discussing limitations of MHPAEA, as compared to MHPA).
52. See id. (“MHPAEA . . . did not apply to small group health plans, individual health plans, the Medicare Program, Medicaid non-managed care plans, or any self-funded, non-federal governmental plans whose sponsor opted out of MHPAEA.”).
53. See Shamash, supra note 27, at 278 (discussing differing levels of mandatory state parity laws). For a discussion on the varying levels of mandating power, see infra notes 61–67 and accompanying text.
54. See Tovino, supra note 20, at 38 (“In terms of its substantive provisions, MHPAEA also was neither a mandated offer nor a mandated benefit law; that is, nothing in the MHPAEA required a covered group health plan to actually offer or provide any mental health benefits.”).
III. SEARCHING FOR A CURE: CALIFORNIA’S PARITY ACT

While federal legislation fails to provide a comprehensive framework for covering mental illnesses in the private insurance context, many state mental health parity laws require insurers to offer broader coverage for mental health benefits. At issue in *Harlick* was California’s Parity Act, which the California legislature passed in 1999. The Parity Act sought to improve access to mental health care by requiring health insurance plans to provide equal coverage for physical and mental health illnesses.

A. Analyzing California’s Parity Act

Four factors influence the comprehensiveness of state mental health parity laws. First, the statutory definition of mental illness indicates the breadth of the parity law and can range from a “broad-based mental illness” to a narrow “serious mental illness” definition. Although Californ-
nia’s Parity Act uses the word “severe mental illness,” the statute’s definition of “severe” encompasses the same priority populations that a “serious mental illness” definition addresses, including schizophrenia, schizoaffective disorder, bipolar disorder, major depressive disorders, panic disorder, obsessive-compulsive disorder, pervasive developmental disorder or autism, anorexia nervosa, and bulimia nervosa.60

Second, the mandating structure that the legislature chooses also determines the comprehensiveness of a state mental health parity law.61 A mandatory benefit structure requires insurers to provide mental health benefits.62 Conversely, a mandatory offer structure only requires insurers to offer a plan with mental health benefits and to charge accordingly.63 The weakest mandating structure is the mandated-if-offered framework, which requires insurers to provide mental health benefits to the same extent that they provide physical health care.64 The Parity Act reads, “[e]very health care service plan contract . . . that provides hospital, medical, or surgical coverage shall provide coverage for the diagnosis and medically necessary treatment of severe mental illnesses of a person of any age . . . .”65 The Parity Act, unlike federal parity laws, is a mandated benefit statute that requires all non-exempt insurers to provide coverage for the diagnosis and medically necessary treatment of severe mental illnesses.66 As seen in Harlick, a state’s chosen framework can lead to contentious litigation.67

60. See CAL. HEALTH & SAFETY CODE § 1374.72(d)(1)-(9) (West 2003) (defining scope of mental illnesses required by Parity Act). Though California’s statute defines this list of mental illnesses as “severe,” rather than “serious,” the list is consistent with other states’ definitions of “serious mental illness.” See Peck & Schef- fler, supra note 35, at 1091 (discussing states’ definitions of mental illnesses).

61. See Shamash, supra note 27, at 290 (analyzing how mandating structure of parity laws impact its comprehensiveness).

62. See Kaplan, supra note 33, at 351–53 (discussing mandatory benefit framework). Kaplan notes that common statutory language for a mandated benefit statute reads as follows: “a plan shall provide benefits for diagnosis and mental health treatment under the same terms and conditions as provided for covered benefits for the treatment of other physical illnesses.” Id. at 351.

63. See id. at 352 (discussing mandatory offer framework for state parity laws). A mandated offer statute would typically read, “insurers must make available coverage for the treatment of mental illness . . . .” Id. at 352.

64. See id. (defining various parity frameworks and their levels of mandating power). The language of a mandated-if-offered statute would read, “in the case of a group health plan that provides mental health benefits, those benefits must be provided on par with benefits for other physical illnesses . . . .” Id.

65. CAL. HEALTH & SAFETY CODE § 1374.72(a) (West 2003) (emphasis added).

66. See id. (stating that all insurers must provide mental health coverage). For a discussion of the various mandating frameworks, see supra notes 61–65 and accompanying text.

67. See id. (requiring that all insurers are obligated to provide mental health coverage on parity with physical health coverage). As a mandated-benefit statute, the Parity Act requires insurers to provide coverage for “medically necessary treatment of severe mental illnesses,” which includes the following: outpatient services, inpatient hospital services, partial hospital services, and prescription drugs, if the
Third, how state legislators choose to regulate the terms of insurance plans also dictates the statute’s comprehensiveness.68 The Parity Act regulates insurance plans by requiring that “[t]he terms and conditions applied to the benefits required by this section . . . shall be applied equally to all benefits under the plan contract.”69 However, the Parity Act only requires the following terms and conditions to be equal among mental health and physical health benefits: maximum lifetime limits, copayments, and individual and family deductibles.70

Lastly, the exemptions contained in a state mental health parity law can easily frustrate its comprehensiveness.71 The largest exemption placed on state mental health parity laws is the Employee Retirement Income Security Act of 1974 (“ERISA”).72 As a federal scheme that regulates plan covers them. Id. § 1374.72(a), (b)(1)–(4). For definitions of these care settings, see infra note 106. Based on this mandated benefit language, the main issue in Harlick was whether the Parity Act required coverage of residential care, which required a preliminary analysis of whether subsection (b) of the Parity Act was an exhaustive list of treatments. See Harlick v. Blue Shield of Cal., 686 F.3d 699, 712 (9th Cir. 2012). In addition, the Ninth Circuit also decided whether the Parity Act, under subsection (b) required coverage for all medically necessary treatments of the mental illnesses enumerated in subsection (d). See id. at 713–17 (interpreting Parity Act).

68. See Shamash, supra note 27, at 291 (analyzing how parity law’s regulation of terms and conditions affects law’s comprehensiveness).

69. CAL. HEALTH & SAFETY CODE § 1374.72(c)(1)–(3) (West 2003).

70. See id. (limiting applicable terms and conditions). The Parity Act does not regulate a plan’s other terms and conditions, such as “out-of pocket maximums, and inpatient and outpatient visitation maximums.” See Shamash, supra note 27, at 291 (enumerating different terms and conditions that parity law may regulate). The provision may not be exhaustive however, as it uses the language “shall include, but not be limited to” when it lists the terms and conditions. CAL. HEALTH & SAFETY CODE § 1374.72(c) (West 2003). For a discussion on how the Ninth Circuit interpreted this same statutory language under subsection (b) of the Parity Act, see infra notes 117–21 and accompanying text.

71. See Shamash, supra note 27, at 291–92 (analyzing how federal legislation can exempt or preempt state parity laws and inhibit their efficacy). For a brief discussion of ERISA preemption in the context of state parity laws, see infra note 72.

72. 29 U.S.C. § 1002 (2006) (regulating state laws relating to employee benefit plans). ERISA broadly preempts any state law that relates to an employee benefit plan. See id. § 1144(a) (explaining statute’s preemptions). An exception to this broad preemption lies in the “savings clause,” which “saves” certain state laws from preemption, such as those laws regulating insurance. See id. § 1144(b)(2)(A). A state law is exempt from ERISA preemption if it is directed towards “entities engaged in insurance” and if the law “substantially affect[s] the risk pooling arrangement between the insurer and the insured.” Kentucky Ass’n of Health Plans, Inc. v. Miller, 538 U.S. 329, 342 (2003). The Tenth Circuit has upheld a district court’s holding that ERISA does not preempt state parity laws. See Douglas S. v. Altius Health Plans, Inc., 409 Fed. App’x 219, 222 n.3 (2010) (declining to review district court’s finding that ERISA did not preempt state parity law because “neither party briefed this issue . . . and it was unnecessary to reach this issue to resolve this appeal”); see also Z.D. ex rel. J.D. v. Grp. Health Coop., 829 F. Supp. 2d 1009, 1015 (W.D. Wash. 2011) (holding that ERISA did not preempt Washington’s mental health parity law). Conversely, the Eighth Circuit has held that an additional ER-
employee health benefit plans, many state law parity claims are dismissed upon the threshold issue of whether ERISA preempts the parity law.73

B. Applying the Parity Act: Inconsistency in the Lower Federal and State Courts

The patchwork approach that federal and state governments have taken towards parity legislation has hindered the efficacy of federal and state parity laws.74 Despite advocacy efforts and court cases addressing the comprehensiveness of mental health parity laws, most state and federal parity laws remain riddled with exemptions and limited mandates.75 The Ninth Circuit’s ruling finally provides an example of a comprehensive state parity regime that places the patient, rather than the insurance company, at the center of the parity analysis.76

Since the passage of the Parity Act, both lower federal and California state courts have grappled with interpreting the law, and more specifically, the subsection that specifies what modalities of treatment are to be provided on an equal basis.77 In Harlick, the Ninth Circuit addressed whether the list of mandated services in subsection (b) of the Parity Act was exhaus-

ISA provision, the “deemer clause,” continues to exempt some employee benefit plans from state mental health parity laws. See Daley v. Marriott Int’l, Inc., 415 F.3d 889, 894–95 (8th Cir. 2005) (holding that “self-funded ERISA plans are exempt from state regulation insofar as that regulation ‘relate[s] to’ the plans” (alteration in original)). The circuit courts’ disagreement regarding whether state parity laws are exempted by the savings clause or deemer clause is beyond the scope of this Casenote. For a further discussion on how ERISA interacts with state parity legislation, see Quass, supra note 57, at 55–56.

73. See Daley, 415 F.3d at 894–95 (“[S]elf-funded ERISA plans are exempt from state regulation insofar as that regulation ‘relate[s] to’ the plans.” (alteration in original)).

74. See Shamash, supra note 27, at 301–06 (discussing how federal and state mental health parity laws interact).

75. See Tovino, supra note 20, at 38–39 (comparing exemptions in MHPA and MHPAEA); see also Shamash, supra note 27, at 292–93 (analyzing federal limitations on state parity acts).

76. See California’s Mental Health Parity Act Requires Health Plan to Cover “Medically Necessary” Residential Treatment for Anorexia Nervosa, CAL. INS. L. & REG. REP. (THOMPSON WEST), July 2012, at 4 [hereinafter Parity Act Requires "Medically Necessary" Coverage] (“California’s Mental Health Parity Act requires insurers and health care plans subject to the Act to provide medically necessary treatment for eating disorders, even if its policy specifically excludes such treatment.”). For a discussion of this regulation and the Ninth Circuit’s interpretation, see infra notes 128–30 and accompanying text.

77. See CAL. HEALTH & SAFETY CODE § 1374.72(b)(1)–(4) (West 2003) (“These benefits shall include the following: (1) outpatient services, (2) inpatient hospital services, (3) partial hospital services, [and] (4) prescription drugs, if the plan contract includes coverage for prescription drugs.”). The Department of Managed Health Care (“DMHC”) was charged with promulgating the regulation that would enforce the Parity Act. See Harlick, 686 F.3d at 712 (“[T]he California Department of Managed Health Care . . . promulgated a regulation implementing the Parity Act in 2003.”). For a discussion of this regulation and the Ninth Circuit’s interpretation, see infra notes 128–30 and accompanying text.
tive.\footnote{See Harlick, 686 F.3d at 712 (stating that court would hear issue of whether residential care was required by Parity Act because both parties requested ruling on that issue and because record was fully developed).} If so, the subsection would only mandate parity in outpatient services, inpatient hospital services, partial hospital services, and prescription drugs under certain plans.\footnote{See id. (determining that if subsection was not exhaustive, Parity Act would only require parity in four modalities of treatment).}

In Wayne W. v. Blue Cross of California,\footnote{Id. at *3.  The plaintiff in Wayne was a minor diagnosed with severe attention deficit hyperactivity disorder, mood disorder, substance abuse, and other high-risk behaviors. See id. at *1. The plaintiff was placed in a residential treatment center for adolescents, where he stayed for 371 days between 2004 and 2005. See id. Because Blue Cross’s contract placed an annual limit of one hundred days of treatment at such a facility, the plaintiff’s additional care was denied in 2005 when he exceeded his annual limit. See id. The plaintiff argued that, “Blue Cross’s application of the limitation on treatment at Island View violates California law, ERISA, and the Plan.” Id. at *2. The court found that, “[e]ven assuming for the sake of argument that the California parity statute at issue is saved from ERISA preemption,” the Parity Act did not require Blue Cross to provide residential treatment “on the same basis as other medical benefits.” Id. at *3.} the district court for the District of Utah held that the Parity Act “does not, on its face, require Blue Cross to provide benefits for stays at a residential treatment center on the same basis as other medical benefits.”\footnote{Id. at *1 (explaining application of California Parity Act in Utah).} Although Utah has its own mental health parity law, the district court interpreted California’s Parity Act because the plaintiff was a beneficiary of his father’s benefit plan, which was provided by Blue Cross of California.\footnote{Id. at *4.  In reaching this conclusion, the court reasoned that the non-exhaustive list in subsection (c) of the Parity Act implies that the absence of similar wording in subsection (b) “can only signify that the four specifically listed benefits are the only ones required by the law . . . .” Id.} In its interpretation of California’s Parity Act, the court reasoned that interpreting subsection (b) of the Parity Act as an exhaustive list “comports with general rules of statutory construction.”\footnote{Id. (emphasizing that DMHC’s intent was crucial to interpretation of Parity Act).} Moreover, the court noted that interpreting the Parity Act any other way would violate the intent of the Department of Managed Health Care (“DMHC”).\footnote{See id. (emphasizing that DMHC’s intent was crucial to interpretation of Parity Act).}

The DMHC’s administrative history leading to the promulgation of the Parity Act’s accompanying regulations became the crux of the Northern District of California’s rationale in Daniel F. v. Blue Shield of California.
nia. The court referred to the plan’s contract, noting that inpatient mental health services were covered, “but only when those services are provided at a ‘Hospital’ . . . .” Id. Because the treatment facility was not accredited as a psychiatric hospital, or even a “psychiatric health care facility” under pertinent California law, Blue Shield did not err in rejecting coverage. See id. (reasoning that lack of accreditation under state law did not require Blue Shield to cover residential treatment).

87. See id. at *9 (deferring to insurance company in regards to mental health coverage). The court expanded its reasoning outside of the plan contract, looking to the administrative history of the DMHC’s promulgation of the Parity Act’s regulation, which cited a lack of residential care as a plan’s “policy decision.” See id. (citing administrative agency’s previous research to justify limiting mental health coverage). Rather than adopting an expansive meaning of what constitutes “medically necessary treatment,” the court interpreted the Parity Act to require “Blue Shield [to] provide[ ] benefits for mental health conditions on a par with those for other medical conditions, for outpatient services, inpatient hospital services, and partial hospital services.” Id. at *8.

88. Id. at *9 (citing Yamaha Corp. of Am. v. State Bd. of Equalization, 960 P.2d 1031, 1036 (Cal. 1998)).


90. 104 Cal. Rptr. 3rd 545 (Ct. App. 2010).

91. Id. at 565. In Arce, the plaintiff was a four-year-old boy who was diagnosed with autism, and was a member of a Kaiser health plan that excluded “custodial care” from its coverage. See id. at 478–79 (describing plaintiff’s mental health illness). The Kaiser plan defined custodial care as “assistance with activities of daily living, . . . or care that can be performed safely and effectively by people, who in order to provide the care, do not require medical licenses or certificates or the presence of a supervising licensed nurse.” Id. at 479.
read the . . . protections of the Mental Health Parity Act. 92 Moreover, the appellate court corrected the trial court’s finding that the Parity Act required the plaintiff to prove why the treatment was medically necessary.93 In doing so, the Arce court noted two ways in which an insurance company could violate the Parity Act.94 The first and most widely acknowledged way of violating the Parity Act occurs when an insurance company wrongfully denies care that was medically necessary for the diagnosis or treatment of a severe mental illness.95 In addition, the Arce court held that an insurance company’s failure to make the medically necessary inquiry at all constitutes a second means of violating the Parity Act.96

IV. DIAGNOSING A SICK SYSTEM: THE NINTH CIRCUIT’S RULING IN HARIICK V. BLUE SHIELD OF CALIFORNIA

In Harlick, the Ninth Circuit addressed the scope of the Parity Act in deciding whether one of the Act’s subsections only required parity in limited modalities of treatment.97 Though the court limited its analysis to residential treatment of anorexia nervosa, the majority broadly held that the Parity Act required coverage for the diagnosis and medically necessary treatment of all severe mental illnesses listed in the statute.98 Such a holding is not only cognizant of the case-specific needs of mental health patients, but it also illustrates how judicial action can augment legislative

92. Id. at 565. The trial court reasoned that because the Parity Act only mandates “medically necessary treatment,” the plaintiff must prove that the therapies at issue were medically necessary in order to determine whether the Parity Act had been violated. See id. (determining that trial court erred in holding that plaintiff must prove whether treatment was medically necessary). The appellate court rejected this reasoning and noted that:

It is possible that Arce also could prove a statutory violation by showing that Kaiser categorically denies coverage for mental health care services that may, in some circumstances, be medically necessary, and that Kaiser does so without considering whether such services are in fact medically necessary for its individual plan members.

Id.

93. See id. (concluding that trial court “too narrowly read . . . the protections of the Mental Health Parity Act”).

94. See id. at 565–67 (establishing two-prong analysis for violations of Parity Act).

95. See id. at 565 (noting that denial of medically necessary treatment is “one means of establishing a violation [of] the statute,” but “not the exclusive means”).

96. See id. at 566 (stating that insurance company’s categorical denial of reviewing medically necessary inquiry constitutes violation of Parity Act). Unlike the district courts in Wayne W. and Daniel F., the appellate court in Arce suggested that an insurer’s liability could be expanded to include occurrences when the company “never considers the issue of medical necessity because it has concluded that there is no coverage for these therapies in the first place.” Id. at 565.

97. See Harlick v. Blue Shield of Cal., 686 F.3d 699, 712 (9th Cir. 2012).

98. See id. at 721 (reasoning that such interpretation was “common sense”).
efforts by providing states with a broad, regulatory scheme for mental health parity.99

A. Facts and Procedural History of Harlick

Plaintiff Jeanene Harlick brought suit against Blue Shield of California (“Blue Shield”) after the insurer refused to cover her residential treatment for anorexia.100 Harlick had been suffering from anorexia nervosa since she was about eighteen years old.101 When Harlick was thirty-eight years old, she relapsed and sought intensive outpatient treatment for her anorexia.102 This treatment was covered through Blue Shield, who was her employer’s health insurance provider.103

As Harlick’s condition worsened, her doctor recommended a more intense course of treatment than the outpatient treatment that she had been receiving.104 Blue Shield informed Harlick that, pursuant to her plan, only medically necessary “partial or inpatient (full-time) hospitalization” was covered.105 Though Blue Shield referred Harlick to several facilities that were covered under her plan, her doctors “determined that none of the in-network facilities suggested by Blue Shield could provide effective treatment.”106 As such, Harlick sought treatment at an out-of-network provider, the Castlewood Treatment Center, in Missouri.107

99. See id. (holding that insurance companies were required to provide all medically necessary treatment for severe mental illnesses); see also infra note 172 (discussing other state courts’ mental health parity holdings). But see Tovino, supra note 20, at 2 (describing courts’ failure to effectively rule in favor of patients’ rights).

100. See Harlick, 686 F.3d at 706.

101. See id. at 703 (recounting plaintiff’s history of anorexia).

102. See id. (discussing plaintiff’s previous treatment of anorexia).

103. See id. (noting that Blue Shield had previously covered treatment of plaintiff’s anorexia).

104. See id. (describing Harlick’s worsening anorexia).

105. Id. (explaining denial of coverage).

106. Id. at 703–04.

107. See id. at 704 (describing Harlick’s new course of treatment). Castlewood’s care levels were at varying degrees of intensity, including: “a community support group, an outpatient program, an intensive outpatient program, day treatment, ‘Step Down’ or partial hospitalization, and residential care.” Id. Despite these varying methods of care, Castlewood’s website “consistently” classifies the facility as residential. Id. (discussing website and its information on residential treatment). For purposes of this Note, Blue Shield’s definitions for these methods of care will be used. Blue Shield defines an inpatient as “an individual who has been admitted to a Hospital or a Skilled Nursing Facility as a registered bed patient and is receiving Services under the direction of a Physician.” BLUE SHIELD OF CAL., SHIELD SAVIER 4000: HEALTH PLAN FOR INDIVIDUALS AND FAMILIES, EVIDENCE OF COVERAGE AND HEALTH SERVICE AGREEMENT 69 (2012), available at https://www.blueshieldca.com/producer/download/public/ShieldSaver4000_7-12.pdf (defining types of care provided under basic Blue Shield plan). An outpatient facility is defined as “a licensed facility, not a Physician’s office or Hospital, that provides medical and/or surgical services on an Outpatient basis.” Id. at 65. An intensive outpatient care program is defined as “an Outpatient Mental Health (or substance...
Blue Shield paid for Harlick’s first eleven days of treatment at Castlewood, but refused to pay for the rest of her treatment. Various internal documents showed that upon review by Blue Shield employees, Harlick’s coverage was denied because the treatment facility “appear[ed] to be residential care as stated in the consent to treatment/treatment plan [and] [r]esidential treatment is not a benefit.” In her disputes with Blue Shield, Harlick received several inconsistent letters stating why coverage was denied. Though all of the letters from Blue Shield employees explained that residential treatment was not covered under her plan, other employees noted that Harlick needed to be authorized by the Mental Health Services Administrator to seek out-of-state treatment. In corresponding with Harlick, employees also noted that the Parity Act did not require them to offer residential treatment because the plan did not cover residential care “whether the diagnosis [wa]s for a mental health condition or a medical condition.”

108. See Harlick, 686 F.3d at 705 (recounting plaintiff’s communications with Blue Shield). In their communication with Harlick, Blue Shield claimed that the first eleven days of coverage were due to a coding error. See id. at 708.

109. Id. at 704–05. Harlick’s plan covered the following mental health services: inpatient services, limited outpatient services, office visits, psychological testing, and in-person and telephone counseling. See id. For physical illnesses, the plan covered “extensive hospital treatment,” outpatient care, office visits, and subacute care. See id. (discussing coverage for physical illnesses).

110. See id. at 705–07 (recounting plaintiff’s communications with Blue Shield). For a discussion of the communications between Harlick and Blue Shield during her appeals process, see infra notes 111–12 and accompanying text.

111. See Harlick, 686 F.3d at 705 (explaining plaintiff’s communications with insurance company during internal reviews process). This was clarified in later letters, in which another employee explained that the preauthorization requirement did not apply to out-of-state facilities; see also Thompkins v. BC Life & Health Ins. Co., 414 F. Supp. 2d 953, 960 (C.D. Cal. 2006) (holding that Parity Act “does not limit application of the parity law on the basis of where the individual beneficiaries live or seek medical care”).

112. Harlick, 686 F.3d at 706. After citing a preauthorization requirement and the inapplicability of California’s Parity Act, Blue Cross sent a final letter to Harlick that explained the ultimate reason for denial of coverage—her plan did not cover residential care. See id. (noting that plaintiff had exhausted Blue Shield’s internal review process). Moreover, the letter explained that the first eleven days of her facility expenses were only paid because of a “coding error.” Id. (noting error in payment). The medical coder used a billing code that “did not identify the claim as a mental health diagnosis,” so the claim was paid. Id.
Harlick’s mother appealed Blue Shield’s coverage decision to the California Insurance Commissioner.113 After an investigation was conducted by the DMHC, the agency’s senior counsel noted that, “although [Harlick] had been provided with conflicting information from the Plan regarding its basis for denial,” Blue Shield had denied coverage because Harlick’s plan did not cover residential care.114 Harlick brought suit against Blue Shield in the Northern District of California.115 The district court granted Blue Shield’s motion for summary judgment, finding that “Harlick’s Plan unambiguously excluded coverage for residential care.”116 The court did not reach the question of whether the Parity Act required Blue Shield to cover Harlick’s residential treatment.117

On August 26, 2011, a panel of three Ninth Circuit judges held that Blue Shield must provide coverage for a beneficiary’s mental health treat-

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113. See id. (explaining plaintiff’s administrative appeals process through DMHC). In his investigation of Blue Shield’s denial of Harlick’s care, the California Insurance Commissioner inquired, (1) [W]hy Harlick had been told that residential care was not medically necessary; (2) why Harlick was told that benefits would be denied because care was not pre-authorized, even though the Plan clearly stated that lack of preauthorization resulted only in a $250 penalty; and (3) whether Castlewood could be covered as an SNF [skilled nursing facility].

114. Id. (alterations in original).


116. Harlick, 686 F.3d at 706 (describing district court’s reasoning). The district court also held that Castlewood could not be considered a skilled nursing facility, which would have been covered under Harlick’s plan. See Harlick, 2010 WL 760484, at *5 (analyzing plaintiff’s claim that Castlewood was skilled nursing facility). In its reasoning, the district court noted that Blue Shield defines a skilled nursing facility as “a facility with a valid license issued by the California Department of Health Services as a Skilled Nursing Facility or any similar institution licensed under the laws of any other state, territory, or foreign country.” Id. The district court looked to Missouri’s definition of a skilled nursing facility. See id. (analyzing whether definition of skilled nursing facility could fall within Blue Shield’s covered modalities of treatment). Because Missouri only defined skilled nursing facilities in terms of physical illnesses, the court held that “[i]f it is impossible for Castlewood to be licensed as a SNF in Missouri, then the Court cannot regard Castlewood as a SNF.” Id. at *6. The court also noted that, despite Missouri’s limited definition of a skilled nursing facility, Harlick also failed to present any evidence that Castlewood’s professional staff included nurses. See id. (rejecting plaintiff’s argument that Castlewood was skilled nursing facility for purpose of Blue Shield coverage).

117. See Harlick, 686 F.3d at 706 (reviewing issues resolved by district court). The district court reasoned that because Castlewood was not a skilled nursing facility, and thus did not involve any facet of Harlick’s plan that was denied to her, “the Court d[id] not need to reach Plaintiff’s argument that Harlick’s plan violates the MHPA [Parity Act].” Harlick, 2010 WL 760484, at *6.
ment at a residential facility, despite the plan’s explicit exclusion of residential treatment.\footnote{See Harlick v. Blue Shield of Cal., 656 F.3d 832, 849–50 (9th Cir. 2011) (“We therefore conclude that the most reasonable interpretation of the Parity Act . . . is that plans within the scope of the Act must provide coverage of all ‘medically necessary treatment’ for the nine enumerated ‘severe mental illnesses’ under the same financial terms as those applied to physical illnesses.”). withdrawn and superseded, 686 F.3d 699 (9th Cir. 2012).} Blue Shield petitioned the Ninth Circuit to set aside its decision, arguing that the panel misinterpreted the Parity Act to require all medically necessary services.\footnote{See Harlick, 686 F.3d at 721 (Smith, J., dissenting in part and concurring in part) (discussing Blue Shield’s petition for rehearing and petition for rehearing en banc). For a full discussion of Judge Smith’s dissent, see infra note 144.} The insurance company asserted that such a reading of the Parity Act is contradictory to California’s Knox-Keene Act, which only requires insurers to cover basic services for physical illnesses.\footnote{See 9th Circuit Upholds Landmark Mental Illness Coverage Ruling: Harlick v. Blue Shield of Cal., WESTLAW J. INS. COVERAGE (Thompson West) June 15, 2012, 2 (“Blue Shield petitioned for the full 9th Circuit to set aside the panel’s ruling, arguing for the first time that the regulation[ ] . . . reference[s] California’s Knox-Keene Act . . . [which] requires that insurers only cover basic services for physical illnesses, not all medically necessary services . . . .”).} The panel rejected Blue Shield’s petition, but withdrew its opinion and issued a new opinion on June 4, 2012.\footnote{See Harlick, 686 F.3d at 703 (“This court’s opinion filed on August 26, 2011 . . . is withdrawn and replaced by the attached Opinion and Dissent.”).}

B. Majority Opinion

The Ninth Circuit held that while residential care was not covered under Harlick’s plan, California’s Parity Act required Blue Shield to cover Harlick’s residential care for her anorexia.\footnote{See id. at 721 (interpreting Parity Act as requiring coverage of all medically necessary treatment, even if specific treatment is not included in individual’s plan). Harlick first claimed, pursuant to her plan’s terms, that if Blue Shield refused to cover residential care, then Blue Shield should still have covered Harlick’s stay at Castlewood as a “skilled nursing facility,” which was covered under Harlick’s plan. See id. at 709 (reviewing plaintiff’s arguments against Blue Shield). The court reasoned that because Castlewood did not have any medical staff, it could not qualify as a skilled nursing facility under California or Missouri law. See id. at 709–10 (analyzing whether definition of Castlewood fits within Blue Shield’s coverage for skilled nursing facility). Harlick argued that because California’s licensing laws included “similar institutions” under its skilled nursing facility category, Castlewood should be considered a “similar institution.” Id. at 709 (citing CAL. HEALTH & SAFETY CODE § 1250(c) (West 2000)). The court held that “the Plan covers SNFs in California, as well as institutions in other states that provide around-the-clock nursing care for physical illnesses, even if they are given a different name in those states.” Id. at 710. Because Castlewood lacked medical staff and was referred to as a residential facility on its website, the court concluded that Blue Shield did not abuse its discretion in finding that Castlewood was not a skilled nursing facility. See id.}
The administrator’s decision to deny Harlick’s benefits.\textsuperscript{123} The court next ana-

\textsuperscript{123} See id. at 707 (discussing whether there was abuse of discretion in Blue Shield’s decision to deny residential care). The Ninth Circuit began its analysis by determining “whether the plan explicitly grants the administrator discretion to interpret the plan’s terms.” \textit{Id.} (citing \textit{Abatie v. Alta Health & Life Ins. Co.}, 458 F.3d 955, 967 (9th Cir. 2006)). Here, both parties conceded that discretion was permitted under Harlick’s plan, and the court thus proceeded to review the ERISA plan administrator’s decision in denying Harlick’s benefits. \textit{See id.} at 707 (analyzing whether Blue Shield abused its discretion in denying care for Harlick’s residential treatment at Castlewood). The majority opinion emphasized that their review would be “‘tempered by skepticism’ when the plan administrator has a conflict of interest in deciding whether to grant or deny benefits.” \textit{Id.} (quoting \textit{Abatie}, 458 F.3d at 959). Such a conflict arises where, as in \textit{Harlick}, the plan administrator both reviews coverage decisions and pays for the benefits. \textit{See id.} (applying conflict of interest analysis to Blue Shield’s denial of coverage).

The amount of skepticism placed on the plan administrator’s decision differs based on the severity of the conflict. \textit{See id.} (describing how various levels of skepticism are applied to insurance plan based on whether conflict of interest is found). For example, “[t]he conflict is less important when the administrator takes ‘active steps to reduce potential bias and to promote accuracy,’ such as using an ‘independent review process,’ or segregating employees who make coverage decisions from those who deal with the company’s finances.” \textit{Id.} (citing \textit{Abatie}, 458 F.3d at 969 n.7). Conversely, a conflict is taken more seriously if the plan has a history of bias, has given inconsistent reasons for denial of care, or has failed to fully review the denial claim. \textit{See id.} (enumerating factors that led court to apply more skepticism to insurance company’s denial of coverage).

Harlick asserted four reasons why the court should apply the skepticism analysis to Blue Shield’s decision. \textit{See id.} First, Blue Shield had a conflict of interest because the company made coverage decisions and paid for such coverage. \textit{See id.} (stating plaintiff’s first argument for ERISA abuse of discretion analysis). In addition, Blue Shield had offered inconsistent reasons for the denial of Harlick’s care. \textit{See id.} (considering plaintiff’s second argument as to why higher level of skepticism applied to Blue Shield plan). Besides its inconsistent reasoning, Blue Shield also did not fully review Harlick’s claims because the company did not offer a reason as to why the Parity Act did not apply. \textit{See id.} (noting that Blue Shield’s refusal to give concrete reason for denial weighed in favor of abuse of discretion). Lastly, Blue Shield excluded residential treatment from Harlick’s plan but did not define what constituted residential treatment. \textit{See id.} (concluding plaintiff’s four arguments against Blue Shield in court’s abuse of discretion analysis).

In its review of these four assertions, the court stated that the record did not indicate “whether Blue Shield has a history of bias in claims administration . . . .” \textit{Id.} The court agreed with Harlick that Blue Shield’s communications with her were “confusing and frustrating,” though nothing indicated that the changed reasons of denial were done in bad faith. \textit{See id.} at 708 (rejecting plaintiff’s contention that Blue Shield’s denial of coverage was due to bad faith). The court then rejected Harlick’s claim that Blue Shield did not consider its compliance with the Parity Act, as one letter to Harlick stated that, “Blue Shield believed that the Act did not mandate coverage.” \textit{Id.} Lastly, the court reasoned that while Blue Shield did not define residential treatment, “there [wa]s no indication that Blue Shield exploited any uncertainty about the meaning of ‘residential care.’” \textit{Id.} Thus, the court found two reasons for tempering its review with skepticism: Blue Shield’s “structural conflict,” and the company’s confusing communications with Harlick. \textit{See id.} (weighing factors against Blue Shield in abuse of discretion analysis).

The court concluded that, despite these reasons, there was no abuse of discretion and, based on Harlick’s plan alone, residential treatment for anorexia was not required. \textit{See id.} at 708 (holding that Harlick’s plan did not require coverage for residential treatment).
lyzed whether the Parity Act required coverage of residential care, even if Blue Shield’s plan did not explicitly offer it.\textsuperscript{124} The court then expanded its inquiry, and analyzed whether the Parity Act required coverage for all medically necessary treatments of anorexia.\textsuperscript{125} Finally, the court applied its findings and analyzed whether residential care was medically necessary for Harlick’s treatment.\textsuperscript{126}

1. \textit{Does the Parity Act Require Coverage of Residential Care?}

The Ninth Circuit noted that subsection (b) of the Parity Act states that benefits “shall include” outpatient services, inpatient hospital services, partial hospital services, and prescription drugs if the plan already covers them.\textsuperscript{127} While non-exhaustive lists were used in other portions of the Parity Act, subsection (b) remained ambiguous.\textsuperscript{128} To resolve this ambiguity, the Ninth Circuit looked to the Parity Act’s enforcing regulation, 

\textsuperscript{124. See id. at 712–16 (analyzing whether Parity Act alone compelled Blue Shield to provide coverage for Harlick). For a discussion of the Ninth Circuit’s reasoning regarding whether the Parity Act requires coverage of residential treatment, see infra notes 127–31 and accompanying text.}

\textsuperscript{125. See Harlick, 686 F.3d at 714–19 (examining Parity Act). For a discussion of the Ninth Circuit’s reasoning in deciding whether the Parity Act requires insurers to provide all medically necessary treatment for anorexia, see infra notes 132–44 and accompanying text.}

\textsuperscript{126. See Harlick, 686 F.3d at 719–21 (considering whether residential care was medically necessary). Although Blue Shield did not dispute the medical necessity of Harlick’s treatment during her administrative appeals process, the company argued that, “it should be allowed to reopen its administrative process in order to determine whether Harlick’s residential care was medically necessary.” Id. at 719. The Ninth Circuit rejected this argument, stating that the rule “in this circuit and in others, is that a court will not allow an ERISA plan administrator to assert a reason for denial of benefits that it had not given during the administrative process.” Id. at 719–20. During Blue Shield’s communications with Harlick and her mother, the insurance company never stated that they were denying coverage because it was not medically necessary; rather, the insurance company repeatedly stated that coverage was denied because Harlick’s plan did not cover residential treatment. See id. at 720 (demonstrating that insurance company did not cite medical necessity as reason for Harlick’s coverage denial). Because the insurance company did not preserve this issue for appeal, the Ninth Circuit held that “Blue Shield forfeited the ability to assert that defense . . . .” Id. at 721.}

\textsuperscript{127. See id. at 711 (noting benefits Parity Act provides).}

\textsuperscript{128. See id. at 712 (reasoning that subsection (b) remained ambiguous because of express and specific language in Parity Act’s other provisions). Subsection (a) specifically outlined one limitation: coverage must be provided for “medically necessary treatment of severe mental illnesses.” Id. at 711 (citing CAL. HEALTH & SAFETY CODE § 1374.72(a) (West 2003)). In addition, subsection (c) was “explicitly characterized as a non-exhaustive list” because it used the language “shall include, \textit{but not be limited to . . . .}” Id. at 712 (emphasis added) (citing § 1374.72(c)). Compared to these other statutory provisions, subsection (b) remained ambiguous because it stated “shall include,” but did not indicate whether the list of care facilities was exhaustive. See id. (citing § 1374.72(b)) (interpreting Parity Act as non-exhaustive).}
which was promulgated by the DMHC in 2003. The regulation states that:

The mental health services required for the diagnosis, and treatment of conditions set forth in Health and Safety Code section 1374.72 [the Parity Act] shall include, when medically necessary, all health care services required under the Act including, but not limited to, basic health care services within the meaning of Health and Safety Code sections 1345(b) [Knox-Keene Act] and 1367(i) [Knox-Keene Act], and section 1300.67 of Title 28 [relating to Knox-Keene Act].

The Ninth Circuit reasoned that the regulation’s wording, “including, but not limited to” justified the court’s holding that subsection (b)’s list of services was not exhaustive.

2. Does the Parity Act Require Coverage for All Medically Necessary Treatments of Anorexia?

In the crux of its opinion, the Ninth Circuit furthered its holding by stating that the Parity Act obliges insurers to cover not only residential care, but all medical necessary treatments enumerated in the Parity Act. The Ninth Circuit reached its holding by rejecting Blue Shield’s proposed three-pronged test to determine when a “medically necessary” treatment must be covered. Blue Shield argued that a medically necessary treatment must be covered when the treatment: (1) is a level of care specified in subsection (b) of the Parity Act; (2) “is a ‘basic health care service’” pursuant to the Knox-Keene Act; or (3) “is an additional (non-mandated)
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benefit that the plan has chosen to provide for the treatment of” physical
and mental illnesses. 134

The Ninth Circuit relied heavily on the DMHC’s administrative history
in its rejection of Blue Shield’s argument.135 The court reiterated the
regulation’s wording of “including, but not limited to” to justify the inclusions
of all medical treatments.136 Next, the court cited the DMHC’s
“unambiguous[ ] reject[ion]” of a similar argument made by Blue Shield
during the agency’s notice-and-comment process leading up to the regula-
tion’s promulgation.137 In that notice-and-comment process, the DMHC
explicitly noted: “it is sufficient to state that the plans must provide all medically
necessary services. To the extent that certain services are medically necessary, then
those services will be provided.”138

134. See id. at 713 (outlining Blue Shield’s recommended three-prong
inquiry). The court cited Blue Shield’s brief, which argued that the Parity Act’s im-
plementing regulation was to be interpreted as stating: “mental health services
required under the Parity Act ‘shall include, when medically necessary, all health
care services required under the [Knox-Keene] Act, including, but not limited to, basic
health care services within the meaning of [the statutory provisions].’” Id. (altera-
tions in original).

135. See id. at 717 (justifying court’s reliance on DMHC’s authority as state
agency). In relying on the DMHC’s intent in its interpretation of the Parity Act,
the Ninth Circuit noted that California law permits deference to state agencies
when “the subject matter of the statute is especially technical or complex, or if the
agency is interpreting its own regulation.” Id. (citing Yamaha Corp. of Am. v. State
Bd. of Equalization, 960 P.2d 1031, 1037 (Cal. 1998)). Moreover, an agency’s in-
terpretation of their rule is most likely to be correct after a notice-and-comment
process, which occurred in the promulgation of the Parity Act’s regulation. See id.
(deferring to agency interpretation of Parity Act). An agency’s interpretation is
equally credible when the agency has “maintained a consistent interpretation over
time.” Id.

136. See id. at 714 (“Blue Shield plays down the importance of the phrase
‘including but not limited to’ by italicizing the words preceding and following that
phrase. But the phrase is critical.”). For the text of Blue Shield’s interpretation of
the Parity Act’s regulation, see supra note 134 and accompanying text.

137. See Harlick, 686 F.3d at 714 (explaining Blue Shield’s argument and why
DMHC rejected it).

138. Id. at 715. Though the Ninth Circuit relied heavily on the DMHC’s ad-
ministrative history in supporting its holding, Blue Shield argued that the agency
had interpreted the regulation differently on at least three different occasions. See
id. at 717 (analyzing DMHC’s varying interpretations of Parity Act’s regulation).
First, Blue Shield cited a case “in which DMHC demurred to a complaint seeking
coverage of a medically necessary treatment for autism . . . .” See id. (reviewing
Blue Shield’s claim that DMHC inconsistently interpreted Parity Act regulation).
The court responded by asserting that “[p]ositions taken by an agency for pur-
poses of litigation ordinarily receive little deference under California law.” Id. (citing
Yamaha Corp., 960 P.2d at 1045). Second, Blue Shield cited a survey conducted
by the DMHC, in which the agency called an insurance company’s lack of residen-
tial coverage a “policy decision.” Id. at 717. In response to that claim, the court
reasoned that the “DMHC was conducting a survey of residential treatment cover-
age as part of a larger preliminary study of mental health parity. The study was
not—and was not designed to be—an enforcement proceeding.” Id. at 718.
Lastly, Blue Shield cited a letter written by DMHC’s counsel in response to a com-
plaint from Harlick’s mother. See id. (deciding whether DMHC consistently inter-
Additionally, the court drew on the language of the Parity Act and reasoned that because the California legislature previously enumerated a specific exception for plans that carried prescription drugs, the legislature would have created other exceptions limiting medically necessary treatments. Finally, the Ninth Circuit asserted that the third prong of Blue Shield’s proposed test “lack[ed] support in common sense” because there are “some medically necessary treatments for severe mental illness [that] have no analogue in treatments for physical illnesses.”

The Ninth Circuit then turned to Blue Shield’s contention that because the regulation’s reference to the word “Act” was assumed to refer to the Knox-Keene Act, “coverage mandated by the Parity Act for severe mental illnesses [was] no greater than coverage mandated by the Knox–Keene Act for physical illnesses.” The majority opinion rejected this argument and found that the Parity Act and the Knox-Keene Act “operate in fundamentally different ways.” The court reasoned that “[b]ecause the Parity Act applies to severe mental illnesses, some of which are life-threatening, it makes sense that the Act requires insurers to cover all medically necessary treatments.” Conversely, because the Knox-Keene Act applies to all physical illnesses, “it makes equal sense” that the legislature would “not require insurers to cover all medically necessary treatments,” but rather only basic health services.

The court rejected Blue Shield’s contention that this letter shows that the Parity Act does not mandate coverage for residential treatment, and stated that “Blue Shield misunderstands the scope of the DMHC’s review” as it was only intended to serve as an independent medical review. An independent medical review, the court stated, “deals solely with the question whether treatment was medically necessary for a particular patient,” not whether an insurance company can categorically deny a treatment.

Judge Smith opposed the majority’s ruling, emphasizing that the original opinion’s interpretation of the word “Act” in the regulation to mean “Parity Act,” was the “lynchpin for our conclusion that the Parity Act was not limited by the provisions of the Knox-Keene Act.” Thus, he asserted that because the majority opinion had changed what “Act” the regulation was referring to, the holding should have also limited “medically necessary treatments” to those within the scope of the Knox-Keene Act.
V. THE FRAILTY OF THE LEGISLATIVE FRAMEWORK: CAN WE ACHIEVE PARITY WITHOUT THE HELP OF THE COURTS?

The Ninth Circuit’s ruling in Harlick has elicited positive feedback from public health professionals and eating disorder advocates alike. The court’s expansion of medically necessary treatment for anorexia has been trumpeted as the “landmark victory for those suffering from eating disorders.” Moreover, the Harlick holding carries implications for other mental illnesses included in the Parity Act. The court broadly held that “Blue Shield ‘shall provide coverage for the diagnosis and medically necessary treatment’ of ‘severe mental illnesses,’ including anorexia nervosa, for plans coming within the scope of the Act.” Thus, the Ninth Circuit did not limit its holding to residential treatment for anorexia, but rather, interpreted the Parity Act as requiring coverage for all medically necessary treatment for the statute’s enumerated mental illnesses.

In his statutory interpretation argument, Judge Smith attacked the emphasis the majority placed on the words “including, but not limited to,” in the Parity Act’s implementing regulation. He noted that California law on statutory interpretation has held that “while the phrase ‘including, but not limited to,’ is admittedly a ‘phrase of enlargement,’ this phrase is ‘not a grant of carte blanche that permits all actions without restriction . . . .’” Moreover, Judge Smith reasoned that the regulation’s reference to the Knox-Keene Act shortly after the phrase “suggests that other non-listed services would similarly be of the type required under the Knox-Keene Act,” not the Parity Act. He clarified that the scope of the court’s analysis in Arce was limited to an “unequal provision of coverage compared to physical illnesses,” rather than a discussion of whether the Parity Act requires all medically necessary treatment for severe mental illnesses.

In his second argument regarding the Parity Act’s legislative history, Judge Smith took note of the “elusive” history associated with the law and argued that the majority opinion’s reliance on legislative history “results in the proverbial situation where the majority is ‘looking over a crowd and picking out its friends.’” (quoting People v. Seneca Ins. Co., 62 P.3d 81, 86 (Cal. 2003)).

See Pollack, supra note 8, at 1 (reporting on public and stakeholder reactions to Harlick holding). For a discussion of stakeholder reactions to the Ninth Circuit’s ruling, see infra notes 146–54 and accompanying text.


146. Harlick, 686 F.3d at 721 (“California’s Mental Health Parity Act provides that Blue Shield ‘shall provide coverage for the diagnosis and medically necessary treatment’ of ‘severe mental illnesses,’ including anorexia nervosa, for plans coming within the scope of the Act.”); see also Parity Act Requires “Medically Necessary” Coverage, supra note 76 (“The Harlick opinion will compel insurers to conduct medical necessity reviews of proposed treatments for a broad range of mental health conditions.”).

147. Colliver, supra note 13.

148. Id.

149. Id. (holding that Parity Act covers diagnosis and all medically necessary treatment of “severe mental illnesses”); see also Parity Act Requires “Medically Necessary” Coverage, supra note 76 (“In addition to anorexia nervosa, subsection (d) of the Parity Act specifies that severe mental illness includes schizophrenia, schizoaffective disorder, bipolar disorder (manic-depressive illness), major depres-
A. Public Reaction to the Ninth Circuit’s Holding

The Ninth Circuit’s broad holding has led to a divisive debate on the merits of mental health parity legislation, as well as a court’s ability to enforce parity if insurers had previously not covered such medically necessary treatments.150 One health economist has supported parity measures, stating that, “[p]arity seeks a fair approach to allocating treatment resources, so that a patient is not disadvantaged simply because he or she had the misfortune of being struck by a mental illness.”151 Conversely, some medical professionals have expressed hesitation towards the Ninth Circuit’s ruling because of the limited efficacy of controlled treatments, like residential care.152 In terms of eating disorders, one doctor stated that the regimented treatment at residential care facilities often leads to relapse “because patients are often unable to deal with the reduced structure in their life following discharge.”153 Health policy experts have also noted that the Harlick ruling “opens a slippery slope that has no natural limit.”154

However, the Harlick holding should not be interpreted as opening the floodgates for mental health patients to receive unbridled access to health care.155 Rather, the Harlick ruling is broad enough to permit greater access to care, while continuing to limit such care to what is med-

150. See Parity Act Requires “Medically Necessary” Coverage, supra note 76 (“Harlick is not likely to be the last word on the scope of benefits mandated under the Parity Act.”). For a discussion on expanding mental health parity legislation through the courts, see infra notes 158–74 and accompanying text.


152. See Sally Satel, A Serious Medical Condition, N.Y. Times (Oct. 15, 2011), http://www.nytimes.com/roomfordebate/2011/10/14/should-insurers-pay-for-eating-disorders/anorexia-nervosa-is-a-serious-medical-condition (arguing that residential care may not be most effective care for eating disorder patients “because patients are often unable to deal with the reduced structure in their life following discharge”). But see Pollack, supra note 8, at 1 (“[S]ome doctors . . . say that hospitalization, which insurers typically cover, might stabilize a patient and restore weight but does not generally treat the underlying psychological issues. Outpatient treatment . . . provide[s] counseling but not round the clock. Residential treatment, they say, occupies a vital niche between those two.”).

153. See Satel, supra note 152 (explaining limited success of residential treatment center).


155. See Pollack, supra note 8 (“While the ruling applies only to California’s law, some experts think it will influence courts, state agencies and insurers elsewhere. ‘You’ll see it bleed over,’ said Scott Petersen, a lawyer in Salt Lake City who often represents insurance companies in parity cases.”).
This ruling not only acknowledges the necessity of individualized care for mental health patients, but it also permits doctors to make decisions regarding their patient’s medically necessary treatment without the concern that the patient’s insurance company can deny the treatment.

B. The Ninth Circuit’s Framework as a Model for Future Parity Policies

Unlike most court decisions regarding parity laws, the Harlick holding set forth a parity analysis that expanded beyond statutory interpretation. The court offered a unique contribution to mental health parity analysis by furthering policies that were consistent with the DMHC’s intent. Moreover, the court tailored its analysis to the individualized needs of mental health treatment. By employing this framework, the Harlick case demonstrated that in order to achieve true parity, legislators and insurance companies must realize that “[s]ome medically necessary treatments for severe mental illness have no analogue in treatments for physical illnesses.”

In its ruling, the Ninth Circuit has held that all California insurers within the scope of the Parity Act must cover all medically necessary treatment for schizophrenia, schizoaffective disorder, bipolar disorder, major depressive disorder, panic disorder, obsessive compulsive disorder, autism,

156. See Harlick v. Blue Shield of Cal., 686 F.3d 699, 721 (9th Cir. 2012) (holding that Blue Shield was required to cover diagnosis and medically necessary treatment of severe mental illness within scope of Parity Act).

157. See Colliver, supra note 13 (explaining how insurance companies dictate care). Colliver interviewed Dr. Neal Anzai, medical director of the eating disorders program at Alta Bates Summit Medical Center in Berkeley, who stated that “his patients have to be ‘literally on the verge of death’ to get hospitalized and then their insurance coverage often dictates how much care or what kind of care comes next.” Id.

158. See Harlick, 686 F.3d at 721–25 (Smith, J., dissenting) (analyzing lower federal courts’ statutory interpretation of Parity Act).

159. See id. at 717 (majority opinion) (justifying its deference to DMHC by noting that “an agency’s interpretation is more likely to be correct when the interpretation has gone through formal notice-and-comment rulemaking, when there are ‘indications of careful consideration by senior agency officials,’ or when the agency has maintained a consistent interpretation over time”). Here, the Ninth Circuit cited the DMHC’s formal notice-and-comment process leading up to the promulgation of the Parity Act’s regulation. See id. at 714–15 (reviewing administrative history before promulgation of Parity Act regulation). In this notice-and-comment process, the DMHC explicitly rejected Blue Shield’s interpretation of subsection (b) as exhaustive. See id. at 715 (deferring to agency interpretation of Parity Act).

160. See id. at 716 (noting that some treatments for mental health illnesses “have no analogue in treatments” for physical illnesses). For a discussion of the individualistic needs associated with mental health care, see infra notes 162–68 and accompanying text.

161. Harlick, 686 F.3d at 716 (emphasizing distinction between physical and mental illnesses).
anorexia, and bulimia. This holding is consistent with what the mental health community already knows: parity laws that only require equality in certain modalities of treatment, like inpatient and outpatient visits, frustrate the clinical community’s understanding that physical and mental illness often require different treatment. Perhaps the largest difference between physical and mental health care is the individualized care that most mental health patients need. For example, while prescription drugs may alleviate symptoms of mental illnesses, mental health professionals recommend a combination of prescriptions with “psychosocial treatments and support.” These psychosocial treatments should be individualized, as the American Psychological Association recommends mental health physicians to “adapt or tailor psychotherapy to those specific patient characteristics in ways found to be demonstrably and probably effective.” This combined treatment of prescription drugs and individual therapy significantly reduces symptoms and improves the quality of life for seventy to ninety percent of mental health patients. With the Ninth Circuit’s ruling, this combined treatment is now possible for those insured under California health plans.

Further, the Ninth Circuit’s ruling provides a solution to the criticism that legislation is insufficient to solve the inequities in insurance coverage. Although recent legislation like the Affordable Care Act has

162. See id. (concluding that Parity Act required insurance companies to cover all medically necessary treatment for enumerated severe mental illnesses).
163. See Gardner, supra note 35, at 687 (noting that “psychopharmalogical treatment of severe mental illness is rarely an ultimate cure”).
166. See NUHW Report, supra note 164, at 15.
167. See id. (discussing different therapies that aid in mental health recovery); see also Gardner, supra note 35, at 687 (enumerating recovery rates for several mental illnesses). Once an individual with a mental illness can receive medically necessary treatment, the elimination of symptoms can often be extremely successful. See id. (explaining efficacy of pharmaceutical and therapeutic treatment for mental health patients). Gardner notes that whereas the success rate for heart disease is around forty-five percent, the success rates for mental illnesses are as follows: sixty percent for schizophrenic patients; eighty to ninety percent for bipolar patients; seventy to ninety percent for panic disorder patients; seventy five percent for obsessive compulsive patients; and seventy to eighty percent for depressed patients. See id.
168. See, e.g., Parity Act Requires “Medically Necessary” Coverage, supra note 76 (discussing Ninth Circuit’s broad holding).
169. See Kaplan, supra note 33, at 359 (asserting that “[m]ental health parity may not be an issue that can be solved with legislation”).
moved closer toward achieving mental health parity on the federal level, its mandating power remains limited.170 The Affordable Care Act, when read together with the MHPAEA, requires insurers to provide parity for mental health, substance abuse, and behavioral health services.171 Although the Affordable Care Act does not preempt state parity laws, the federal legislation only establishes a minimal set of mandatory coverage.172

With insurance companies’ reluctance to comply with state parity laws, as well as the weak mandating power of federal parity legislation, the courts have given mental health patients a stronger voice by enforcing state parity laws.173 Outside of California, judicial action has been effective in New Jersey, where a settlement between Aetna Insurance and its beneficiaries resulted in the enforcement of a new policy which requires Aetna to provide coverage for eating disorders in the same manner as other covered mental illnesses.174

170. See Tovino, supra note 20, at 40–45 (discussing ACA’s implications for mental health parity); see also Shamash, supra note 27, at 309–15 (discussing impact of ACA on federal parity laws). Though the ACA contains provisions that “expand both mental health parity law and mandatory mental health and substance use disorder benefits,” this expansion is limited by an ACA provision that exempts health plans that were in effect before March 23, 2010. See Tovino, supra note 20, at 40–42 (explaining ACA’s significant limitations on health benefit expansions). Only non-grandfathered health plans, or those that were established after March 23, 2010, are required to offer essential health benefits. See id.

171. See Shamash, supra note 27, at 318 (analyzing cumulative effect of ACA on federal mental health parity law).

172. See id. (acknowledging limitations to ACA’s scope in context of mental health parity).


174. See DeVito v. Aetna, Inc., 536 F. Supp. 2d 523, 534 (D.N.J. 2008) (denying motion to dismiss, which challenged denial of benefits for eating disorder). In DeVito, both plaintiffs were the parents of daughters who suffered from eating disorders. See id. at 525 (explaining plaintiffs’ histories with eating disorders). One plaintiff was denied treatment after Aetna informed the family that the treatment was not medically necessary. See id. Conversely, the other plaintiff was able to receive treatment, but was later denied coverage after the treatment “exceeded the contractual limitations for coverage of non-Biological Based Mental Illnesses.” Id. The district court denied Aetna’s motion for dismissal. Id. at 534. In June 2008, Aetna made a $250,000 settlement, agreeing to reimburse one hundred New Jersey policyholders who were denied coverage related to the diagnosis and treatment of eating disorders. See McGow, supra note 36, at 392 (discussing Aetna’s settlement and its implications for increasing access to medically necessary care for eating disorders). Courts in New Jersey have enforced similar policies among Aetna’s competitor insurance companies, such as Horizon and Amerihealth. See Pollack, supra note 8 (discussing impact of courts’ holdings on parity laws outside of California).
VI. THE PROGNOSIS FOR HARLICK: TOTAL PARITY OR FURTHER COMPLICATIONS?

In 2010, Laura Burton’s husband contacted Blue Shield hoping to find “approved treatment facilities” for his wife, who had been suffering from depression and alcohol abuse.175 Unable to receive specific information about approved residential treatment facilities from the insurance company, Laura Burton was admitted to Cottonwood Tucson inpatient mental health facility.176 Upon admission, Laura was diagnosed with “alcohol dependence; major depressive disorder; posttraumatic stress disorder; panic disorder with agoraphobia; nicotine dependence; [and] sedative-hypnotic dependence.”177 Two months later, Blue Shield denied coverage for Laura’s stay at Cottonwood Tucson.178 Laura appealed the denial of coverage twice, and was denied both times.179 In its denials, Blue Shield argued that the Burtons’ plan did not cover residential treatment.180 The insurer also claimed that substance abuse treatment was only covered insofar as such treatment was used “to treat potentially life threatening symptoms of acute toxicity or acute withdrawal when [the patient is] admitted through the emergency room.”181 Such life threatening symptoms, Blue Shield asserted, were not present in the case of Laura Burton.182

Prior to Harlick, Laura Burton would have had little legal recourse after Blue Shield’s internal reviews of her claim.183 However, when Bur-
ton sued Blue Shield in January 2012, the district court cited to the initial Harlick ruling, noting that the Parity Act “may require coverage of treatment that is not within the scope of an actual plan.” The court reasoned that because two of Burton’s diagnosed illnesses were enumerated in the Parity Act and her treatment at Cottonwood was “at least in part, treatment for a severe mental illness,” the treatment fell within the scope of the Parity Act and Blue Shield was required to cover Laura’s treatment.

As seen in Burton v. Blue Shield of California Life and Health Insurance Co., Harlick has already begun to change the legal landscape of mental health parity by expanding access to care for mental health patients. The Burton court’s holding suggests that lower federal courts are willing to apply the Ninth Circuit’s Harlick holding. While the Harlick precedent bodes well for all mental health patients in terms of expanding access to care, an important question remains. In applying the Parity Act to all medically necessary treatments for severe mental illnesses, as Harlick requires, who decides what constitutes medically necessary treatment?

nifer court applied, see supra note 123. The court held that, based on the “reasonableness of [the reviewing doctor’s] judgment,” the denial of plaintiff’s benefits was not an abuse of discretion. Id. at *12; see also Brunalli, supra note 30, at 598 (explaining courts’ involvement in insurance company’s denial of benefits for plaintiff). Without a state parity claim, as Brunalli explains, “litigation is premised on the ERISA’s cause of action for the improper denial of benefits under the terms of an employee benefit plan.” Id.


185. See id. (explaining reasoning behind decision that there was no abuse of discretion).


188. See Burton, 2012 WL 242841, at *5 (“The Ninth Circuit interpreted the Act to require that insurance companies provide coverage under the same financial terms and conditions for medically necessary treatment of ‘severe mental illnesses’ and medical conditions.”).

189. See Harlick v. Blue Shield of Cal., 686 F.3d 699, 721 (9th Cir. 2012) (“[I]t appears that inpatient residential treatment was indeed necessary. But we need not decide that question.”). The court noted that because Blue Shield did not bring the issue up during the administrative process, it had “forfeited the ability to assert that defense,” and thus the court did not have to determine whether the treatment was medically necessary. See id.

190. See id. at 719–21 (discussing medical necessity in Harlick’s case). For a summary of the Ninth Circuit’s medical necessity analysis, see supra notes 133–38 and accompanying text. In its reasoning, the Ninth Circuit initially noted that “Blue Shield, as the plan administrator, normally makes the medical necessity determination in the first instance.” Harlick, 686 F.3d at 719 (emphasis added) (citing Sarchett v. Blue Shield of Cal., 729 F.2d 267, 272–73 (1987)). Despite the majority’s assertion that they “need not decide” the question of medical necessity, the court nevertheless looked to Harlick’s doctors’ recommended treatments and con-
In order for mental health patients to receive lifesaving treatment, courts should defer to the plaintiff’s doctors in determining whether a treatment is medically necessary.\textsuperscript{191} Deference to physicians promotes Parity Act compliance, as it prevents insurance companies from limiting coverage.\textsuperscript{192} Moreover, deference to the mental health clinical community is a continuation of the Ninth Circuit’s rationale, and a long-awaited change to parity analysis.\textsuperscript{193} For patients like Anna Westin, such change did not come soon enough.\textsuperscript{194} But for patients like Jeanene Harlick and Laura Burton, the Ninth Circuit’s holding reaffirms a mental health patient’s need for individualized treatment, and provides a cure for the chronic discrimination that these patients have faced in the courtroom, and in society.\textsuperscript{195}

\textbf{Excluded that, “it appears that inpatient residential treatment was indeed necessary.”} Harlick, 686 F.3d at 721. Though the Harlick court initially suggested that the medical necessity inquiry should be reserved for the ERISA plan administrator, the majority opinion’s deference to Harlick’s doctors suggests that a court, when viewing the record, can draw inferences of medical necessity depending on the doctor’s recommended treatment. \textit{See id.} ("Given that Harlick’s doctors believed that outpatient treatment was insufficient, that Harlick entered Castlewood at 65% of her ideal body weight, and that Harlick needed a feeding tube while at Castlewood, it appears that inpatient residential treatment was indeed necessary."). \textit{Id.} at 721.

\textsuperscript{191} See \textit{id.}

\textsuperscript{192} See Brunalli, supra note 30, at 594 (explaining that most insurance companies took advantage of minimal state and federal regulation of insurance plans to “reduce health care costs” by “using health insurance policies with greater restrictions and limitations on mental illnesses”).

\textsuperscript{193} See Colliver, supra note 13 (interviewing Harlick’s attorneys, who stated that Harlick’s story illustrates "the discrimination insurance companies put on mental illnesses and the very little understanding they have about eating disorders").

\textsuperscript{194} See Westin, supra note 2 (recounting Anna Westin’s history with anorexia and her subsequent suicide). For a further discussion of Anna Westin’s story, see supra notes 2–7 and accompanying text.

\textsuperscript{195} See Harlick, 686 F.3d at 716 (stating that Blue Shield’s argument “lacks support in common sense” because “it makes no sense in a case such as Harlick’s to pay for time in a Skilled Nursing Facility—which cannot effectively treat her anorexia nervosa—but not to pay for time in a residential treatment facility that specializes in treating eating disorders”); see also NUHW Report, supra note 164, at 15 (stating that psychotherapy for mental health patients must “adapt or tailor . . . those specific patient characteristics in ways found to be demonstrably and probably effective” (quoting John C. Norcross & Bruce E. Wampold, \textit{Evidence-Based Therapy Relationships: Research Conclusions and Clinical Practice}, 48 \textit{Psychotherapy} 98 (2011))).
WHAT'S YOUR PRIORITY?: REVITALIZING PENNSYLVANIA'S APPROACH TO EQUITABLE SUBROGATION OF MORTGAGES AFTER FIRST COMMONWEALTH BANK v. HELLER

GLENN R. McGILLIVRAY*

“[E]quitable subrogation simply seeks to maintain the proper order of priorities . . . keeping the first mortgage first and the second mortgage second.”1

I. FIRST THINGS FIRST: INTRODUCTION TO REFINANCING AND PRIORITY LIEN POSITION FOR MORTGAGE LOANS

As the housing market began to crash in 2008, Jan, a single mother of three, found her most prized possession—her home—threatened by foreclosure.2 After losing her job because of the economic downturn, she was forced to deplete her savings to keep up with her monthly bills.3 She soon fell behind on her mortgage payments, leaving her with a difficult decision: save her home from foreclosure or continue putting food on the table for her children.4 A saving grace presented itself when a third party

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1. Bank of Am., N.A. v. Prestance Corp., 160 P.3d 17, 20 (Wash. 2007) (en banc) (adopting Restatement approach with regard to equitable subrogation and holding that lender can be equitably subrogated to first-priority lien despite having actual or constructive notice of junior lienholders).

2. See generally Craig E. Pollack & Julia F. Lynch, Op-Ed., Foreclosures Are Killing Us, N.Y. TIMES (Oct. 2, 2011), http://www.nytimes.com/2011/10/03/opinion/foreclosures-are-killing-us.html (illustrating vast impact of foreclosure crisis that caused record number of foreclosures). Foreclosure may properly be characterized as a “bona fide public health crisis,” as it often results from the illness of homeowners. Id. (“When breadwinners become ill, they miss work, lose their jobs, face daunting medical bills—and have trouble making mortgage payments as a result.”). Furthermore, foreclosure itself has adverse health effects on homeowners, including increases in anxiety and depression. See id.

3. See generally Renae Merle & Tomoch Murakami Tse, Mortgage Foreclosures Reach All-Time High, Wash. POST (Mar. 7, 2008), http://www.washingtonpost.com/wp-dyn/content/article/2008/03/06/AR2008030601447.html (noting that more homeowners had fallen into foreclosure than ever before).

lender contacted her about refinancing her loan. The lender would provide lower monthly payments on her mortgage by lowering the interest rate and extending the date of fulfillment. With this help, Jan was able to make the new monthly payments once she returned to work, and she avoided foreclosure altogether.

During the mortgage crisis, many Americans faced a similar predicament. After the housing bubble burst and the economy sank into recession, monthly loan payments soared out of reach for many homeowners.


6. See generally Joseph E. Stiglitz & Mark Zandi, Op-Ed., The One Housing Solution Left: Mass Mortgage Refinancing, N.Y. Times (Aug. 12, 2012), http://www.nytimes.com/2012/08/13/opinion/the-one-housing-solution-left-mass-mortgage-refinancing.html?scp=1&sq=&st=nyt&n=r=0 (“More than four million Americans had lost their homes since housing bubble began bursting . . . . [And] an additional 3.5 million homeowners are in the foreclosure process or are so delinquent on payments that they will be soon.”). With interest rates at record lows, mass mortgage refinancing would allow homeowners to drastically reduce their monthly payments and significantly lessen the chance of default. See id. (highlighting importance of refinancing). Moreover, mass refinancing is economically beneficial because over half of American homeowners are strong candidates for it, and, accordingly, stand to increase disposable income and spending. See id.

7. See Gil Mackey, The Importance of Refinancing: Getting it Right, Mortgage Credit Problems, http://www.mortgagecreditproblems.com/articles/refinancing/the-importance-of-refinancing-getting-it-right.htm (last visited Feb. 20, 2013) (“Refinancing your mortgage is a great way to lower your monthly payments, get a better interest rate, or take advantage of home equity for a cash loan . . . .”). Common loan types for refinancing a mortgage are: (1) fixed-rate, (2) adjustable-rate, (3) interest-only, and (4) hybrid, which all may provide different advantages (or pitfalls) to the borrower. See id. (suggesting that prospective borrowers shop around to find most beneficial mortgage for refinancing).

8. See generally Sunayana Mehra, MOODY’S ANALYTICS: METHODOLOGY FOR FORECASTING FORECLOSURES 7 (2011), available at https://www.economy.com/home/products/samples/RealtyTrac_Methodology_062011.pdf (noting that late-stage delinquency rates and local economic conditions such as house price depreciation and job loss are main drivers of foreclosures); see also Mortgages and the Markets, N.Y. Times (Aug. 25, 2011), http://topics.nytimes.com/top/reference/timestopics/subjects/m/mortgages/index.html (explaining mortgage crisis of 2008). The mortgage crisis was caused in part by the purchase of homes during the real estate boom by many unqualified buyers who could not afford the payments as “the economy turned down and layoffs soared.” Id. (“By late 2008, as the wheels were coming off Wall Street, some economists were estimating that 8 million to 10 million borrowers might lose their homes because they could not afford to repay or refinance their loans.”). See Editorial, Still No Justice for Mortgage Abuses, N.Y. Times (Sept. 1, 2012), http://www.nytimes.com/2012/09/02/opinion/sunday/still-no-justice-for-mortgage-abuses.html (discussing settlement between large banks and state and federal officials for widespread foreclosure fraud). Nearly 3 million borrowers are in or near foreclosure. See id. (citing disproportionate number of short sales relative to principal reductions from loan modification).

9. See Grant S. Nelson, Confronting the Mortgage Meltdown: A Brief for the Federalization of State Mortgage Foreclosure Law, 37 Pepp. L. Rev. 583, 584 (2010) (noting high unemployment rates, rising foreclosure levels, and increased welfare rolls); see
A driving force behind the mortgage crisis was the issuance of subprime mortgages. These mortgages allowed people with low incomes and less-than-stellar credit scores to purchase homes that they otherwise could not afford. When housing prices declined, many of these borrowers were left “under water,” with their homes valued at less than their mortgage loans. Coupled with the overall economic downturn, many of these homeowners were forced into foreclosure.

Also, Mortgages and the Markets, supra note 8 (“Mortgages form the financial underpinnings of the nation’s housing market and have allowed more than two-thirds of households to own their own homes.”). Wide-spread refinancing would provide a strong stimulus for the economy because it would lower borrowers’ mortgage payments immediately, allowing them to invest savings elsewhere. See id. (encouraging refinancing as solution to problems in housing market).

10. See Kevin M. Baum, Note, Apparently, “No Good Deed Goes Unpunished”: The Earmarking Doctrine, Equitable Subrogation, and Inquiry Notice Are Necessary Protections When Refinancing Consumer Mortgages in an Uncertain Credit Market, 83 St. John’s L. Rev. 1361, 1361 n.1 (2009) (explaining need for—and advantages of—refinancing for Americans with subprime mortgages). Subprime mortgages allowed individuals who could not qualify for traditional loans to take out mortgages to purchase homes. See id. (reporting high default rate for subprime borrowers); see also Nelson, supra note 9, at 585 (explaining how subprime mortgages were integral part of real estate bubble). Subprime mortgages are security interests that do not meet traditional credit standards, but were approved during the housing boom. See id.

11. See Steven Gjerstad & Vernon L. Smith, Opinion, From Bubble to Depression?, Wall St. J. (Apr. 6, 2009), http://online.wsj.com/article/SB12389761281791281.html (explaining that housing bubble began in 1997, while price decline began in 2006). By 2008, falling home prices left many homeowners under water, with a house less valuable than the loan they took out to pay for it. See id. (noting that 10.5 million households had negative equity in December 2008).

12. See Merle, supra note 3 (reporting that percentage of outstanding mortgages in foreclosure reached all-time high). The default rate was particularly high among homeowners with subprime loans. See id. (noting that forty-two percent of homeowners had adjustable subprime loans).

When a homeowner defaults on a mortgage loan the lender has the right to foreclose on the property. During the mortgage crisis, many homeowners elected to refinance their loans to combat high monthly payments and avoid foreclosure. In other words, the homeowners used the proceeds from a new loan to pay off the balance of their original loan. In general, homeowners look to refinance when interest rates on mortgage loans are low or when they need additional capital. Thus, homeowners nearing foreclosure capitalized on the historically-low interest

14. See Debra Pogrund Stark, *Facing the Facts: An Empirical Study of the Fairness and Efficiency of Foreclosures and a Proposal for Reform*, 30 U. Mich. J.L. Reform 639, 699 (1997) (noting that real estate foreclosures are expensive and time consuming, needlessly increasing costs associated with making loans). A real estate mortgage is an interest in real estate, offered by a homeowner in order to secure a specific debt. See *id.* at 643 (explaining that when mortgagor defaults on payment of debt secured by mortgage, acceleration clause makes the entire indebtedness due immediately). Under the current foreclosure process, a mortgage holder has a right to foreclose on the property, while the borrower typically has a period of time to pay off debt before the lender forces the sale of the property. See *id.* (noting two dominant forms of foreclosure in United States: (1) judicial foreclosure sale and (2) non-judicial foreclosure sale).

15. See *Restatement (Third) of Prop.: Mortgs.* § 7.6 cmt. b (1997) (“A person’s interest in real estate may be jeopardized by the threat of foreclosure of a prior mortgage.”). The Restatement recognizes that paying off a mortgage may be the only practical way to protect a lender’s interest. See *id.* (recognizing importance of refinancing). See also Sang Jun Yoo, Note, *A Uniform Test for the Equitable Subrogation of Mortgages*, 32 Cardozo L. Rev. 2129, 2136 (2011) (defining mortgage refinancing as transaction where existing mortgage is discharged and replaced with new mortgage). Homeowners typically refinance when interest rates on new mortgage loans are lower than on their existing loans or when the homeowner needs additional capital. See *id.* (indicating that refinancing mortgagees only agree to issue refinancing mortgage on condition that prior property interests are satisfied). See also Armour, *supra* note 13 (noting that homeowners are capitalizing on falling interest rates to lower monthly mortgage payments). Refinancing applications comprised eighty-five percent of all mortgage applications in 2008. See *id.* (marking highest rates of refinancing since 2003).


17. See Yoo, *supra* note 15, at 2136 (explaining that homeowners typically seek refinancing when interest rates are low or when they need additional capital).
rates, allowing them to shop around for more favorable loan agreements.18

In a refinancing transaction, the lender only agrees to pay off the original mortgage loan “on the condition that all prior interests on [the] property are satisfied.”19 If an undisclosed lien remains on the property the lender may find itself in a secondary lien position.20 Lien priority is crucial to mortgage lenders because, in the event of foreclosure, the lienholder with the highest priority is the first to receive foreclosure proceeds.21 Therefore, lenders are reluctant to refinance loans in states where they are not assured that they will be the primary lienholder on the property.22

One of the most important concepts for refinancing lenders is equitable subrogation.23 This common law doctrine allows a lender who pays

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18. See Rachel Louise Ensign, It’s a Good Time to Refinance, WALL ST. J. (Mar. 23, 2012), http://online.wsj.com/article/SB10001424052702303812904577295762407392928.html (reporting that interest rates are beginning to increase after country’s mortgage crisis, so it may be time to initiate refinancing proceedings). The article makes it clear that “[i]f you’re considering refinancing, there’s really no point in waiting.” See id. (encouraging homeowners to refinance). Also, the author explains that one may choose to refinance for a shorter-term loan, thus allowing the borrower to pay off the loan more quickly; others may choose to extend the pay off period, which would take the borrower longer to pay off, but with lower monthly payments. See id. (noting that refinance deals vary depending on borrower’s financial situation and location); see also Vickie Elmer, Complaints Against Lenders, N.Y. TIMES (Sept. 6, 2012), http://www.nytimes.com/2012/09/09/realestate/mortgages-complaints-against-lenders.html (noting “fatigue and frustration” of borrowers attempting to modify or refinance their loans (citing CONSUMER FIN. PROT. BUREAU, SEMI-ANNUAL REPORT 17 (2012)).

19. See Yoo, supra note 15, at 2136 (noting that refinancing lenders agree to issue refinancing loan on condition that all prior interests are satisfied).

20. See id. (explaining that mortgage refiners agree to title searches to identify all prior interests on property that must be satisfied).

21. See Nelson & Whitman, supra note 16, at 305 n.2 (noting that priority is “critical” to mortgage lenders). If an intervening lien acquires priority over the refinancing lender, there is a much higher risk that the foreclosure proceeds will be insufficient to pay the mortgage obligation in full. See id. (recognizing possible windfall that could be granted to intervening lienholder).

22. See Bank of Am., N.A. v. Prestance Corp., 160 P.3d 17, 25 (Wash. 2007) (en banc) (finding that lender providing funds to pay off existing mortgage expects to receive same security as loan being paid off). Furthermore, the court recognized that refinancing is “common place” in today’s economy. Id. (adopting Restatement approach to equitable subrogation in context of refinancing); see also Adam M. Starr, Moving up in a Down Market: Rediscovering Equitable Subrogation, REAL EST. NEWSALERT (Miller Starr Regalia, Walnut Creek, Cal.), May 2009, available at http://www.msrlaw.com/mediafiles/moving-up-in-a-down-market-rediscovering-equitable-subrogation.pdf (noting that lenders are turning to equitable subrogation to preserve and protect their real property security from intervening liens).

23. See Henry C. Winiarski Jr., Equitable Subrogation in the Context of Interests in Real Property: The Basics and the Areas Needing Authoritative Clarification, 85 CONN. B.J. 231, 232 (2011) (explaining that equitable subrogation prevents injustice in form of unjust enrichment). Furthermore, courts primarily apply the doctrine to adjust the priority of real property interests by substituting one party for another. See id. (defining equitable subrogation as “remedy of restoration” that restores order of
the obligation of another to take the lien position of the prior lender.\textsuperscript{24} States vary in their approach to equitable subrogation, ranging from restrictive to liberal.\textsuperscript{25} Pennsylvania’s approach is relatively conservative as compared to other states, disallowing subrogation in most refinancing contexts.\textsuperscript{26} For example, in \textit{First Commonwealth Bank v. Heller},\textsuperscript{27} defendant Catharine Heller took out a loan in order to refinance the mortgages on her property.\textsuperscript{28} Ameriquest, the refinancing lender, agreed to grant the loan under the assumption that it would take a priority lien position on her property.\textsuperscript{29} In reality, an intervening lien remained undisclosed, so

priorities by allowing party to assume status or priority previously enjoyed by another party. The author explains that the doctrine is used to maintain an order of priorities that was unintentionally altered by mistake. \textit{See id.} (noting that mistakes are often caused by attorneys or title searchers).

\textsuperscript{24} \textit{See Restatement (Third) Prop.: Mortgs. § 7.6 cmt. b (1997)} (“A person’s interest in real estate may be jeopardized by the threat of foreclosure of a prior mortgage. Performing that mortgage obligation may be the only or most feasible means of protecting the interest.”); \textit{see also} Yoo, \textit{supra} note 15, at 2131 (recognizing that equitable subrogation assigns priority rights that original creditor would have held, had debt not been satisfied, to party who satisfied debt). The author explains that in the context of mortgage refinancing, equitable subrogation works to resolve problems caused by undiscovered intervening liens. \textit{See id.} (illustrating how refinancing mortgagee is provided priority rights accruing from mortgage or lien that was satisfied).

\textsuperscript{25} \textit{See Prestance}, 160 P.3d at 21 (“Courts generally consider knowledge in one of three ways when applying equitable subrogation to a refinancing lender.”). The court lists the three approaches: “[1] the Restatement approach that says actual or constructive knowledge of intervening interests is irrelevant; [2] a minority approach that says a plaintiff with either actual or constructive knowledge cannot seek equitable subrogation; . . .” and (3) a majority approach that allows equitable subrogation with constructive knowledge, but not with actual knowledge. \textit{See id.} (applying Restatement approach after discussing merits and drawbacks to each alternative); \textit{see also} John C. Murray, Equitable Subrogation: Can a Refinancing Mortgagee Establish Priority Over Intervening Liens?, 45 REAL PROP. TR. & EST. L.J. 249, 251 (2010) [hereinafter Murray, \textit{Refinancing}] (indicating that courts have adopted three different jurisdictional approaches to equitable subrogation). The author notes that while many cases and commentators favor the Restatement approach, it is still not the majority position. \textit{See id.} (demonstrating benefits of Restatement approach).

\textsuperscript{26} \textit{See generally} Harris Ominsky, Mortgage Priorities: Pennsylvania Rule May Impair Refinancing. REAL EST. L. REP., Oct. 2008 (discussing Pennsylvania’s approach to equitable subrogation and how it differs from Restatement approach). The author argues that Pennsylvania’s current approach could impair borrowers’ ability to refinance their loans. \textit{See id.} (noting that Superior Court of Pennsylvania in \textit{1313466 Ontario, Inc. v. Carr}, 954 A.2d 1 (Pa. Super. Ct. 2008) suggested legislative review); \textit{see also} Laurie Fiore, Using Equitable Subrogation in Title Disputes in Pennsylvania, \textit{Complex Title Issues}, at 139 (2005) (describing elements of Pennsylvania approach and cases that have failed to meet each element).


\textsuperscript{28} \textit{See id.} at 1154 (stating that Heller received $119,000 loan to pay off prior loans on her property). At this point there were still three loans encumbering the property, but Heller only paid off two, leaving one remaining. \textit{See id.} (noting that Ameriquest’s loan was subordinate).

\textsuperscript{29} \textit{See id.} (noting that public record revealed three mortgages when loan was executed). Ameriquest’s loan was used to pay off two loans from 1990 and 1995
Ameriquest was forced to take a secondary lien position. By denying Ameriquest subrogation, the court punished a lender for providing a struggling homeowner the opportunity to refinance. The court held that Ameriquest was not entitled to equitable subrogation because it was a volunteer and did not have an interest in paying off the prior loans.

This Note argues that the current state of Pennsylvania’s equitable subrogation law is outdated, and urges the state, through judicial opinion or legislation, to take a more liberal approach to such a valuable legal doctrine. Part II explains the history of the doctrine and details the vary- respectively, but First Commonwealth’s 2000 mortgage remained. See id. (finding that First Commonwealth held primary lien position).

30. See id. (explaining that First Commonwealth’s 2000 mortgage took priority over Ameriquest’s new mortgage). Thus, the 2000 lien took priority position on the property when Ameriquest’s loan proceeds were used to pay off the 1990 and 1995 loans. See id. (recognizing that Ameriquest should have been aware of First Commonwealth’s mortgage because title search would have revealed lien); see also RESTATEMENT (THIRD) OF PROP.: MORTGS. § 7.6 cmt. b (1997) (stating that person’s interest in real property is jeopardized by threat of foreclosure of priority mortgage). Furthermore, paying off the prior mortgage may be the only practical way to protect a lender’s interest. See id. (illustrating importance of equitable subrogation in protecting lienholder’s interest in property); 73 AM. JUR. 2D Subrogation § 58 (2012) (defining “intervening lienholder” as one that intervenes in sequence when there has been prior, intervening lien, followed by release of prior lien, and creation of new lien in favor of party who funded release of prior lien). Moreover, in order to avoid unjust enrichment in favor of the intervening lienholder, the mortgagee is entitled to subrogation to the rights of the senior encumbrance. See id. (demonstrating role subrogation plays in protecting refinancing lender’s interests).

31. See Heller, 863 A.2d at 1160 (holding that Ameriquest was not entitled to remedy of equitable subrogation). Furthermore, court held that First Commonwealth had every right to foreclose on the property as the priority lienholder. See id. (noting that Ameriquest’s negligence in failing to discover intervening lien caused it to be junior to First Commonwealth’s mortgage). The court explained that Ameriquest filed a petition to intervene seeking to assert its right to equitable subrogation. See id. at 1154 (revealing that default judgment was entered against Heller and writ of execution was granted, allowing Sheriff to foreclose on her house). Ameriquest filed a petition to stay the sheriff’s sale, which the court granted, but then vacated after denying its petition to intervene. See id. at 1154–55 (holding that Ameriquest had not demonstrated prerequisites to establish remedy of equitable subrogation).

32. See id. at 1160 (holding that Ameriquest was not entitled to equitable subrogation and thus secured subordinate interest to First Commonwealth’s lien). The court found that First Commonwealth had the undisputed right to foreclose in priority position and that it was not necessary to protect Ameriquest’s interest. See id. (finding that intervening in case would not be necessary to provide Ameriquest relief). In addition, it found that “courts of equity will not relieve a party from the consequences of error due to his own ignorance or carelessness when there were available means which would have enabled him to avoid the mistake if reasonable care had been exercised.” Id. at 1159 (quoting Home Owners’ Loan Corp. v. Crouse, 30 A.2d 330, 332 (1943)) (internal quotation marks omitted).

33. See Nelson & Whitman, supra note 16, at 305–06 (explaining that making subrogation available liberally can eliminate risk that intervening liens will take priority over refinancing mortgages). In recent years, many courts have adopted the Restatement approach or followed its logic. See id. at 314 (finding that Restate-
ing approaches taken by different jurisdictions in the United States. Part III discusses the doctrine’s development within Pennsylvania and how the court applied it leading up to *Heller*. Part IV addresses how the Superior Court of Pennsylvania applied the doctrine in *Heller* and describes the effect that this decision has on lenders, borrowers, and refinancing in general. Finally, Part V looks to other states for more liberal approaches to equitable subrogation and provides Pennsylvania with a solution to its problematic approach. In order for Pennsylvania to keep up with the current trend in courts and foster sound economic policy, it must adopt the Restatement approach to equitable subrogation.

**II. BUILDING UP: THE DEVELOPMENT OF EQUITABLE SUBROGATION IN PENNSYLVANIA**

While other states continue to expand the doctrine of equitable subrogation, Pennsylvania maintains a restrictive approach. In Pennsylvania, a lender cannot employ equitable subrogation if the lender is considered a “mere volunteer.” This approach prevents the application of the doctrine in almost all refinancing contexts and greatly restricts its fundamental purpose.

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34. For a further discussion of the history of equitable subrogation and the different jurisdictional approaches, see *infra* notes 39–98 and accompanying text.

35. For a further discussion of the facts, holding, and rationale of *Heller*, see *infra* notes 99–165 and accompanying text.

36. For a further discussion of how Pennsylvania courts have applied the doctrine established in *Heller*, see *infra* notes 166–68 and accompanying text. For a further discussion of other states’ approaches to equitable subrogation, see *infra* notes 180–202 and accompanying text. For a further discussion of why Pennsylvania should change its approach to equitable subrogation, see *infra* notes 203–25.

37. For a further discussion of the recommended alternative to Pennsylvania’s approach see *infra* notes 226–33 and accompanying text.

38. See *infra* notes 226–33 (arguing that Pennsylvania should adopt Restatement approach to equitable subrogation).

39. See *Heller*, 863 A.2d at 1153, 1158 (requiring four-part test for equitable subrogation to apply).

40. *Id.* at 1158–59 (noting that claimant cannot act as volunteer).

41. See Ominsky, *infra* note 26 (noting that lender who extends loan to pay off earlier loan is “volunteer” in Pennsylvania).
A. History of Equitable Subrogation: Background and General Approaches

Originally, equitable subrogation was only applied in the context of sureties, however, its application expanded over time. The doctrine was then adopted in the context of mortgage refinancing, where it protected lenders from losing priority position. Most courts recognize that the doctrine is based in equity and apply it in a manner that prevents unjust enrichment and an unearned windfall. In the context of mortgage loans, subrogation applies when loan proceeds from a new loan are used to satisfy a prior lien. When this occurs, the new lender—i.e., refinancing lender—stands in the shoes of the prior lienholder. In general, the doctrine applies when a person has assumed or satisfied the obligation of another and thus obtains the rights, priorities, liens, and remedies of the former obligee.

42. See Gregg H. Mosson, Comment, Equitable Subrogation in Maryland Mortgages and the Restatement of Property: A Historical Analysis for Contemporary Solutions, 41 U. BALT. L. REV. 709, 715 (2012) (explaining that concept of subrogation evolved from British common law when surety guaranteed debt, was forced to pay upon default, and after paying, appealed to equity court to pursue repayment from defaulting debtor). American equity courts first granted this right based on principles of justice, and legal courts increasingly adopted it to compel discharge of debt by party that should pay it. See id.

43. See Restatement (Third) of Prop.: Mortgs. § 7.6 cmt. a (1997) (“[Subrogation] may arise when one pays or performs in full an obligation owed by another and secured by a mortgage.”).

44. See Note, Subrogation of Purchaser to Rights of Senior Mortgagee Against Junior Encumbrances, 48 YALE L.J. 683, 683 (1939) [hereinafter Subrogation] (describing subrogation as substitution of one person in place of another with reference to lawful claim or right). The author further states that the doctrine is purely equitable and is applied when a prospective subrogee assumes or satisfies an obligation for which another is primarily liable. See id. at 683–84 (noting equitable nature of subrogation and importance of liberal application).

45. See John C. Murray, Equitable Subrogation: Is the Trend Toward the Restatement Approach?, 21 PROB. & PROP. 19, 19 (Dec. 2007) [hereinafter Murray, Trend] (stating that doctrine of equitable subrogation generally provides that new lender stands in shoes of prior lienholder when proceeds from new loan are used to satisfy prior lien). The article recognizes that equitable subrogation is designed to prevent a windfall amounting to an unjust enrichment for the intervening lienholder. See id. (explaining that purpose of equitable subrogation is to prevent unjust enrichment).

46. See 73 AM. JUR. 2D Subrogation § 58 (2012) (“Under the doctrine of equitable subrogation, where fairness and justice require, one who advances money to discharge a prior lien on real or personal property and takes a new mortgage as security is entitled to be subrogated to the rights under the prior lien against the holder of an intervening lien of which he was ignorant.”). Equitable subrogation serves as an exception to modern recording statutes when determining priority of multiple mortgage interests. See id. (illustrating that equitable subrogation enables lender to step into shoes of prior mortgagee in order to receivie that mortgagee’s priority over subsequent liens).

47. See Robert M. Smith, Note, What Happened to the Equity in Equitable Subrogation?: Metmore Financial, Inc. v. Landoll Corp., 64 Mo. L. Rev. 503, 503 (1999) (“The doctrine of equitable subrogation provides courts with a vehicle to allow a lending institution that has paid off an existing loan to take the original lending institution’s place in priority status.”).
Courts recognize two types of subrogation: (1) conventional and (2) equitable (or legal).\textsuperscript{48} Conventional subrogation requires an express or implied agreement that one lienholder will be subrogated to the position of another.\textsuperscript{49} On the other hand, equitable subrogation is not based on agreement, but rather the equities of the particular case.\textsuperscript{50} Therefore, equitable subrogation has developed a complicated history in common-law, as it is applied differently from state to state.\textsuperscript{51}

Courts have adopted three different approaches to equitable subrogation, reflecting different apportionments of equity: (1) the majority position holds that a party with actual knowledge of an intervening lien cannot seek equitable subrogation; (2) the minority position holds that a party with actual or constructive knowledge of an intervening lien cannot seek equitable subrogation; and (3) the \textit{Third Restatement of Property} approach states that actual or constructive knowledge of an intervening lien is irrelevant and does not bar application of equitable subrogation.\textsuperscript{52} Many schol-

\begin{footnotesize}
\textsuperscript{48} See \textit{Subrogation}, supra note 44, at 684 (noting distinction between conventional and legal subrogation). The author goes on to state that the boundaries of subrogation are difficult to describe, and that the tendency is to extend the usefulness of the doctrine. \textit{See id.}, at 685 (describing different approaches to doctrine); \textit{see also} \textit{Murray, Refinancing}, supra note 25, at 267 (“There are two broad categories of subrogation rights: contractual or conventional rights, and common-law or equitable rights.” (quoting Aames Capital Corp v. Interstate Bank of Oak Forest, 734 N.E.2d 493, 498 (Ill. App. Ct. 2000)). The author explains that equitable subrogation is utilized to prevent unjust enrichment, while conventional subrogation arises from agreement. \textit{See id.} (explaining difference between conventional and legal subrogation).

\textsuperscript{49} See Aames Capital Corp. v. Interstate Bank of Oak Forest, 734 N.E.2d 493, 498 (Ill. App. Ct. 2000) (noting that conventional subrogation arises from express or implied understanding, where one party pays debt of another and by agreement is entitled to rights of original creditor).

\textsuperscript{50} See \textit{id.} (explaining that equitable subrogation is common law doctrine used to prevent unjust enrichment). There is no general rule for applying equitable subrogation, “since the right depends upon the equities of each particular case.” \textit{Id.} (describing different instances where doctrine applies).

\textsuperscript{51} See 73 AM. JUR. 2D \textit{Subrogation} § 58 (2012) (stating that decisions for equitable subrogation are based on equity, as courts’ goals are to avoid windfalls and prejudice to interests of junior lienholders); \textit{see also} \textit{Bruce H. White & William L. Medford, Equitable Subrogation: The Saving Grace for Unperfected Lenders?}, 24 AM. BANKR. INST. J. 38, 38 (2005) (“Because equitable subrogation is a state law doctrine, it may differ from state to state or may not exist at all, and its application will differ.”).

\textsuperscript{52} Compare Aurora Loan Servs. L.L.C. v. Senchuk, 36 So.3d 716, 724 (Fla. Dist. Ct. App. 2010) (applying majority approach, finding that constructive notice did not preclude equitable subrogation), \textit{with} Mortg. Elec. Registration Sys., Inc. v. Roberts, 366 S.W.3d 405, 409 (Ky. 2012) (applying minority approach, holding that constructive notice did preclude equitable subrogation), \textit{and} Bank of Am., N.A. v. Prestance Corp., 160 P.3d 17, 29 (Wash. 2007) (en banc) (applying Restatement approach and finding that equitable subrogation should be applied to prevent unjust enrichment). \textit{See also RESTATEMENT (THIRD) OF PROP.: MORTGS.} § 7.6(a) (1997), which states in relevant part:

One who fully performs an obligation of another, secured by a mortgage, becomes by subrogation the owner of the obligation and the mortgage to the extent necessary to prevent unjust enrichment. Even though the per-
ars recognize that a liberal application of equitable subrogation preserves
the equitable nature of the doctrine.\textsuperscript{53}

1. \textit{Majority Approach: No Actual Knowledge}

The majority position allows equitable subrogation in many cases, ex-
cept those where the lender had actual knowledge of a prior lien.\textsuperscript{54} This
formance would otherwise discharge the obligation and the mortgage,
they are preserved and the mortgage retains its priority in the hands of
the subrogee.

\textit{Id.} (providing liberal approach to equitable subrogation).

\textsuperscript{53} \textit{See} \textit{Restatement (Third) of Prop.: Mortgs.} \S 7.6 cmt. a (1997) (“Subro-
gation is an equitable remedy designed to avoid a person’s receiving an unearned
windfall at the expense of another.”). The doctrine of equitable subrogation rests
on the equitable maxim that a person should not be enriched by another person’s
(or lender’s) loss. \textit{See} Murray, \textit{Refinancing, supra} note 25, at 250–52 (noting that
trend in case law and commentary appears to be toward Restatement approach, as
it is most favorable to lenders, prevents unjust enrichment, and ensures interven-
ning lienholders do not receive windfall in form of priority lien position); Murray,
\textit{Trend, supra} note 45, at 19 (explaining that doctrine is used to prevent unjust en-
richment). Equitable subrogation is designed to prevent unjust forfeiture on one
hand and a windfall in the form of unjust enrichment on the other. \textit{See id.} (find-
ing that equity should be enforced as justice requires).

\textsuperscript{54} \textit{See}, e.g., Foster v. Porter Bridge Loan Co., 27 So. 3d 481, 488 (Ala. 2009)
(holding that constructive notice will not preclude application of equitable subro-
gation); Newberry v. Scruggs, 986 S.W.2d 853, 858 (Ark. 1999) (finding that equi-
table subrogation applied when judgment lien prevented refinancing mortgagee
from taking priority position); Equicredit Corp. of Conn. v. Kasper, 996 A.2d 1245,
1246 (Conn. App. Ct. 2010) (holding that equitable subrogation did not apply
because plaintiff had actual and constructive notice of defendant’s lien); E. Sav.
Bank v. Cach, L.L.C., 55 A.3d 344, 350 (Del. 2012) (denying right to apply equita-
ble subrogation); HSBC Bank USA, N.A. v. Mendoza, 11 A.3d 229, 335 (D.C. 2010)
(“[L]ender who pays off a pre-existing mortgage and takes a new mortgage as se-
curity for the loan will be subrogated to the rights of the first mortgagee as against
any intervening lienholders, even if the lender is on constructive notice.”);
\textit{Senchuk}, 36 So. 3d at 721–22 (holding that lender was entitled to equitable subro-
gation and that constructive notice did not preclude application); Chase Manhattan
Mortg. Corp. v. Shelton, 722 S.E.2d 743, 748 (Ga. 2012) (finding that equitable
subrogation was not available based on lenders inexcusable neglect); Beneficial
Haw., Inc. v. Kida, 30 P.3d 895, 920 (Haw. 2001) (holding that equitable subro-
gation could not be applied because other party did not have right to foreclose);
State v. Cont’l Cas. Co., 879 P.2d 1111, 1115 (Idaho 1994) (finding that state was
not volunteer and thus was entitled to equitable subrogation); Home Owners’
Loan Corp. v. Rupe, 283 N.W. 108, 111 (Iowa 1938) (applying equitable subroga-
tion, stating that intervener was not misled or injured); United Carolina Bank v.
Beesley, 663 A.2d 574, 576 (Me. 1995) (holding that mortgagee was entitled to
equitable subrogation); G.E. Capital Mortg. Servs. v. Levenson, 657 A.2d 1170,
1179 (Md. 1995) (finding that equitable subrogation could be applied prior to
successful foreclosure sale); Grenada Bank v. Young, 104 So. 166, 168 (Miss. 1925)
(holding that appellee was not volunteer and thus entitled to subrogation); Ship-
man v. Terrill, 276 P. 21, 24 (Mont. 1929) (recognizing doctrine of equitable sub-
curiam) (finding that negligence on behalf of title insurer did not preclude equita-
ble subrogation claim); Chase v. Ameriquest Mortg. Co., 921 A.2d 369, 377 (N.H.
2007) (holding that all four elements of equitable subrogation claim were satis-
rule holds that actual knowledge of an existing lien precludes application of equitable subrogation, while constructive knowledge of such a lien does not.55 Supporters of this doctrine rely on three arguments.56 First, they contend that granting equitable subrogation liberally would contradict the stability and predictability of the recording rule “first in time, first in right.”57 Second, allowing subrogation with actual knowledge would permit a party to knowingly achieve a higher priority position through equity when it could not have done so otherwise.58 Third, courts suggest that a

(denying equitable subrogation because refinancing mortgagee was not compelled to refinance loan and failed to properly search public records); ABN AMRO Mortg. Grp. v. Kangah, 126 Ohio St.3d 425, 2010-Ohio-3779, 934 N.E.2d 924, 927 (holding that negligence and prejudice to junior lienholder precluded application of equitable subrogation); Dimeo v. Gesik, 98 P.3d 397, 402 (Or. Ct. App. 2004) (finding that bank had reasonable basis for asserting equitable subrogation claim); Highmark Fed. Credit Union v. Wells Fargo Fin. S.D., 2012 S.D. 38, ¶¶ 7–9, 814 N.W.2d 814, 817 (holding that equitable subrogation did not apply because bank failed to accompany loan with written demand to satisfy mortgage as provided by statute); Bankers Trust Co. v. Collins, 124 S.W.3d 576, 579 (Tenn. Ct. App. 2003) (denying equitable subrogation because debt was not paid through fraud or mistake); Homeside Lending, Inc. v. Miller, 2001 UT App 247, ¶¶ 21–27, 31 P.3d 607, 612 (holding that without mistake or fraud, it would be inappropriate to apply equitable subrogation); Centreville Car Care, Inc. v. N. Am. Mortg. Co., 559 S.E.2d 870, 874 (Va. 2002) (reversing decision awarding equitable subrogation because it would prejudice junior lienholder); Countrywide Home Loans, Inc. v. First Nat’l Bank of Steamboat Springs, N.A., 2006 WY 132, ¶¶ 20–22, 144 P.3d 1224, 1230 (denying to adopt Restatement approach to equitable subrogation).

55. See Bank of Am., N.A., 160 P.3d at 22–23 (noting that majority approach is followed by many jurisdictions, but not all). The court recognized that the majority approach engenders belief that constructive notice should not block equitable subrogation, but that actual knowledge of intervening liens does preclude use of the doctrine. See id. at 22 (electing not to follow this approach); Houston v. Bank of Am. Fed. Sav. Bank, 78 P.3d 71, 73 (Nev. 2003) (explaining that majority of states preclude application of equitable subrogation when lienholder had actual knowledge of existing lien); see also Melinda Margolies & Brian Margolies, Equitable Subrogation and Negligent Title Searches: When Title Insurance Becomes Irrelevant, DRI Today, http://clients.criticalimpact.com/newsletter/newslettercontentshow.cfm?contentid=12053&id=1375 (last visited Oct. 1, 2012) (noting that majority rule precludes application of equitable subrogation when subsequent lienholder has actual knowledge).

56. See Prestance, 160 P.3d at 22 (noting that there are three reasons generally given in support of majority approach to equitable subrogation). The court goes on to state that these reasons are unconvincing and elects to adopt the Restatement approach rather than the majority rule. See id. at 23 (describing advantages of Restatement approach). But see Countrwide Home, 144 P.3d at 1231 (holding that interest in clarity and certainty in land title matters outweighs interest of protecting lending institutions).

57. Prestance, 160 P.3d at 22 (explaining that some believe subrogation violates “first in time” rule). The court goes on to state that equitable subrogation could not present much of a threat to the recording acts if jurisdictions allow an ignorant subrogee with constructive knowledge, but not one with actual knowledge. See id. at 23 (highlighting that argument for majority approach would deny all application of doctrine).

58. See id. at 22 (noting that supporters of majority approach believe that lender should not be allowed to knowingly “leap-frog” another lienholder’s prior-
lender cannot reasonably expect to assume first priority lien position when that lender has actual knowledge of an intervening lien with higher priority.\footnote{59}

Critics of the majority approach argue that it fosters “willful ignorance,” and encourages potential mortgagees to refuse to conduct title searches that may reveal intervening liens.\footnote{60} In practice, the majority approach “places a premium on ignorance.”\footnote{61} In addition, courts use actual notice as an indicator of the refinancing lender’s intent to receive priority, rather than the lender’s actual intent.\footnote{62} Finally, courts rejecting the majority approach contend that it promotes inconsistent applications of the doctrine by precluding subrogation for actual knowledge and not for constructive knowledge.\footnote{55}

2. Minority Approach: No Actual or Constructive Knowledge

The minority approach, adopted by a small number of states, requires that the refinancing lender not have actual or constructive knowledge of the prior lien.\footnote{64} Proponents of this approach believe that mortgage lend-
ers and other sophisticated businesses should be held to a higher standard when determining lien position, and that they should not be rewarded for failing to properly execute a title search.\textsuperscript{65} Nevertheless, this approach has been widely criticized for eliminating the doctrine of equitable subrogation entirely and obviating its underlying purpose.\textsuperscript{66} Very few courts continue to apply the minority rule because it precludes equitable subrogation in most cases, especially with regard to mortgage refinancing.\textsuperscript{67} Critics argue that the minority approach fails to serve the primary purpose of equitable subrogation—protecting the interests of refinancing lenders who are unintentionally subordinated to an intervening lien.\textsuperscript{68} Accordingly, if an intervening lien is of record, then the refinancing lender must have constructive notice under most states’ recording acts.\textsuperscript{69} Therefore, the only time equitable subrogation would apply is in cases where fraud or acquired.” (quoting Kuhn v. Nat’l Bank of Holton, 87 P. 551, 552 (Kan. 1906))); Mortg. Elec. Registration Sys., Inc. v. Roberts, 366 S.W.3d 405, 409 (Ky. 2012) (affirming Wells Fargo rule, which permits actual or constructive knowledge to preclude equitable subrogation); Wells Fargo Bank v. Commonwealth, 345 S.W.3d 800, 810 (Ky. 2011) (holding that equitable subrogation should not be granted to lender that had constructive notice of intervening lien). The Kansas Court of Appeals held in Harms that, absent fraudulent conduct, a lender is presumed to have knowledge of all facts that the records disclose. See Harms, 40 P.3d at 332 (advocating minority approach).

The Missouri Supreme Court described equitable subrogation as a “fairly drastic remedy . . . allowed only in extreme cases bordering on if not reaching the level of fraud.” Ethridge v. TierOne Bank, 226 S.W.3d 127, 134 (Mo. 2007) (en banc) (quoting Thompson v. Chase Manhattan Mortg. Corp., 90 S.W.3d 194, 206 (Mo. Ct. App. 2002)).

\textsuperscript{65} See Wells Fargo, 345 S.W.3d at 807 (holding that professional mortgage lenders should be held to higher standard for purposes of determining whether lender acted under justifiable or excusable mistake when improperly investigating prior liens).

\textsuperscript{66} See Prestance, 160 P.3d at 21–22 (“For practical purposes, this rule swallows the doctrine and is widely criticized.”); see also Wells Fargo, 345 S.W.3d at 807 (noting that critics have seen approach as “obviating the doctrine completely”); Nelson & Whitman, supra note 16, at 315–16 (“We have vigorously criticized this approach and find it impossible to understand in light of the fact that subrogation in this situation harms no one, leaving the intervening lien exactly where it started.” (footnote omitted)).

\textsuperscript{67} See Prestance, 160 P.3d at 21 (“If all persons who negligently confer an economic benefit upon another are disqualified from equitable relief because of their negligence, then the law of restitution, which was conceived in order to prevent unjust enrichment, would be of little or no value.” (quoting Ex parte AmSouth Mortg. Co., 679 So. 2d 251, 255 (Ala. 1996))). But see Roberts, 366 S.W.3d at 409 (denying equitable subrogation based on constructive notice); Mill Creek Lumber & Supply Co. v. First United Bank & Trust Co, 2012 OK CIV APP 53, ¶¶ 16–20, 278 P.3d 12, 16 (holding that constructive notice precluded equitable subrogation).

\textsuperscript{68} See Prestance, 160 P.3d at 22 (“This rule renders equitable subrogation nearly useless since a refinancing mortgagee will almost always have either actual or constructive knowledge of junior lienholders.”).

\textsuperscript{69} See id. (noting that equitable subrogation has little use when there are no junior lienholders because plaintiff is only party with interest in property, in which case lender’s priority is immaterial).
deceit is present.70 This is an extremely narrow application of an important equitable doctrine.71 For this reason, most jurisdictions have stopped using this approach.72

3. Third Restatement Approach: “To the Extent Necessary to Prevent Unjust Enrichment”73

A number of states that apply equitable subrogation in a more liberal manner have adopted the Third Restatement approach or a near equivalent.74 The Restatement instructs that “[o]ne who fully performs an

70. See id. (concluding that under minority approach, equitable subrogation is only applicable when mortgagor fraudulently hides junior interest).

71. See id. (noting that cases in which mortgagor fraudulently hides junior lien interest are extremely rare).

72. But see Roberts, 366 S.W.3d at 409 (noting majority approach, but following rule established in Wells Fargo); Wells Fargo Bank v. Commonwealth, 345 S.W.3d 800, 810 (Ky. 2011) (applying minority approach); Mill Creek Lumber, 278 P.3d at 16 (following minority approach).

73. RESTATEMENT (THIRD) OF PROP.: MORTGS. § 7.6(a) (1997).


Some courts have not adopted the Restatement approach entirely, but apply a method that balances the equities and seeks to prevent unjust enrichment. See, e.g., Rush v. Alaska Mortg. Grp., 937 P.2d 647, 650 (Alaska 1997) (applying “unjust enrichment” standard and noting that actual knowledge was not dispositive in eq-
obligation of another, secured by a mortgage, becomes by subrogation the owner of the obligation and the mortgage to the extent necessary to prevent unjust enrichment." Further, the Restatement provides specific examples of where subrogation is appropriate in the context of mortgage refinancing: (1) in order to protect interest in property; (2) under legal duty; (3) because of misrepresentation, mistake, duress, undue influence, deceit, or other imposition; or (4) upon the request of the obligor. The Restatement specifically provides a diverse range of circumstances where subrogation is available in order to prevent unjust enrichment and encourage application of the doctrine. Moreover, the Restatement does not allow actual or constructive knowledge to preclude the application of equitable subrogation. Rather, it permits the doctrine to apply as justice requires, allowing it to serve its equitable purpose. The drafters of the Third Restatement note that in most cases equitable subrogation prevents an unwarranted and unjust windfall, and should therefore be applied broadly.

B. Pennsylvania's Application of the Equitable Subrogation Doctrine

Pennsylvania courts have consistently recognized the doctrine of equitable subrogation, but have applied it in a relatively conservative man-

uitable subrogation matter). The Rush court applied a two-part test for equitable subrogation: “(1) whether there was an intent to subordinate the new deed of trust and (2) whether paramount equities favor the junior creditor.” See id. at 651.

75. RESTATEMENT (THIRD) OF PROP.: MORTGS. § 7.6(a) (1997) (noting that discharge of obligation would also discharge mortgage, but that lien position is preserved in hands of subrogee).

76. See id. § 7.6(b) (illustrating different circumstances where subrogation is appropriate to prevent unjust enrichment).

77. See id. § 7.6 cmt. a (noting that equitable subrogation is designed to avoid person receiving unearned windfall at expense of another).

78. See id. § 7.6 cmt. e (“Under this Restatement, however, subrogation can be granted even if the payor had actual knowledge of the intervening interest; the payor’s notice, actual or constructive, is not necessarily relevant.”).

79. See id. (finding that question under Restatement does not look to notice, but instead whether payor reasonably expected to get security with priority equal to mortgage being paid).

80. See id. § 7.6 cmt. a (concluding that intervening lienholders are not prejudiced by subrogation because they are no worse off than before senior obligation was discharged). Furthermore, the drafters explain that without subrogation the junior interest would be promoted undeservedly, giving them an “unwarranted and unjust windfall.” See id. (justifying broad application of equitable subrogation).
In *Campbell v. Foster Home Ass’n*, the Supreme Court of Pennsylvania established the state’s approach to equitable subrogation. There, the defendant paid off a prior mortgage for $6,000 with the proceeds of another mortgage loan. Nevertheless, the court found that the defendant was acting as a volunteer because he had no interest in the property, and the plaintiff had no knowledge of the debt being paid off. Furthermore, the court noted that the payment was not made under compulsion, and if subrogation was granted it would exist in every case of “officious payment of the debt of another.” Since *Campbell*, Pennsylvania courts have consistently denied equitable subrogation based on the so-called “volunteer doctrine.” While other states have moved away from

81. *See, e.g.*, *In re Commonwealth Trust Co. of Pittsburgh*, 93 A. 766, 768–69 (Pa. 1915) (holding that doctrine of equitable subrogation did not apply in favor of mere volunteer, when no contract existed between parties); *Campbell v. Foster Home Ass’n*, 30 A. 222, 224–25 (Pa. 1894) (finding that payment of prior mortgage was act of volunteer, and thus equitable subrogation was unavailable); *Appeal of Forest Oil Co.*, 12 A. 442, 443–44 (Pa. 1888) (refusing petition for subrogation as petitioner brought claim late and did not allege sufficient facts); 1313466 Ontario, Inc. v. *Carr*, 954 A.2d 1, 4–5 (Pa. Super. Ct. 2008) (finding that *Heller and Home Owners’* are still binding precedent, and that party seeking intervention was volunteer under Pennsylvania’s equitable subrogation doctrine); *Home Owners’ Loan Corp. v. Crouse*, 30 A.2d 330, 332 (Pa. Super. Ct. 1943) (holding that plaintiff was stranger to defendant and voluntary agent with no interest in property); *see also* Fiore, *supra* note 26, at 139 (summarizing equitable subrogation approach applied in Pennsylvania).

82. 30 A. 222 (Pa. 1894).

83. *See id.* at 224 (holding that subrogation was not available because payment of prior mortgage was act of mere volunteer). The court went on to state that “[w]hile subrogation is founded on principles of equity and benevolence . . . it will not be decreed in favor of a mere volunteer, who, without any duty, moral or otherwise, pays the debt of another.” *Id.* at 225 (noting that equitable subrogation “will not arise in favor of a stranger, but only in favor of a party who, on some sort of compulsion, discharges a demand against a common debtor”).

84. *See id.* at 224 (explaining that issue was whether equitable subrogation applied in favor of appellant).

85. *See id.* at 225 (holding that payment of $6,000 was not made under compulsion or protection of any rights or interests previously acquired). The court found that the defendant loaned money to remove a prior lien and paid off that lien without the knowledge or consent of plaintiff. *See id.* (“[O]ne who is only a volunteer cannot invoke the aid of subrogation, for such a person can establish no equity.”). Finally, the court stated that for a person not to qualify as a “volunteer,” that person must have paid upon request, or as surety, or under some compulsion that required protection of a personal right. *See id.* (affirming volunteer prong).

86. *Id.* (“[O]ne who discharges an incumbrance [sic] upon property which he has no interest in having relieved is not thereby subrogated to the rights of the holder of the incumbrance [sic], and the loaning of money to discharge a lien does not subrogates the lender to the rights of the lien holder.”).

this approach, Pennsylvania remains on the more conservative end of the equitable subrogation spectrum. Pennsylvania maintains a four-part approach, requiring that: "(1) the claimant paid the creditor to protect his own interest; (2) the claimant did not act as volunteer; (3) the claimant was not primarily liable for the debt; and (4) allowing subrogation will not cause injustice to the rights of others." Under Pennsylvania recording law, the mortgage recorded first holds priority and thus will recover proceeds first upon foreclosure.

Subsequent case law in Pennsylvania has enforced the equitable subrogation standard and preserved the four-part test. After Campbell, the Superior Court further clarified the volunteer rule in Home Owners’ Loan Corp. v. Crouse, holding that there was no right to assert equitable subrogation to a lender with no legal obligation or interest in the property. In Home Owners’, a husband and wife took out a loan to pay off all prior encumbrances on their home, but failed to pay off a judgment lien. While

88. Compare Carr, 954 A.2d at 4 (denying equitable subrogation because of volunteer rule), with Sourcecorp, Inc. v. Norcutt, 274 P.3d 1204, 1208 (Ariz. 2012) (holding that doctrine of equitable subrogation should not turn on whether lender is volunteer).

89. See Heller, 863 A.2d at 1158 (holding that refinancing lender was volunteer who could not adopt primary position); see also Tudor Development Grp., Inc. v. U.S. Fid. & Guar. Co., 968 F.2d 357, 362 (3d Cir. 1992) (finding that bank that satisfied its own primary liability rather than that of another could not invoke doctrine of equitable subrogation).

90. See 42 PA. CONS. STAT. ANN. § 8141(1) (West 1978) (defining “purchase money mortgage” as mortgage taken to secure payment of all or part of purchase price); Pennsylvania is a race notice jurisdiction with regard to recording statutes, which means that purchase money mortgages have priority “from the time they are delivered to the mortgagee, if they are recorded within ten days after their date; otherwise, from the time they are left for record.” Id.; see also 21 PA. CONS. STAT. ANN. § 622 (West 1927) (“All mortgages, or defeasible deeds in the nature of mortgages . . . shall have priority according to the date of recording”).

91. Compare Campbell v. Foster Home Ass’n, 30 A. 222, 225 (Pa. 1894) (holding that second position lienholder, that paid off first position lien, was mere volunteer in making such payment, and not entitled to subrogation), with Home Owners’ Loan Corp. v. Crouse, 30 A.2d 330, 331 (Pa. Super. 1943) (“One who is under no legal obligation or liability to pay a debt and who has no interest in, or relation to, the property is a stranger or volunteer with reference to the subject of subrogation.”).


93. See id. at 331 (“A mere volunteer or intermeddler who, having no interest to protect, without any legal or moral obligation to pay, and without an agreement for subrogation, or an assignment of the debt, pays the debt of another is not entitled to subrogation . . . .”). The Home Owners’ court noted that the payor must have acted out of “compulsion,” which only occurs when the lienholder is forced to pay in order to protect his or her interests. See id.

94. See id. (noting that couple intended to pay liens against their home with loan from Home Owners’, but failed to recognize one outstanding judgment lien). The court explained that Home Owners’ had no knowledge of the intervening lien and assumed that it would have priority lien position on the property. See id. (discussing Home Owners’ request to intervening lienholder to subordinate its lien, but intervening lienholder refused to do so).
the homeowners disclosed all other liens, they failed to disclose the judgment lien, which put the lender in a secondary lien position. The court held that the refinancing lender could not subrogate to the position of the intervening lienholder because it was not required to pay the prior debts. Furthermore, the court found that granting subrogation in favor of Home Owners’ would prejudice the intervening lienholder. Ultimately, the court recognized that the majority of Pennsylvania’s sister states did not apply this standard, but stood by its reasoning that the lender was a volunteer.

III. First Commonwealth Bank v. Heller: Pennsylvania Refuses to Put Equitable Subrogation First

The Superior Court’s decision in Heller reaffirmed the equitable subrogation precedent in Pennsylvania. The court continued to apply the antiquated volunteer rule, thus precluding the application of the doctrine in the refinancing context. This decision will have dramatic effects on both homeowners and lenders as the housing market begins to rebound.

95. See id. at 331 (noting that homeowners set forth all liens that encumbered property, but made no reference to outstanding judgment lien for $682.50, leaving lender unaware). The court recognized that the lender was likely without knowledge of the judgment lien, but the intervening lienholder refused to subordinate its loan. See id. (finding that Home Owners’ loan was subordinate).

96. See id. at 332 (holding that Home Owners’ was stranger to borrowers that had no legal obligation or compulsion to pay borrowers’ debts). Therefore, the refinancing lender was a voluntary agent with no interest in the property, and it could agree or refuse to make the loan as it pleased. See id.

97. See id. (stating that Home Owners’ negligence in failing to adequately search public records caused them to be unaware of intervening lien). In addition, the court held that “courts of equity will not relieve a party from the consequences of an error due to his own ignorance or carelessness when there were available means which would have enabled him to avoid the mistake if reasonable care had been exercised.” Id. (denying equitable subrogation).

98. See id. (“Subrogation, being of equitable origin and nature, may be resorted to only when one has an equity to invoke which does not injure an innocent party.”). The court found that Home Owners’ subrogation would unjustly prejudice the intervening lienholder, and thus would injure an innocent party. See id.

99. See id. (applying four-part test for equitable subrogation and holding that equitable subrogation did not apply to refinancing mortgagee).

100. See id. (finding that refinancing mortgagee was volunteer).

101. See Stiglitz & Zandi, supra note 6 (noting that mass refinancing would allow homeowners to drastically reduce their monthly payments and significantly reduce chance of default).
A. Facts and Procedure: A Difficult Situation for All Parties Involved

In Heller, defendant Catharine Heller, like many homeowners, sought to refinance multiple mortgages on her home.102 When purchasing her home in 1990, Heller took out a loan from Central Bank, which she secured with a mortgage.103 In addition, Heller obtained a line of credit from Mid-State Bank in the amount of $15,000.104 Next, Heller received a large loan from First Commonwealth Bank.105 In 2000, First Commonwealth granted Heller a loan to refinance her prior loan.106 Shortly after, Heller received a loan from Ameriquest for $119,000.107 Heller used the Ameriquest loan to pay off the Central Bank loan and the Mid-State line of credit.108 Nevertheless, the $15,000 line of credit remained open, and Heller never paid off the remaining First Commonwealth loan.109 At the time Ameriquest extended its loan to Heller, three mortgages encumbering the property were on public record.110 However, due to a faulty title search, Ameriquest failed to uncover First Commonwealth’s mortgage.111

102. See Heller, 865 A.2d at 1154 (explaining that Heller received three loans and one line of credit, which were all secured by mortgage on real property titled in her name).

103. See id. (explaining that Central Bank, predecessor to plaintiff, extended loan to Heller for $73,170, which she secured with mortgage on her home).

104. See id. (noting that Mid-State Bank extended $15,000 line of credit in February 1995).

105. See id. (noting that in March 1990, Central Bank, predecessor to First Commonwealth, extended loan in amount of $73,170 to Heller). Also, Heller opened up a line of credit in 1995 from Mid-State Bank. See id.

106. See id. (explaining that Heller received loan from First Commonwealth in 2000 for $76,680.26, which she used to pay off her 1997 loan). The 1997 loan was also from First Commonwealth. See id.

107. See id. (detailing Ameriquest’s August 2001 loan for amount of $119,000, which Heller used to pay off Central Bank’s 1990 loan, and Mid-State’s 1995 line of credit).

108. See id. (acknowledging that proceeds of 2001 loan were used to pay off Central Bank’s 1990 loan and Mid-State’s 1995 line of credit, but the latter remained open).

109. See id. (noting that public records would have revealed three mortgages on property at time of loan). Further, the court explained that the mortgage securing the 1995 line of credit remained open, thus, the mortgage remained of record. See id. Further, a title search executed at the time the 2001 loan was issued would have revealed all three loans encumbering the property. See id. (referring to 1990, 1995, and 2000 mortgages).

110. See id. (noting that in August 2001, when Ameriquest extended $119,000 loan, public records would have revealed three mortgages on Heller’s property). Specifically, Ameriquest could have determined that the (1) Central Bank 1990 Mortgage, (2) Mid-State 1995 Mortgage, and (3) First Commonwealth’s 2000 Mortgage were all encumbering the property. See id.

111. See id. (explaining that Ameriquest recognizes three mortgages existed at time of loan, but admits that title search did not reveal existence of First Commonwealth’s 2000 mortgage). The court also noted that the Mid-State line of credit remained open and First Commonwealth’s loan was unsatisfied, so Ameriquest’s 2001 Mortgage was now in third position for recovery in foreclosure. See id.
Accordingly, First Commonwealth’s loan and Mid-State’s line of credit remained on the property, while Ameriquest’s lien fell to third position. In 2003, Heller defaulted on her First Commonwealth loan, and the bank initiated a foreclosure action against her. In order to preserve its interest in Heller’s property, Ameriquest filed a petition to intervene. Ameriquest sought relief under the theory of equitable subrogation, arguing that it should have taken the lien position of the Central Bank loan. Nevertheless, the court denied this petition, holding that Ameriquest’s negligence caused its failure to uncover First Commonwealth’s mortgage. Ameriquest appealed to the Superior Court of Pennsylvania, which affirmed the trial court’s decision. The court held that Ameriquest was a volunteer to the transaction, and it had no obligation to pay Heller’s prior loans. Therefore, Ameriquest could not be subrogated to Central Bank’s lien position; rather, it was relegated to third lien position. Thus, Ameriquest, which rightfully expected to take a priority lien position, was now unjustly made a junior lien.

B. The Superior Court’s Decision in Heller: Following Precedent to Nowhere

The court in Heller noted that the priority of a lien is generally determined by the date it was recorded, but that equitable subrogation is a “widely-recognized exception to the ‘first in time’ rule.” The court re-

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112 See id. at 1154 (recognizing two mortgages of record that encumbered property prior to Ameriquest’s 2001 refinancing loan). The trial court asserted that Ameriquest’s loss of priority resulted from its own negligence in failing to discover First Commonwealth’s mortgage. See id.

113 See id. (“On March 5, 2003, First Commonwealth Bank filed the instant foreclosure action based upon its April 2000 loan.”). While the actual action is between First Commonwealth and Heller, Ameriquest unsuccessfully attempted to file a petition to intervene as an interested party. See id.

114 See id. (acknowledging that appellant Ameriquest filed petition to intervene on June 10, 2003, two months after First Commonwealth had filed its foreclosure action). After Ameriquest’s petition was denied and summary judgment entered against Heller, the court issued a writ of execution to foreclose on Heller’s home. See id. The trial court granted a stay on the sheriff’s sale, but after holding a hearing on Ameriquest’s petition, the court denied petition and vacated the stay. See id. Finally, the trial court entered an opinion explaining that Ameriquest did not have the right to equitable subrogation because negligence caused it to be in the secondary lien position. See id. at 1155.

115 See id. (noting appellant’s petition to intervene).

116 See id. (explaining that trial court held appellant’s negligence resulted in failing to discover First Commonwealth’s mortgage).

117 See id. at 1160 (denying Ameriquest’s petition to intervene).

118 See id. (holding that Ameriquest was not entitled to equitable subrogation and was therefore subordinate to First Commonwealth’s mortgage).

119 See id. at 1155 (describing trial court’s decision to deny equitable subrogation).

120 See id. at 1154 (illustrating that three mortgages remained on Heller’s property, two of which held priority to Ameriquest’s mortgage).

121 Id. at 1156 (noting that doctrine of equitable subrogation is recognized in Pennsylvania as an exception to the Pennsylvania recording act).
lied heavily on the precedent established in *Home Owners’*, where the court found that the refinancing lender was a volunteer because it was a stranger to the borrower and had no legal obligation to pay the borrower’s debts.\footnote{122. See id. at 1159 (holding that refinancing mortgagee was not entitled to equitable subrogation because it was volunteer) (quoting Home Owners’ Loan Corp. v. Crouse, 30 A.2d 330, 331 (Pa. Super. Ct. 1943)). In *Home Owners’,* the court held that it “requires something more than the mere payment of a debt in order to entitle the person paying the same to be substituted in place of the original creditor.” *Id.* (denying equitable subrogation).} In addition, the court in *Home Owners’* held that “courts of equity will not relieve a party from the consequences of an error due to his own ignorance or carelessness.”\footnote{123. *Home Owners’,* 30 A.2d at 332 (noting that Home Owners’ negligence in failing to properly search public records caused unawareness of intervening judgment lien).} The court in *Heller* held that the facts were “practically indistinguishable” from those presented in *Home Owners’.*\footnote{124. *Heller*, 30 A.2d at 1160 (“The trial court therefore properly found [that Ameriquest] was not entitled to the remedy of equitable subrogation.”). In *Home Owners’,* a creditor paid various earlier liens on the homeowner’s property, but was unaware of an intervening judgment lien. *Home Owners’,* 30 A.2d at 331. The creditor requested subordination, but the lienholder refused. See *id.* After analogizing the facts of *Home Owners’* to the case before the court, it found that the creditor was a mere volunteer and, as such, was not entitled to subrogation. See *Heller*, 30 A.2d at 1158–59 (citing *Home Owners’,* 30 A.2d at 331).} The court noted that courts should be inclined to “favor and further” equitable subrogation, but that it requires more than “mere payment of a debt” to entitle a person to subrogation.\footnote{125. See *Heller*, 30 A.2d at 1158 (explaining four criteria that must be satisfied for equitable subrogation to apply). Pennsylvania establishes four requirements for claim of equitable subrogation: “(1) the claimant paid the creditor to protect his own interests; (2) the claimant did not act as volunteer; (3) the claimant was not primarily liable for the debt; and (4) allowing subrogation will not cause injustice to the rights of others.” *Id.*} Following the precedent established in *Home Owners’,* the court affirmed that “[a] mere volunteer or intermeddler who, having no interest to protect, without any legal or moral obligation to pay” is not entitled to equitable subrogation.\footnote{126. See *id.* (holding that under Pennsylvania law, appellant did not meet four criteria for equitable subrogation).} Furthermore, the court quoted *Home Owners’* stating that “[o]n the

\footnote{127. Id. at 1159 (quoting Home Owners’ Loan Corp. v. Crouse, 30 A.2d 330, 331 (1943)) (explaining that to be entitled to equitable subrogation, party’s equity should be strong and superior to opposing party).} The court explained:

The payor must have acted on compulsion, and it is only in cases where the person paying the debt of another will be liable in the event of a default or is compelled to pay in order to protect his own interests, or by virtue of legal process, that equity substitutes him in the place of the cred-
who is under no legal obligation or liability to pay a debt and who has no interest in, or relation to, the property is a stranger or volunteer with reference to the subject of subrogation."129 Finally, the court found that granting subrogation would prejudice the rights of the intervening lienholder.130

The outcome in Heller was the product of overreliance on antiquated precedent.131 In Heller, the court found that Ameriquest did not have an independent interest in Heller’s property and was not compelled to satisfy her mortgages.132 Furthermore, it held that Ameriquest was not entitled to equitable subrogation and held a subordinate lien position to First Commonwealth.133 Nevertheless, the court recognized that the decision in Home Owners’, and thus this decision, was “not in accord with the Restatement or with the case law of many of our sister states.”134

C. Critical Analysis: The Court in Heller Defeats Purpose of Equitable Subrogation

The court in Heller maintained Pennsylvania’s tradition of restrictive application of equitable subrogation.135 First, the court reestablished the overly burdensome volunteer rule, finding that one seeking equitable subrogation must not be a volunteer.136 Second, it failed to address actual or

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129. Id. (quoting Home Owners’ Loan Corp. v. Crouse, 30 A.2d 330, 331 (1943)).
130. See id. (holding that courts of equity will not relieve party from errors caused by its own ignorance or carelessness). The court noted that reasonable care would have allowed Home Owners’ to avoid the mistake. See id. (explaining that negligence caused lender to fail to discover intervening lien).
131. See Heller, 863 A.2d at 1159 (noting that court in Home Owners’, decided over sixty years earlier, applied principles of equity and fairness and denied creditor equitable subrogation).
132. See id. at 1159–60 (noting that lender in Home Owners’ was under no legal obligation or compulsion to pay homeowner’s debts).
133. See id. at 1160 (holding that appellant was not entitled to equitable subrogation, and that its lien was subordinate to that of appellee).
134. Id. at 1159–60 (emphasis added) (footnote omitted) (noting that Home Owners’ was not overruled and remains binding precedent). Furthermore, the court found that the facts were practically indistinguishable from Home Owners’. See id.
135. See id. at 1160 (denying equitable subrogation to refinancing lender).
136. See id. (holding that refinancing lender was volunteer).
constructive notice.\footnote{137} Third, the court applied a negligence standard that limits the fundamental purpose of the doctrine.\footnote{138}

1. Pennsylvania’s Precedent Puts Refinancing Lenders Last

While the court in \textit{Heller} followed the precedent established in \textit{Home Owners’}, its approach defeats the purpose of equitable subrogation.\footnote{139} The volunteer rule that Pennsylvania applies is inoperably strict.\footnote{140} Moreover, the rule greatly increases the risk of harm that refinancing lenders face when issuing a loan to pay off a prior mortgage.\footnote{141} In \textit{Heller}, the court found that Ameriquest was a volunteer.\footnote{142} Such a holding prevents refinancing lenders from asserting a right of equitable subrogation in Pennsylvania.\footnote{143} For this reason, many courts outside of Pennsylvania interpret the volunteer rule liberally or have eliminated it altogether.\footnote{144} The Restatement eliminates the volunteer rule, recognizing that it is “highly variable and uncertain,” and causes “considerable confusion.”\footnote{145} When strictly applied, the volunteer rule places the entire burden on refinancing lenders.\footnote{146} Noting the importance of equitable subrogation in the context of refinancing, it seems counterintuitive to prevent refinancing lenders from taking advantage of such a valuable doctrine.\footnote{147}

\footnote{137. See id. at 1154 (noting that Ameriquest was unaware of prior lien).  
138. See id. at 1155 (disfavoring equitable subrogation because mistake resulted from appellant’s negligence).  
139. See Grant S. Nelson & Dale A. Whitman, Real Estate Finance Law, Practitioner Series § 10.4 (3d ed. 1994) (discussing and disparaging volunteer rule); see also Subrogation, supra note 44, at 684–85 (noting that in legal subrogation class of persons included within term “volunteer” has been reduced).  
140. See Winiarski, supra note 23, at 236 (arguing that voluntary actor and volunteer are not synonymous). In Connecticut “one may act voluntarily without being deemed a ‘volunteer.’” Id.  
141. See Mosson, supra note 42, at 721 (explaining that some courts define volunteer like gift givers, while others exclude voluntary commercial actors).  
142. See Heller, 863 A.2d at 1160 (denying equitable subrogation to refinancing lender).  
143. See Restatement (Third) Prop.: Mortgs. § 7.6 cmt. b (1997) (noting that Restatement does not adopt “volunteer” rule, but rather requires that subrogee “pay to protect some interest”).  
144. See Mosson, supra note 42, at 721 (finding that many courts define “‘mere volunteers’ more widely, thus excluding voluntary commercial actors, like refinancers with no stake in prior loans’); see also Subrogation, supra note 44, at 686 (finding that there is no general agreement for definition of volunteer, but majority of courts define it as one “who did not have some previous interest to protect”).  
145. Restatement (Third) of Prop.: Mortgs. § 7.6 cmt. b (1997) (noting that prior case law has indicated that “volunteer” is not entitled to subrogation, but refusing to adopt this requirement). The Restatement only requires that subrogee pay to protect an interest, which eliminates the volunteer rule. See id.  
146. See Subrogation, supra note 44, at 686 (“A minority of courts is prone to call everyone a volunteer who was not in the position of a surety or who did not have some previous interest to protect in the subject matter in question.”).  
147. See Yoo, supra note 15, at 2136 (“Homeowners typically seek to refinance when interest rates on new mortgages are lower than interest rates on existing mortgage loans, or when they are in need of additional capital.”).}
2. Court Promotes the Volunteer Rule, But Fails to Address Actual or Constructive Notice

Although the court in *Heller* did not explicitly address actual or constructive knowledge within the opinion, it indicated that Ameriquest’s title search did not reveal the existence of First Commonwealth’s mortgage.\(^{148}\) Assuming that this is true, as the court did, Ameriquest did not have actual knowledge of the intervening lien.\(^{149}\) Ameriquest did have constructive notice because First Commonwealth properly recorded its mortgage.\(^{150}\) Nevertheless, the majority approach does not preclude equitable subrogation for constructive notice, so this would not be determinative in Pennsylvania.\(^{151}\) Interestingly, the court in *Heller* did not analyze Ameriquest’s knowledge of the prior lien, which is the focal point in most jurisdictions.\(^{152}\) Instead, the court placed enormous significance on the volunteer rule, which makes the doctrine’s application in the refinancing context much more difficult.\(^{153}\) In contrast to Pennsylvania’s standard, many jurisdictions allow a request from a homeowner to constitute an interest in the property.\(^{154}\) Thus, in those jurisdictions, refinancing lenders are not considered strangers when the borrower seeks to refinance.\(^{155}\)


\(^{149}\) See id. (explaining that Ameriquest conceded existence of three mortgages, but presumed that failure to find First Commonwealth lien was due to searcher’s error).

\(^{150}\) See id. (finding that three mortgages remained of record when Ameriquest refinanced Heller’s loan).

\(^{151}\) See Bank of Am., N.A. v. Prestance Corp., 160 P.3d 17, 21 (Wash. 2007) (en banc) (noting that constructive notice only plays part in minority approach to equitable subrogation).

\(^{152}\) See, e.g., Foster v. Porter Bridge Loan Co., 27 So. 3d 481, 485–86 (Ala. 2009) (holding that constructive notice will not preclude application of equitable subrogation); Equicredit Corp. of Conn. v. Kasper, 996 A.2d 1243, 1246 (Conn. App. Ct. 2010) (holding that equitable subrogation did not apply because plaintiff had actual or constructive notice of defendant’s lien); HSBC Bank USA, N.A. v. Mendoza, 11 A.3d 229, 295 (D.C. 2010) (“[A] lender who pays off a pre-existing mortgage and takes a new mortgage as security for the loan will be subrogated to the rights of the first mortgagee as against any intervening lienholders, even if the lender is on constructive notice of the existence of the junior liens.”).

\(^{153}\) See Heller 863 A.2d at 1158–60 (describing volunteer rule and holding that Ameriquest constituted volunteer under Pennsylvania law).

\(^{154}\) See Home Owners’ Loan Corp. v. Sears, Roebuck & Co., 193 A. 769, 772 (Conn. 1937) (holding that mortgagee was not volunteer based on agreement with homeowner); Prestance, 160 P.3d at 21 (allowing mortgagee to subrogate under Restatement); see also Restatement (Third) Prop.: Mortgs. § 7.6(b)(4) (1997) (allowing equitable subrogation “upon a request from the obligor”).

\(^{155}\) See Subrogation, supra note 44, at 686 (“[T]he liberal view leads to the result that the only volunteer would be one who, without an invitation from any other party and purely as a philanthropist, relieved another from an obligation.”).
eliminating the volunteer element, Pennsylvania could greatly promote refinancing and protect the interests of both lenders and borrowers.156

3. Court Uses Third Party Negligence to Rule Out Equitable Subrogation

The negligence standard applied by the court in Heller is too strict of a standard for an equitable doctrine.157 In effect, Pennsylvania law prevents parties from invoking equitable subrogation when prior mortgages did not show up in their title search.158 Regardless of whether the mistake resulted from third party negligence, the onus falls on the refinancing lender.159 Following this logic, equitable subrogation would only apply when the intervening lien was not of record.160

This philosophy eliminates a majority of circumstances when the equitable doctrine would apply.161 Furthermore, it encourages refinancing lenders to refuse to refinance prior liens because of the major risk involved.162 The Restatement recognizes that a strict interpretation of equitable subrogation is not necessary because the intervening lienholder is not adversely affected by subrogation.163 In other words, the intervening

156. See Restatement (Third) of Prop.: Mortgs. § 7.6 cmt. b (1997) (“The meaning of the term ‘volunteer’ is highly variable and uncertain, and has engendered considerable confusion.”).
157. See Starr, supra note 22, at 2 (noting that standard for equitable subrogation is “culpable and inexcusable neglect” in failing to protect senior priority position).
158. See Heller 863 A.2d at 1155 (defining Ameriquest’s “problem” as negligence in title searching).
159. See Prestance, 160 P.3d at 21 (explaining that rule that strictly punishes negligence “swallows the doctrine” of equitable subrogation).
160. See id. (“If all persons who negligently confer an economic benefit upon another are disqualified from equitable relief because of their negligence, then the law of restitution, which was conceived in order to prevent unjust enrichment, would be of little or no value.” (quoting Ex Parte AmSouth Mortg. Co., 679 So.2d 251, 255 (Ala. 1996))).
161. See Restatement (Third) of Prop.: Mortgs. § 7.6 cmt. e (1997) (“The most common context for this sort of subrogation is the ‘refinancing’ of a mortgage loan”); Nelson & Whitman, supra note 16, at 315 (describing minority approach to equitable subrogation as “the most hostile to the refinancing lender”). While Pennsylvania does not apply the minority approach, its volunteer rule and negligence standard place the burden on the lender. See also Oinsky, supra note 26 (noting that lender who extends loan in order to pay off earlier loans is “volunteer” under Pennsylvania law).
162. See Nelson & Whitman, supra note 16, at 305–06 (arguing that making equitable subrogation available liberally can “eliminate the risk that intervening liens . . . will take priority over refinancing mortgage”). Moreover, the authors posit that adopting the Restatement approach would greatly reduce the need for new title insurance when refinancing. See id. (noting advantages of Restatement approach to equitable subrogation).
163. See Restatement (Third) of Prop.: Mortgs. § 7.6 cmt. a (1997) (“The holders of intervening interests can hardly complain about this result, for they are no worse off than before the senior obligation was discharged.”); see also id. § 7.6 cmt. e (concluding that holders of intervening interests are not materially prejudiced by subrogation in refinancing context).
lienholder is in no worse position because it did not expect to be in a priority position.\textsuperscript{164} Therefore, negligence on behalf of an attorney or title searcher should not preclude a lender from taking advantage of equitable subrogation.\textsuperscript{165}

IV. WHAT’S NEXT AFTER \textit{Heller}?: MOVING TOWARD THE RESTATEMENT

Pennsylvania’s current precedent establishes an inequitable approach to equitable subrogation.\textsuperscript{166} It restricts the doctrine in the refinancing context, thus limiting its most valuable purpose.\textsuperscript{167} In order for Pennsylvania to adapt to the changing economic climate, it must adopt the Restatement approach to equitable subrogation.\textsuperscript{168}

A. Pennsylvania Continues to Follow Inequitable Precedent

Pennsylvania courts continue to follow the precedent established in \textit{Heller}.\textsuperscript{169} For example, in \textit{1313466 Ontario, Inc. v. Carr},\textsuperscript{170} the court held that a refinancing lender could not be equitably subrogated to a prior lien position.\textsuperscript{171} In \textit{Carr}, Jeffrey Carr, a homeowner, received a loan from U.S. Bank, which he used to pay off three prior loans.\textsuperscript{172} Nevertheless, Carr

\begin{itemize}
\item \textsuperscript{164.} See id. § 7.6 cmt. e (explaining that payor will have benefit of subrogation to mortgage that was discharged only if payor was promised repayment of funds and reasonably expected to receive senior mortgage).
\item \textsuperscript{165.} See id. (noting that under Restatement, subrogation can be granted even if payor had actual knowledge of intervening interest). The critical inquiry is “whether the payor reasonably expected to get security with a priority equal to the mortgage being paid.” \textit{Id.} Thus, third party negligence should not affect this expectation. See \textit{id.} (stating that “payor’s notice . . . is not necessarily relevant”).
\item \textsuperscript{166.} See, e.g., \textit{1313466 Ontario, Inc. v. Carr}, 954 A.2d 1, 2 (Pa. Super. Ct. 2008) (providing example of how Pennsylvania’s approach precludes homeowners from receiving refinancing loans if there are intervening liens).
\item \textsuperscript{168.} See Nelson & Whitman, \textit{supra} note 16, at 353 (arguing that widespread adoption of Restatement will help both homeowners and lenders).
\item \textsuperscript{169.} See \textit{Carr}, 954 A.2d 2 at 2 (holding that case was indistinguishable from recent case in \textit{Heller}, and thus bank in question was not entitled to relief under equitable subrogation). The \textit{Carr} court noted that Pennsylvania’s interpretation of the doctrine of equitable subrogation places lenders in a dilemma, because if the intervening lienholder refuses to subrogate lien position, the lienholder will not be able to refinance the homeowner’s loan. See \textit{id.} at 5–6; see also \textit{Newcrete Prods. v. City of Wilkes-Barre}, 37 A.3d 7, 15 (Pa. Commw. Ct. 2012) (explaining that “Pennsylvania’s doctrine allows a party who satisfies an encumbrance to assume the same priority position as the holder of the prior encumbrance” (citing generally \textit{First Commonwealth Bank v. Heller}, 863 A.2d 1153 (Pa. Super. Ct. 2004))).
\item \textsuperscript{170.} 954 A.2d 1 (Pa. Super. Ct. 2008).
\item \textsuperscript{171.} See \textit{id.} at 5 (holding that bank was not entitled to equitable subrogation because it was acting as volunteer).
\item \textsuperscript{172.} See \textit{id.} at 1–2 (explaining that Carr used U.S. Bank loan to pay off three prior loans). The proceeds of the U.S. Bank loan were used to pay off Lendent and Household loans, and another unsecured loan. See \textit{id.}
failed to satisfy an additional mortgage on the property, of which U.S. Bank was completely unaware.\textsuperscript{173} When Carr defaulted on his loan payments, the mortgagee in priority position foreclosed on Carr’s home.\textsuperscript{174} The intervening lienholder was now threatening U.S. Bank’s interest in the property.\textsuperscript{175} U.S. Bank petitioned to intervene in the foreclosure action by making an argument for equitable subrogation.\textsuperscript{176} However, the court found that U.S. Bank was not entitled to relief because it was a volunteer in the matter and because its own negligence caused it to overlook the intervening lien.\textsuperscript{177} The court in Carr followed the precedent established in \textit{Home Owners’} and \textit{Heller}, and it reiterated the State’s policy on equitable subrogation.\textsuperscript{178} Accordingly, Pennsylvania law has been unable to adapt to the changing needs of homeowners, and the increase of refinancing in the current housing market.\textsuperscript{179}

B. \textit{The National Trend Toward the Restatement Approach}

Recent state court cases demonstrate a national trend toward adopting the Restatement approach to equitable subrogation.\textsuperscript{180} The courts that have adopted the Restatement approach support it because it favors lenders, prevents unjust enrichment, and ensures that secondary lienholders do not receive windfalls.\textsuperscript{181} Furthermore, the Restatement allows for uniform application of the doctrine and limits the uncertainty

\begin{footnotesize}
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\item \textsuperscript{173} See id. at 2 ("U.S. Bank was unaware of the Ontario mortgage due to an error in its title search.").
\item \textsuperscript{174} See id. (explaining that Carr defaulted on his payments for Ontario mortgage, who then obtained two judgments in mortgage foreclosure).
\item \textsuperscript{175} See id. (detailing Carr’s defaults on his payments and discussing Ontario’s subsequent foreclosure action).
\item \textsuperscript{176} See id. (acknowledging two judgments secured by Ontario in foreclosure actions, in which U.S. Bank sought to intervene).
\item \textsuperscript{177} See id. at 5 (finding that facts were indistinguishable from \textit{Home Owners’} and \textit{Heller}, and that U.S. Bank constituted volunteer under analysis from both cases).
\item \textsuperscript{178} See id. (noting that decision was guided by principle of \textit{stare decisis}, but also by U.S. Bank’s negligence).
\item \textsuperscript{179} See Armour, \textit{supra} note 13 (noting that refinancing applications made up about eighty-five percent of all mortgage applications in 2008); see also Ominsky, \textit{supra} note 26 (noting that under Pennsylvania law, lender must not have acted as volunteer to be entitled to equitable subrogation).
\item \textsuperscript{180} See, e.g., Green v. HSBC Mortg. Servs., Inc. (In re Green), 474 B.R. 790, 795 (Bankr. D. Md. 2012) (finding lender that refinanced debtor’s obligation on existing, first-priority lien was entitled to be equitably subrogated to rights of first-position lienholder); Citimortgage, Inc. v. Mortg. Elec. Registration Srs., Inc., 813 N.W.2d 332, 336 (Mich. Ct. App. 2011) (holding that “equitable subrogation is available to place a new mortgage in the same priority as a discharged mortgage”); Bank of Am. v. Prestance Corp., 160 P.3d 17, 18 (Wash. 2007) (en banc) (holding that refinancing mortgagee’s actual or constructive notice of intervening liens does not prevent application of equitable subrogation).
\item \textsuperscript{181} See Prestance, 160 P.3d at 18 (adopting Restatement approach to equitable subrogation); see also Murray, \textit{supra} note 25, at 255 (noting that court in \textit{Prestance} dismissed argument that Restatement approach “would obstruct the pre-}
\end{itemize}
\end{footnotesize}
and variability of other approaches.\footnote{See \textit{Restatement (Third) Prop.: Mortgs.} \S 7.6 cmt. a (1997) (concluding that “[s]ubrogation is a broad concept . . . . in which one who performs a mortgage is entitled to subrogation in order to avoid unjust enrichment”). The Restatement approach eliminated the volunteer rule, which it noted caused “considerable confusion.” \textit{Id.} \S 7.6 cmt. b. Furthermore, the Restatement requires the subrogee to have performed in order to protect some “interest,” but not a legally recognized property interest. \textit{See id.} (noting that “a business or financial interest that would be impaired by foreclosure of the mortgage, an interest in reputation, or a moral obligation” would suffice).} Thus, equitable subrogation is more predictable under the Restatement, which only requires that it prevent unjust enrichment.\footnote{See \textit{id.} \S 7.6(a) (“One who fully performs an obligation of another, secured by a mortgage, becomes by subrogation the owner of the obligation and the mortgage to the extent necessary to prevent unjust enrichment.”).} Many states have adopted the Restatement to promote refinancing and curb the threat of foreclosure.\footnote{See Nelson & Whitman, \textit{supra} note 16, at 353 (arguing that widespread adoption of Restatement approach is likely to lead to substantial savings for refinancing homeowners). The article notes a recent trend in courts being favorable to Restatement. \textit{See id.} (noting that continuation of trend is desirable for homeowners who desire to receive substantial savings).}

In one such prominent state court case, \textit{Bank of America, N.A. v. Prestance Corp.},\footnote{160 P.3d 17 (Wash. 2007) (en banc).} the Washington Supreme Court adopted the Restatement approach to equitable subrogation.\footnote{See \textit{id.} at 29 (adopting Section 7.6 of Restatement and holding that lender was entitled to equitable subrogation).} In \textit{Prestance}, homeowners took out a loan from Wells Fargo to satisfy multiple prior liens on their home, including a priority lien from Washington Mutual.\footnote{See \textit{id.} at 19 (explaining that homeowners’ applied for million dollar loan from Wells Fargo to pay off their home purchase loan). Wells Fargo approved the million dollar home equity line of credit in December 2001. \textit{See id.} (noting that Wells Fargo secured loan with deed of trust).} Wells Fargo believed it would take priority over the other loans that its proceeds were used to satisfy; however, one loan remained that it was not subordinate to.\footnote{\textit{See id.} (reporting that Wells Fargo expected to take first lien position on the home).} The Washington Supreme Court applied the Restatement approach, finding that Wells Fargo was entitled to subrogate to first priority lien position in the amount of the loan paid off.\footnote{\textit{See id.} at 20 (finding that equitable subrogation preserves proper priorities by keeping first mortgage first and second mortgage second).} The \textit{Prestance} court recognized that the Restatement approach was not yet the majority position, but found it to be the most equitable stance.\footnote{\textit{See id.} (noting that courts were initially resistant to equitable subrogation, but now many courts apply doctrine liberally).} The court concluded that the purpose of equitable subrogation was to prevent a person from...
receiving "an unearned windfall at the expense of another."191 Furthermore, the court found that the Restatement readily applied in the context of conventional refinancing, which it saw as commonplace in today’s economy.192 Moreover, the court concluded that denying equitable subrogation based on the knowledge of intervening interests "runs contrary to the purposes underlying the doctrine."193 Ultimately, the court found that the Restatement provided the most equitable and sensible approach, allowing subrogation regardless of actual or constructive knowledge of intervening liens.194

More recently, in *Sourcecorp, Inc. v. Norcutt*,195 the Arizona Supreme Court adopted the Restatement approach.196 In *Norcutt*, Dean and Stacey Norcutt purchased a home for cash and satisfied the mortgage on the property.197 However, the couple later discovered that they purchased the home subject to a judgment lien that far exceeded the property’s value.198 Prior to *Norcutt*, Arizona courts applied the same volunteer rule as Pennsylvania.199 Nevertheless, the court adopted the Restatement approach because of the ambiguity in Arizona case law regarding equitable subrogation.200 The court found that equitable subrogation should not turn on whether a person invoking the doctrine was labeled a volunteer.201 Fi-

191. *Id.* at 21 (quoting *Restatement (Third) Prop.: Mortgs.* § 7.6 cmt. a (1997)) (reasoning that Restatement properly emphasizes equitable subrogation’s concern of unjust enrichment).


193. *Id.* (quoting *Bank of N.Y. v. Nally*, 820 N.E.2d 644, 653 (Ind. 2005)).

194. *See id.* at 29 (adopting Restatement and holding that Wells Fargo was equitably subrogated to first-priority lien, regardless of actual or constructive knowledge of intervening liens).


196. *See id.* at 1209 (adopting Restatement approach, and rejecting agreement requirement for equitable subrogation). The court held that equitable subrogation "does not turn on contractual principles, but instead on the concern to prevent unjust enrichment." *Id.* (granting subrogation regardless of express or implied agreement).

197. *See id.* at 1206 (describing Dean and Stacey Norcutt’s home purchase).

198. *See id.* (holding that purchasers were equitably subrogated to mortgage lien’s priority in amount paid to satisfy mortgage).

199. *See id.* at 1207 (noting that prior precedent stated “[a] mere volunteer, who has no rights to protect, may not claim the right of subrogation” (quoting *Mosher v. Conway*, 46 P.2d 110, 113 (Ariz. 1935))). For a discussion of Pennsylvania’s approach, specifically the requirement that a party seeking equitable subrogation must not be a volunteer, see *supra* notes 169–79 and accompanying text.

200. *See id.* (finding that Restatement approach was “most consistent with the rationale for equitable subrogation”).

201. *See id.* at 1208 (holding that Arizona case law was consistent with Restatement approach, which refuses to use term “volunteer” as talisman). Further, the court agreed with the Restatement insofar as “[T]he meaning of the term ‘volun-
nally, the court concluded that the goal of equitable subrogation was preventing unjust enrichment and acknowledged that denying subrogation in this case would grant a windfall to the judgment lienholder.202

C. Pennsylvania Must Change Its Approach to Equitable Subrogation

The volunteer rule in Pennsylvania’s current law is not only out-of-date, but it defeats the purpose of equitable subrogation.203 Pennsylvania’s approach prevents equitable subrogation in all third party refinancing circumstances.204 The purpose of the doctrine is to prevent unjust enrichment, which Pennsylvania’s current approach completely fails to do.205 A liberal application of equitable subrogation is essential to prevent junior lienholders from gaining an undeserved windfall.206 Furthermore, Pennsylvania causes buyers and lenders to suffer substantial losses by denying equitable subrogation in the refinancing context.207 As the court found in Prestance, the purpose of equitable subrogation is to preserve the rightful lien position of lenders.208 Accordingly, adopting the Restatement approach will encourage refinancing and allow homeowners to take full advantage of low interest rates.209 Moreover, volunteer’ is highly variable and uncertain, and has engendered considerable confusion.” Id. (alteration in original) (quoting RESTATEMENT (THIRD) PROP.: MORTGS. § 7.6 cmt. b (1997)).

202. See id. at 1209 ("Equitable subrogation, however, does not turn on contractual principles, but instead on the concern to prevent unjust enrichment."). The court noted that the Restatement “appropriately focuses” on circumstances surrounding subrogation. See id. at 1208 (looking at party’s interest in property).

203. See Subrogation, supra note 44, at 684 (suggesting that volunteer requirement should be abandoned, and equitable subrogation doctrine expanded).

204. See Ominsky, supra note 26 (‘A lender who extends a loan in order to pay off earlier loans is a ‘volunteer’ . . . because the lender was ‘an entirely voluntary agent with no interest in the property . . . .’” (quoting 1313466 Ontario, Inc. v. Carr, 954 A.2d 1, 4 (Pa. Super. Ct. 2008))).

205. See Restatement (Third) Prop.: Mortgs. § 7.6 cmt. a (1997) (“Subrogation is an equitable remedy designed to avoid a person’s receiving an unearned windfall at the expense of another.”).

206. See Bank of Am. v. Prestance Corp., 160 P.3d 17, 20 (Wash. 2007) (en banc) (“It rests upon the maxim that no one shall be enriched by another’s loss, and may be invoked wherever justice and good conscience demand its application in opposition to the technical rules of law.” (quoting Cox v. Wooten Bros. Farms, Inc., 610 S.W.2d 278, 280 (Ark. Ct. App. 1981))).

207. See Nelson & Whitman, supra note 16, at 363 (arguing that widespread adoption of Restatement approach is likely to lead to substantive savings for refinancing homeowners). Furthermore, the authors argue that the Restatement approach is the “fairest” because it rejects conferring a windfall to intervening lienholders. See id. at 327.

208. See Prestance, 160 P.3d at 28 (concluding that allowing subrogation provides incentive for lenders to advance loans to borrowers in order to avoid forfeiture). Moreover, the court found that the Restatement approach “affords enormous financial benefits for many homeowners.” Id. (noting that potential savings amount to billions of dollars).

209. See Nelson & Whitman, supra note 16, at 327 (“[T]he Restatement approach is friendly to first mortgage refinancing, a process that clearly is beneficial
sylvania should relinquish the volunteer rule and base decisions on equity rather than actual or constructive notice. By adopting the Restatement approach, Pennsylvania would protect the rights of lenders and preserve the proper role of equity in refinancing transactions.

Furthermore, adoption of the Restatement would facilitate refinancing and help curb the threat of foreclosure. The court in *Prestance* recognized that a liberal application of equitable subrogation encourages lenders to refinance loans and allows property owners to avoid forfeiture. In addition, the Restatement approach affords tremendous financial benefits to homeowners by allowing seamless refinancing. In the current state of the economy it is vital to encourage refinancing because it allows homeowners to maximize the value in their home. Moreover, adopting the Restatement approach would limit the costs of title insurance for refinancing transactions, which would save borrowers over a billion dollars.

The authors strongly urge the adoption of the Restatement approach to equitable subrogation, arguing that it should become the predominant approach. See *id.* at 327–28 (noting that Restatement approach has gained considerable ground).

210. See *Sourcecorp, Inc. v. Norcutt*, 274 P.3d 1204, 1208 (Ariz. 2012) (en banc) (finding that person who pays debt to protect person’s interests is not volunteer). The court makes clear that the volunteer rule is "highly variable and uncertain, and has engendered considerable confusion." *Id.* (quoting *RESTATEMENT (THIRD) OF PROP.: MORTGS.* § 7.6 cmt. b (1997)).

211. See *Nelson & Whitman*, *supra* note 16, at 353 (noting that lenders and title insurers both support adoption of Restatement for equitable subrogation because it dramatically reduces financial risk associated with refinancing and lessens threat of intervening lienholder taking priority position). The authors ultimately conclude that the Restatement approach should be enacted by Congress in the form of legislation. See *id.* at 366.

212. See *Prestance*, 160 P.3d at 28 ("[B]y facilitating more refinancing, equitable subrogation helps stem the threat of foreclosure."). The court notes that other courts have liberally applied equitable subrogation in order to prevent forfeiture. *See id.*

213. *See id.* ("By allowing subrogation there is an incentive for one to advance sums to help a property owner avoid forfeiture." (quoting *Klotz v. Klotz*, 440 N.W.2d 406, 410 (Iowa Ct. App. 1989))).

214. *See Nelson & Whitman*, *supra* note 16, at 365–66 ("[T]itle insurance costs in residential mortgage refinancings represent billions of dollars annually—costs that are now borne overwhelmingly by homeowners."). The authors recognize that the potential savings from adopting the Restatement could approach billions of dollars. *See id.* at 366.

215. *See Mortgages and the Markets*, *supra* note 8 (recognizing that refinancing provides economic stimulus by lowering borrowers’ mortgage payments and increasing their expendable income).

216. *See Prestance*, 160 P.3d at 28 ("Title insurance primarily ensures there are no intervening liens, and when a jurisdiction adopts the liberal view of equitable subrogation, the insurance premium is greatly reduced."). The court recognized that the savings from title insurance premiums would be passed to homeowners. *See id.* (citing *Nelson & Whitman*, *supra* note 16, at 365).
and Pennsylvania must adopt the Restatement approach in order to promote confidence in the struggling housing market.\textsuperscript{217}

The court in \textit{Carr} presents a compelling case-in-point of the need for Pennsylvania to adopt the Restatement approach, and also suggests a way forward.\textsuperscript{218} The court noted that Carr would not be able to refinance his mortgage with an intervening loan on the property.\textsuperscript{219} Furthermore, under Pennsylvania law, if Carr knew of the intervening lien, neither he nor the bank could take advantage of equitable subrogation.\textsuperscript{220} As the court noted, Pennsylvania’s application of equitable subrogation “may be ripe for legislative review.”\textsuperscript{221}

The dilemma that Carr faced was a frequent problem for homeowners during the mortgage crisis.\textsuperscript{222} Therefore, if Pennsylvania wants to protect homeowners against foreclosure, it must promote refinancing.\textsuperscript{223} The first step Pennsylvania must take is adopting the Restatement approach to equitable subrogation.\textsuperscript{224} In doing so, Pennsylvania will allow borrowers and lenders to protect their individual interests and capitalize on improving conditions in the housing market.\textsuperscript{225}

\textsuperscript{217.} See Nelson & Whitman, \textit{supra} note 16, at 327 (“Restatement approach is friendly to first mortgage refinancing, a process that clearly is beneficial to homeowners.”).

\textsuperscript{218.} See 1313466 Ontario, Inc. \textit{v.} Carr, 954 A.2d 1, 5 (Pa. Super. Ct. 2008) (explaining that Carr could not refinance his home if he was aware of intervening lien); \textit{id.} at 6 (alluding to legislative adoption of Restatement approach).

\textsuperscript{219.} See \textit{id.} (noting that if bank was aware of intervening mortgage then it would not have extended loan to Carr to refinance his home).

\textsuperscript{220.} See \textit{id.} (noting that U.S. Bank would not have extended loan to Carr if it knew of the intervening lien). The court explains that under the Pennsylvania approach neither Carr nor U.S. Bank could take advantage of equitable subrogation, leaving Carr unable to refinance his home altogether. \textit{See id.}

\textsuperscript{221.} \textit{Id.} at 6.

\textsuperscript{222.} \textit{Id.} at 5–6 (“This scenario may be a frequent dilemma for homeowners amidst the current mortgage crisis, where 1.3 million housing properties were subjected to foreclosure activity in 2007, and estimates predict that capital losses in housing may reach into the trillions of dollars in the coming years.” (footnote omitted)). The court recognized the millions of homes foreclosed upon, and thus the importance of refinancing. \textit{See id.} (suggesting legislative review for Pennsylvania’s equitable subrogation approach).

\textsuperscript{223.} See Stiglitz & Zandi, \textit{supra} note 6 (explaining that with interest rates at record lows, mass mortgage refinancing would allow homeowners to drastically reduce their monthly payments and chance of default). The authors highlight the benefit homeowners receive from refinancing. \textit{See id.} (noting that majority of Americans are great candidates).

\textsuperscript{224.} See Nelson & Whitman, \textit{supra} note 16, at 327–28 (“[A]s a normative matter, we strongly urge the adoption of the Restatement subrogation rule. It has already gained considerable ground, and we believe and hope it is well on its way to becoming the predominant rule.”). The authors note that the widespread adoption of the Restatement approach would lead to substantial savings for refinancing homeowners. \textit{See id.}

\textsuperscript{225.} See Ensign, \textit{supra} note 18 (encouraging homeowners to refinance and take advantage of historically low interest rates); \textit{see also} Nelson & Whitman, \textit{supra}
Without the opportunity to refinance her home, Jan and her children would have been forced out onto the street. In order to reduce the chances of this occurring, Pennsylvania must adopt a more liberal approach to equitable subrogation. Pennsylvania’s current equitable subrogation law makes refinancing an extremely risky decision for lenders. The goal of equitable subrogation is to prevent intervening lienholders from receiving an undeserved windfall, which the Pennsylvania approach does not do. In order to allow borrowers to take full advantage of the benefits of refinancing, Pennsylvania must adopt the Restatement approach. In doing so, Pennsylvania would follow a growing trend in the country and provide an outlet to those homeowners who want to take advantage of low interest rates. In a housing market that is still recovering from a crushing recession, it is imperative that Pennsylvania adopt an approach similar to the Restatement.

Note 16, at 327 (concluding that Restatement approach for equitable subrogation is “fairest” and friendly to first mortgage refinancing).

226. See Foreclosure Statistics, supra note 13 (reporting spike in foreclosures during 2008, and describing problems homeowners face when dealing with foreclosure).

227. See Restatement (Third) Prop.: Mortgs. § 7.6 cmt. e (1997) (“The most common context for this sort of subrogation is the ‘refinancing’ of a mortgage loan.”). The most frequent occurrence is when a payor is given a mortgage, but without subrogation, it would be subordinate to some intervening lien. See id. (describing significance of priority and explaining role equitable subrogation plays).

228. See Ominsky, supra note 26 (“[I]n Pennsylvania ‘[t]he payor must have acted on compulsion, and it is only in cases where the person paying the debt of another will be liable in the event of a default or is compelled to pay in order to protect his own interests, or by virtue of legal process, that equity substitutes him in the place of the creditor without any agreement . . . .’” (second alteration in original) (quoting 1313466 Ontario, Inc. v. Carr, 954 A.2d 1, 4 (Pa. Super. Ct. 2008))).

229. See id. § 7.6 cmt. a (“Subrogation is an equitable remedy designed to avoid a person’s receiving an unearned windfall at the expense of another.”); see also Murray, Trend, supra note 45, at 19 (explaining that doctrine of equitable subrogation “rests on the equitable maxim that no one shall be enriched by another’s loss,” and noting it “is designed to prevent an unjust forfeiture on one hand and a windfall amounting to unjust enrichment on the other”).

230. See Nelson & Whitman, supra note 16, at 305 (finding that majority of refinancing expenses can be substantially reduced or eliminated by implementing Restatement). Further, the authors state that making subrogation available liberally can eliminate risk that intervening liens will take priority over refinancing mortgage. See id. at 305–06 (noting that adopting Restatement would greatly reduce need for title insurance when refinancing).

proach to equitable subrogation that facilitates refinancing. By adopting the Restatement approach, Pennsylvania would provide freedom to homeowners, security to lenders, and economic development to all. 233

232. See Restatement (Third) of Prop.: Mortgs. § 7.6 cmt. e (1997) ("Ordinarily lenders who provide refinancing desire and expect [primary lien position], even if they are aware of an intervening lien.").

233. For a critique of Pennsylvania’s current approach, see supra notes 121–65 and accompanying text. For a discussion of the Restatement approach and why Pennsylvania should adopt it, see supra notes 166–225 and accompanying text. See Nelson & Whitman, supra note 16, at 363 (concluding that widespread adoption of Restatement approach to subrogation and refinancing transactions is proper normative matter and will lead to substantial savings for refinancing homeowners). Adopting the Restatement approach would eliminate the risk of losing mortgage priority for refinancing lenders. See id. at 365 (advocating for reform of law of mortgage refinancing and concluding that Restatement approach should be enacted through federal legislation).
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THE FUTURE OF RESIDUAL CLAUSE INTERPRETATION: “SHANKING” THE COMMENTARY AND SIMPLIFYING SENTENCING ENHANCEMENT ANALYSIS AFTER UNITED STATES v. MOBLEY

NICOLAS A. NOVY*

“It will be found an unjust and unwise jealousy to deprive a man of his natural liberty upon the supposition he may abuse it.”

George Washington

I. INTRODUCTION

In September 2009, Jermaine Mobley sought medical treatment for his back at a prison infirmary while serving his 151-month prison sentence for possession with intent to distribute. The physical therapist picked up his right shoe to examine the insole and found a homemade knife, or “shank,” concealed within. Subsequently, Mobley pled guilty to possession of a prohibited object in prison. The sentencing judge enhanced his sentence, and labeled Mobley a “Career Offender” by concluding that possession of a shank in prison amounted to a “crime of violence.” In United States v. Mobley, the Fourth Circuit agreed, and upheld the sentence.

In the mid-1980s, Congress and the Federal Sentencing Commission began targeting career criminals due to evidence suggesting a small group

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2. See United States v. Mobley, 687 F.3d 625, 626 (4th Cir. 2012) (describing background of Mobley’s previous conviction for heroin possession with intent to distribute).

3. See id. (explaining Mobley’s attempt to hide shank underneath examination table after physical therapist discovered it). Shanks are customarily “made by inmates from bits and pieces of metal and sharpened against concrete.” See id. at n.1 (citation omitted).


5. See Mobley, 687 F.3d at 627 (summarizing sentencing judge’s determination that Mobley’s possession amounted to crime of violence). For an analysis of the statutory language, see infra notes 21–27 and accompanying text.

6. 687 F.3d 625, 626 (4th Cir. 2012).

7. Id. at 626 (issuing holding affirming sentence).
of repeat offenders were responsible for a large number of crimes.\textsuperscript{8} Congress enacted the Armed Career Criminal Act (ACCA) in 1986, which imposed minimum sentences on certain felons with multiple prior convictions for “violent felon[ies] or serious drug offense[s].”\textsuperscript{9} The Federal Sentencing Commission followed suit three years later by incorporating nearly identical language into section 4B1.1 of the U.S. Sentencing Guidelines (“Sentencing Guidelines” or “Guidelines”)—the “Career Offender” provision.\textsuperscript{10} Under section 4B1.1, an enhanced sentence is imposed on repeat offenders who have been convicted of three “crime[s] of violence or controlled substance offense[s].”\textsuperscript{11} A crime of violence is defined in pertinent part as, “any offense . . . [that] is burglary of a dwelling, arson, or extortion, involves use of explosives, or otherwise involves conduct that presents a serious potential risk of physical injury to another.”\textsuperscript{12} The last phrase—known as the “residual clause”—is also found in the ACCA definition of “Violent Felony,” was the focus of the \emph{Mobley} opinion and has been the subject of much debate.\textsuperscript{13}

This Note argues that the Fourth Circuit’s decision in \emph{Mobley} was inconsistent with prior Supreme Court decisions, was contrary to original legislative intent, and fails to achieve justice and fairness in sentencing.\textsuperscript{14} To realize a more universal residual clause framework, courts must focus on the primary intent behind the legislation: punish violent acts that are similar in degree and risk to the enumerated offenses in the statute.\textsuperscript{15}

\begin{thebibliography}{99}
\bibitem{9} 18 U.S.C. 924(e)(1); see, e.g., Begay v. United States, 553 U.S. 137, 139–48 (2008) (discussing ACCA and definition of “violent felony” thereunder).
\bibitem{11} See \textit{U.S. SENTENCING GUIDELINES MANUAL} § 4B1.2 (2012) (illustrating which offenses constitute crime of violence). For a specific discussion of the statutory language, see \textit{infra} notes 28–30 and accompanying text.
\bibitem{12} \textit{U.S. SENTENCING GUIDELINES MANUAL} § 4B1.2 (2012) (defining terms in Section 4B1.1, including what constitutes crime of violence).
\bibitem{13} See id.; 18 U.S.C. 924(e)(2)(B)(ii) (providing relevant portion of ACCA definition of “Violent Felony”); see also Montgomery, supra note 10, at 718 (explaining that analysis for violent felonies under ACCA and crimes of violence under Sentencing Guidelines are essentially identical). For a discussion of the Supreme Court’s opinions analyzing the residual clause, see \textit{infra} notes 33–69 and accompanying text.
\bibitem{14} For a discussion of why the \emph{Mobley} court incorrectly interpreted the residual clause provision, see \textit{infra} notes 113–41 and accompanying text.
\bibitem{15} See Begay v. United States, 553 U.S. 137, 143 (2008) (asserting enumerated offenses, i.e., burglary, arson, etc., limit crimes that may fall within residual clause because they must be similar “in kind as well as in degree of risk posed to the examples themselves”); see also United States v. McGill, 618 F.3d 1273, 1277
\end{thebibliography}
Courts should be wary of enhancing an offender’s term based on mere possession because it is the second unlawful act—the use of a weapon—that creates a substantial risk to others.\textsuperscript{16} Equating the two assumes inevitability of the second unlawful act, the use of the weapon, which has not yet occurred.\textsuperscript{17}

Part II of this Note analyzes the statutory language and the purpose of both the ACCA and the Career Offender provision under the Sentencing Guidelines.\textsuperscript{18} Part III traces the Supreme Court opinions that examine the residual clause and create the somewhat ambiguous analysis that circuit courts have labored to apply.\textsuperscript{19} Part IV analyzes the impact of the Guideline’s commentary that directs courts to enhance sentencing based on certain possession offenses.\textsuperscript{20} Part V explains the facts, procedural background, and analysis of the Fourth Circuit’s decision in \textit{Mobley}.\textsuperscript{21} Part VI critiques the holding and reasoning in the \textit{Mobley} decision as inconsistent with Supreme Court precedent and contrary to congressional intent.\textsuperscript{22} Part VII considers the implications of the \textit{Mobley} decision and offers two suitable alternative solutions that create a more manageable

\footnotesize{(11th Cir. 2010) (recognizing Congress included \textit{use} of explosives as enumerated violent felony and, therefore, did not intend for mere possession of explosives to constitute violent felony). For a further discussion on interpreting the residual clause provision in conjunction with the enumerated offenses, see \textit{infra} notes 118–21 and accompanying text, and for a further discussion of \textit{Begay}, see \textit{infra} notes 46–51 and accompanying text.

\textsuperscript{16} See \textit{Serafin} v. United States, 562 F.3d 1105, 1115 (10th Cir. 2009) (holding possession of unregistered weapon did not constitute crime of violence). “[T]he use or risk of force is not implicated in [defendant’s] \textit{possession} of the unregistered rifle, rather it is the risk he would commit another crime to obtain or retain possession.” \textit{Id.} (explaining risk is recognized when weapon is used, not merely possessed). “For example, an individual possessing an unregistered sawed-off shotgun might use it against someone . . . . [b]ut at a minimum, this scenario would result in a charge of aggravated assault or something similar—and that resulting crime potentially qualifies as a ‘crime of violence’—not the possession itself.” \textit{See id.} (emphasizing danger of weapon is inherent in its use).

\textsuperscript{17} See United States v. Bradford, 766 F. Supp. 2d 903, 909 (E.D. Wis. 2011) (holding possession of short-barreled shotgun was not violent felony under ACCA). The court explains that mere possession only has a “hypothetical connection to violence.” \textit{See id.} (“[S]imple possession merely creates a potential for violence and aggression that is ordinarily realized only if possession ripens into use . . . .”).

\textsuperscript{18} For a discussion of the statutory language and the purpose behind the ACCA and \textit{4B1.1} of the Sentencing Guidelines, see \textit{infra} notes 24–32 and accompanying text.

\textsuperscript{19} For a discussion of the Supreme Court decisions that analyze the residual clause, see \textit{infra} notes 36–78 and accompanying text.

\textsuperscript{20} For a discussion of the commentary and the impact that it has had on lower courts, see \textit{infra} notes 83–95 and accompanying text.

\textsuperscript{21} For a discussion of the Fourth Circuit’s decision in \textit{Mobley}, see \textit{infra} notes 96–112 and accompanying text.

\textsuperscript{22} For a critique of the decision in \textit{Mobley}, see \textit{infra} notes 113–141 and accompanying text.
framework for courts to uniformly interpret residual clause offenses in the future.\footnote{23}

II. THE BIRTH OF STATUTORY CONFUSION: THE SENTENCING COMMISSION’S FIRST ATTEMPT TO BROADEN OFFENSES THAT FALL WITHIN THE RESIDUAL CLAUSE

Section 4B1.1 of the Sentencing Guidelines provides a framework for increasing base offense levels for “Career Offenders” who have committed previous “crimes of violence” or “controlled substance offenses.”\footnote{24} Congress initially intended that the Sentencing Commission use the pre-existing definition of a crime of violence when determining whether a defendant should be labeled a Career Offender under the Guidelines.\footnote{25} This universal definition required the substantial risk of physical injury to arise \textit{during the commission} of the offense.\footnote{26} Nevertheless, a few years later the Sentencing Commission expanded the Guidelines’ definition of a Career Offender in section 4B1.2, despite judicial criticism that the new definition swept “too broadly.”\footnote{27}

A defendant is labeled a Career Offender under section 4B1.1 if the defendant was at least eighteen years old at the time of the instant offense, the instant offense is a crime of violence or substance abuse offense, and the defendant has at least two prior convictions for crimes of violence or

\footnote{23. For a discussion of suitable solutions that would provide a workable framework for lower courts to analyze residual clause offenses in the future, see \textit{infra} notes 142–72 and accompanying text.}


\footnote{25. \textit{See} Amy Baron-Evans et al., \textit{Deconstructing the Career Offender Guideline}, 2 \textit{Charlotte L. Rev.} 39, 59 (2010) (stating that congressional intent was to have universal definition of “crime of violence,” however, Sentencing Commission did not comply and amended new definition anyway).}

\footnote{26. \textit{See} 18 U.S.C. § 16(b) (2006) (defining universal crime of violence residual clause as “any other offense that is a felony and that, by its nature, involves a substantial risk that physical force against the person or property of another may be used in the course of committing the offense”); \textit{see also S. Rep. No. 98-225, at 304 (1983) (illustrating Congress’s intent that section 16 “define[ ] the term ‘crime of violence,’ used here and elsewhere in the bill”). The general definition of “crime of violence” found in section 16 and the ACCA’s definition in Section 994(h) were both enacted as part of the Comprehensive Control Act of 1984. See Baron-Evans et al., \textit{supra} note 25, at 59 n.38 (explaining that both definitions stemmed from same act); \textit{see also Sale v. Haitian Ctrs. Council}, 509 U.S. 155, 203 n.12 (1993) (“It is axiomatic that ‘identical words used in different parts of the same act are intended to have the same meaning,’” (quoting Atl. Cleaners & Dryers, Inc. v. United States, 286 U.S. 427, 433 (1932))).}

\footnote{27. \textit{See} Baron-Evans et al., \textit{supra} note 25, at 59 (illustrating Commission’s reluctance to state any reason for changing definition of crime of violence despite judicial animosity).}
substance abuse offenses. In pertinent part, section 4B1.2 defines a “crime of violence” as an offense that “is burglary of a dwelling, arson, or extortion, involves use of explosives, or otherwise involves conduct that presents a serious potential risk of physical injury to another.” The requirement that the substantial risk of physical injury must arise during the commission of the offense is conspicuously absent; thus the Sentencing Commission effectively expanded the scope of the residual clause beyond Congress’s intent.

The language in the ACCA that provides a similar sentencing enhancement for offenders with three prior convictions of a “violent felony” is virtually identical to the Sentencing Guidelines’ definition of a “crime of violence.” Therefore, courts have considered analyses under the ACCA

28. See U.S. SENTENCING GUIDELINES MANUAL § 4B1.1 (2012) (defining “Career Offender”). According to the Guidelines, a “controlled substance offense” is defined as:

[A]n offense under federal or state law, punishable by imprisonment for a term exceeding one year, that prohibits the manufacture, import, export, distribution, or dispensing of a controlled substance (or a counterfeit substance) or the possession of a controlled substance (or a counterfeit substance) with intent to manufacture, import, export, distribute, or dispense.

Id. § 4B1.2(b) (emphais added) (defining controlled substance offense). Possession of a controlled substance, alone, is not sufficient; intent to distribute, or some other form of intent to dispense the substance is also necessary. See id.


30. See Baron-Evans et al., supra note 25, at 59 (describing Commission’s acknowledgment that its new definition “reached offenses not traditionally considered crimes of violence”).

31. See Montgomery, supra note 10, at 718 (acknowledging Supreme Court decisions are wide-reaching because of virtually identical language in both statutes). Nevertheless, the ACCA mandates sentencing enhancement when the instant offense is unlawful possession of a firearm by a felon and the defendant has three prior convictions of “violent felonies.” See 18 U.S.C. § 924(e) (2006) (illustrating examples of sentencing enhancement). In contrast, the Sentencing Guidelines imposes sentencing enhancement when an offender has committed a “crime of violence” and has “at least two prior felony convictions of either a crimes of violence or controlled substance offense.” See U.S. SENTENCING GUIDELINES MANUAL § 4B1.1 (2012) (describing requirements for “Career Offender” sentencing enhancement). This distinction, however, does not change the analysis of either residual clause and is therefore outside the scope of this Note. The ACCA defines a violent felony as follows:

(B) the term “violent felony” means any crime punishable by imprisonment for a term exceeding one year, or any act of juvenile delinquency involving the use or carrying of a firearm, knife, or destructive device that would be punishable by imprisonment for such term if committed by an adult, that—

(i) has as an element the use, attempted use, or threatened use of physical force against the person of another; or

(ii) is burglary, arson, or extortion, involves use of explosives, or otherwise involves conduct that presents a serious potential risk of physical injury to another . . .
residual clause and the Sentencing Guidelines residual clause to be interchangeable.32

III. THE SUPREME COURT’S ATTEMPT TO NARROW THE PLAYING FIELD: CONFUSING BUT IMPLICITLY SOUND

Despite the Sentencing Commission’s best efforts to sweep in unconventional crimes of violence to enhance sentencing more frequently, the “Supreme Court stepped in [and] narrowly interpret[ed] the statutory definitions of ‘crime of violence’ and ‘violent felon[ies]’” as amended by the Commission.33 However, the Supreme Court’s interpretation of the residual clause has resulted in a circuit split and incompatible interpretations applied by various district courts.34 When analyzing whether a certain offense falls within the residual clause and constitutes a crime of violence or a violent felony, courts consider: (1) what information is applicable, and (2) whether the crime falls within the residual clause.35

18 U.S.C. § 924(e)(2)(B). The residual provision in the Sentencing Guidelines only differs slightly by using the phrase “burglary of a dwelling” whereas the ACCA refers to general “burglary.” Compare U.S. SENTENCING GUIDELINES MANUAL § 4B1.2(a) (2012) (requiring “burglary of a dwelling”), with 18 U.S.C. § 924(e)(2)(B) (indicating standard “burglary” is sufficient to classify “violent felony”). For the purpose of this Note, however, the distinction is irrelevant.

32. See United States v. Brown, 514 F.3d 256, 268 (2d Cir. 2008) (explaining courts analyzing offenses under ACCA’s residual clause provision are guided by cases interpreting Section 4B1.2(a)’s residual clause and vice versa, due to nearly identical language in both clauses); see also United States v. Wise, 597 F.3d 1141, 1145 (10th Cir. 2010) (“The residual clause of the ACCA is worded almost identically to that of § 4B1.2(a), and we have held that in interpreting ‘crime of violence’ under § 4B1.2, we may look for guidance to cases construing the ACCA’s parallel provision.”), cert. denied, 131 S. Ct. 3020 (2011); United States v. Tyler, 580 F.3d 722, 724 n.3 (8th Cir. 2009) (“Although the Gordon court was analyzing whether an offense constituted a ‘violent felony’ under the Armed Career Criminal Act, we employ the same test to decide whether an offense constitutes a ‘crime of violence’ under the Sentencing Guidelines because the definitions of ‘violent felony’ and ‘crime of violence’ are virtually identical.” (citing United States v. Wilson, 562 F.3d 965, 967–68 (8th Cir. 2009))). Despite the language being virtually identical, some commentators have suggested that “the ACCA’s definition of ‘violent felony’ should be amended to be consistent with the Guidelines definition of ‘crime of violence’” in order to avoid any further inconsistencies or prejudice. See James G. Levine, Note, The Armed Career Criminal Act and the U.S. Sentencing Guidelines: Moving Toward Consistency, 46 HARV. J. ON LEGIS. 537, 567 (2009) (advocating for one completely uniform definition).

33. Baron-Evans et al., supra note 25, at 59 (explaining that Supreme Court attempted to help resolve issue by narrowly interpreting residual clause language in both ACCA and Sentencing Guidelines).

34. See Montgomery, supra note 10, at 719 (suggesting Supreme Court’s interpretation of residual clause is so irreconcilable that Congress should amend ACCA).

A. The Categorical Approach: Established in Taylor and refined in James

In Taylor v. United States, the Supreme Court established that courts may only consider whether the “generic” offense constituted a crime of violence and are restrained from considering the facts in any particular case. When evaluating an offense as a potential crime of violence, courts must use a “categorical approach that relies only on the state statute’s elements and the fact that there was a conviction under that statute.” The court adopted the categorical approach because the “practical difficulties and potential unfairness of a factual approach [were] daunting.” Only in a narrow range of cases, where the state’s statute is broader than the definition of the generic offense, can the specific facts of the defendant’s offense be considered.

Taylor’s categorical approach was slightly modified in James v. United States. The Supreme Court found that attempted burglary constituted a violent felony under the residual clause despite lacking the statutory ele-

37. See id. at 602 (establishing courts must only consider elements of offense and not underlying facts of defendant’s specific crime).
39. Taylor, 495 U.S. at 601 (describing inherent difficulties in speculating whether defendant’s specific conduct constituted crime of violence); see also Isham M. Reavis, Comment, Driving Dangerously: Vehicle Flight and the Armed Career Criminal Act After Sykes v. United States, 87 WASH. L. REV. 281, 330 (2012) (explaining “ACCA levies a harsh penalty to be applied with anything less than the caution demanded by the categorical approach”). Namely, in some cases “only the Government’s actual proof at trial would indicate whether the defendant’s conduct constituted generic burglary.” Taylor, 495 U.S. at 601 (explaining possibility Government would have to present testimony of witnesses again before sentencing court). The court also noted that nothing in the statute indicates that Congress intended sentencing courts to engage in “elaborate fact finding” when considering the defendant’s prior offenses. See id. (stating lack of congressional history and plain meaning of statute supports categorical approach).
40. See Taylor, 495 U.S. at 602 (considering state statute allowing convictions of burglary for entry of automobile and entry of building). If a state statute includes breaking and entering of an automobile sufficient to support a burglary conviction, factual evidence of defendant’s crime can be introduced at sentencing to show whether the statutory requirements for generic burglary were met. See id. (explaining that convictions of burglary under certain state statutes may not rise to conviction of “generic” burglary). Thus, only when a state statute requires the same or narrower elements to support a conviction for burglary can the Government use that conviction to support a sentencing enhancement. See id. (describing situations where government can use conviction under state law to support sentencing enhancement under Career Offender provision of Sentencing Guidelines).
ments of a generic, completed burglary. Although attempted burglary is not a completed crime, a violent felony under the residual clause need only involve conduct that "presents at least as much risk as one of the enumerated offenses." The court reasoned that attempted burglary, in the ordinary case, involves inevitable face-to-face confrontation that presents just as much, if not more, potential risk to others than a completed burglary.

Although James narrowed the statutory element requirement expressed in Taylor, the Court also recognized the danger in a fact-specific analysis and concluded the "proper inquiry is whether the conduct encompassed by the elements of the offense, in the ordinary case, presents a serious potential risk of injury to another." 

B. Narrowing the Lens of the Residual Clause: The Court Rules on DUI Offenses

Larry Begay was convicted of three driving under the influence ("DUI") felonies under New Mexico law, but the Supreme Court refused to categorize his offenses as violent crimes under the residual clause in Begay v. United States. The Court reasoned that the presence of the enumerated offenses (burglary, arson, etc.) indicated the statute was only intended to cover "similar crimes, rather than every crime that "presents a serious potential risk of physical injury to another." The enumerated examples limit the reach of the residual clause because the clause may only cover crimes that are "roughly similar, in kind as well as in degree of risk."
risk posed, to the examples themselves.”

Specifically, the enumerated offenses all “typically involve purposeful, ‘violent,’ and ‘aggressive’ conduct.”

In Begay, the Court recognized that although a defendant who drives while intoxicated poses a significant potential risk of physical injury to others, the offense does not involve the purposeful, violent, and aggressive conduct that is characteristic of the examples enumerated in the statute.

48. Id. at 143 (explaining courts must give effect to every clause and word when interpreting statutes); see also Leocal v. Ashcroft, 543 U.S. 1, 12 (2004) (advocating that every word in statute must be given effect whenever possible); Duncan v. Walker, 533 U.S. 167, 174 (2001) (discussing clauses in statutes must be read together in order to be correctly interpreted). The court also noted the word “otherwise” did not expand the scope of the clause because “otherwise” means offenses may differ in the “way or manner” they produce certain risks. See Begay, 553 U.S. at 144 (quoting Webster’s Third New International Dictionary 1598 (1961)).

49. Begay, 553 U.S. at 144–45 (quoting United States v. Begay, 470 F.3d 964, 980 (10th Cir. 2006) (McConnell, J., dissenting in part) (citations omitted), reversed and remanded, 553 U.S. 137 (2008)); cf. Model Penal Code § 220.1(1) (1985) (describing “arson” as causing fire or explosion “with the purpose of . . . destroying or damaging any property”). The Court also recognizes this purposeful, violent, and aggressive conduct is the type of conduct that makes a perpetrator who later possesses a gun more likely to “use that gun deliberately to harm a victim.” See Begay, 553 U.S. at 145 (explaining such violent, aggressive, purposeful crimes are characteristic offenses of armed career criminal or career offender). But see Holman, supra note 35, at 229–31 (noting “likely shooter” analysis has no contextual roots in statute or legislative history). The “likely shooter” analysis stems from the ACCA’s requirement that the defendant be charged with the instant offense of felon-in-possession of a firearm after being previously convicted of three “violent felonies.” See id. at 229 (asserting analysis was created for sole purpose to avoid unjust results such as finding DUI offenses as violent felonies). The analysis also directly conflicts with the categorical approach announced in Taylor/James. See id. at 230 (explaining likely shooter analysis “casts a wider net” than categorical approach because in considering whether offender would likely commit deliberate, harmful, crime against another, courts are considering defendant’s previous conduct and not solely whether instant offense creates substantial risk of physical injury to another in ordinary case). For a discussion of the categorical approach, see supra notes 36–45 and accompanying text. Although Begay introduces the “likely shooter” analysis in a case interpreting the ACCA, because the offender was in possession of a gun, the analysis can still be helpful when determining whether a defendant committed a crime of violence under the Sentencing Guidelines because the analysis is predominantly based on targeting a certain “type” of violent career offender. See Cynthia R. Cook, Comment, The Armed Career Criminal Act Amendment: A Federal Sentence Enhancement Provision, 12 Geo. Mason U. L. Rev. 99, 114 (1989) (noting ACCA and USSG both target “the individual who has been deemed a threat to society”).

50. Begay, 553 U.S. at 145 (reasoning DUI felonies are more similar to strict liability crimes, rather than those offenses enumerated in statute that involve violent, aggressive, and purposeful behavior). Although a DUI offender may “drink on purpose . . . . [T]he conduct for which the drunk driver is convicted . . . need not be purposeful or deliberate.” Id. at 145; see also United States v. Begay, 470 F.3d 964, 980 (10th Cir. 2006) (explaining even though DUI offenses “undoubtedly entail[] risk of physical injury to others, drunk driving is a crime of negligence or recklessness, rather than violence or aggression”), rev’d and remanded, 553 U.S. 137 (2008). Although a DUI offense reveals “a degree of callousness towards risk,” it
The Court made clear that the offenses may only fall within the scope of the residual clause if the conduct is similar in nature and degree of risk posed to the enumerated offenses in the statute.  

C. Passive Crimes Fall Outside the Residual Clause

The Supreme Court reiterated its _Begay_ analysis a year later in _Chambers v. United States_, and held that failing to report to a penal institution for weekend confinement did not constitute a violent felony under the residual clause of the ACCA. The Court properly recognized that failing to report is a form of inaction and “a far cry” from the conduct “potentially at issue when an offender uses explosives against property, commits arson, burglarizes a dwelling or residence, or engages in certain forms of extortion.” Although the offender who fails to report is doing “something at the relevant time, there is no reason to believe that the something poses a serious potential risk of physical injury.” The Court supported its reasoning by introducing statistics that demonstrated that violence does not typically occur “during [the] commission of the offense itself.”

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51. See _Embrey_, supra note 8, at 480 (noting that “ _Begay_ test requires not only that the offense present a serious potential risk of physical injury to another, but it must also be ‘roughly similar, in kind as well as degree of risk posed’ to the enumerated offenses” (quoting _Begay_, 553 U.S. at 143–45)). The author states “[a] crime is ‘roughly similar’ to an enumerated offense if it ‘typically involve[s] purposive, “violent,” and “aggressive” conduct.’” _Id._ (quoting _Begay_, 553 U.S. at 143–45) (alteration in original) (emphasis added).

52. 555 U.S. 122 (2009).

53. _See id._ at 123–24 (recounting defendant’s sentence required him to report to prison for eleven weekends of incarceration, and he failed to report on four separate occasions).

54. _Id._ at 128 (comparing failing to report to penal institution with use of explosives, burglary, and arson). Without defining the terms “purposive, violent, and aggressive,” the Court recognized that passive, non-active offenses are too disparate from the characteristics of the enumerated offenses exemplified in the statute. _See id._ (same).

55. _Id._ (implying courts cannot assume defendant would inevitably commit future crime during weekend he failed to report). Furthermore, the contrary assumption seems more likely because an individual “who fails to report would seem unlikely, not likely, to call attention to his whereabouts by simultaneously engaging in additional violent and unlawful conduct.” _See id._ (explaining rationale for holding).

56. _See id._ at 129 (citing U.S. SENTENCING COMM’N, REPORT ON FEDERAL ESCAPE OFFENSES IN FISCAL YEARS 2006 AND 2007 6 (2008)) (acknowledging that of 160 failure to report cases, “none at all involved violence” during commission of offense). The Court, for the first time, demonstrated an offense cannot be categorized as a crime of violence or a violent felony if physical injury results in only one
D. Slight Retreat from Begay Causes Confusion for Lower Courts

The Supreme Court’s most recent attempt to provide lower courts with a clear residual clause framework was predominantly unsuccessful in *Sykes v. United States*. The Court held that knowingly and intentionally fleeing law enforcement in a vehicle was a violent felony under the ACCA and required sentencing enhancement. When an offender intentionally defies law enforcement by fleeing in a vehicle, a “lack of concern for the safety of property and persons . . . [is] an inherent part of the offense.” This intentional disregard for the safety of others is fundamentally why vehicle flight presents a serious potential risk of physical injury to others.

In coming to its conclusion, the Court analogized vehicle flight to the crime of burglary, noting that the danger in burglary is that it “can end in confrontation leading to violence.” Unlike burglary, however, vehicle flights occur in the presence and in defiance of police orders, causing a substantial risk of collisions and injuries to persons and property. In support of its conclusion, the Court introduced statistics to illustrate that vehicle flights result in physical injury to innocent third parties twenty percent more often than burglaries, and held that vehicle flight is significant out of every thousand attempts. See id. at 130 (concluding that failure to report for penal confinement is not violent felony); see also Runyon, *supra* note 38, at 458 (asserting Chambers “set the floor for the level of risk that is insufficient to qualify under the residual clause”).

57. 131 S. Ct. 2267 (2011). See Runyon, *supra* note 38, at 465 (explaining *Sykes* missed an opportunity to provide lower courts with workable residual clause framework that could be consistently applied). Justice Scalia, in his dissent in *Sykes*, provided that “[i]nsanity, it has been said, is doing the same thing over and over again, but expecting different results. Four times is enough.” *Sykes*, 131 S. Ct. at 2284 (Scalia, J., dissenting) (explaining Court has failed, yet again, to provide sufficient guidance to interpret ambiguous residual clause).

58. *See Sykes*, 131 S. Ct. at 2270 (noting vehicular flight was defendant’s third violent felony and required sentencing enhancement).

59. Id. at 2273 (explaining defendant creates possibility that police will “exceed or almost match his speed or use force to bring him within their custody”). In the instant case, defendant “wove through traffic, drove on the wrong side of the road and through yards containing bystanders, passed through a fence, and struck the rear of a house. Then he fled on foot. He was found only with the aid of a police dog.” Id. at 2272.

60. See id. at 2273 (acknowledging dangers inherent in vehicle flight have “violent—even lethal—potential for [risk of physical injury to] others”).

61. Id. (explaining that burglary is enumerated statutory violent felony that presents similar risks to innocent third parties). The Court notes the danger in face-to-face confrontation is of a “greater degree” in vehicle flight because it is the “expected result . . . [and] places property and persons at serious risk of injury.” *See id.* at 2273–74 (anticipating almost inevitable necessity for police to “approach with guns drawn to effect arrest” once vehicle chase ceases).

62. See id. at 2274 (implying vehicle flight has higher degree of risk than enumerated offense—burglary).
cantly more risky than the “closest analog among the enumerated offenses.”

The holding in *Sykes* is consistent with past residual clause precedent, but the Court went out of its way to suggest offenses no longer need to be classified as “purposeful, violent, and aggressive” in order to be characterized as a crime of violence. The Court explained that *Begay* involved a strict liability offense—driving under the influence—and the “purposeful, violent, and aggressive” analysis was only meant to explain that result. The *Sykes* Court suggested that the *Begay* analysis was only applicable to strict liability offenses that do not require purposeful conduct.

Thus, the Court attempted to narrow the analysis and focus primarily on whether the offense at bar is “similar in risk” to the enumerated offenses. Despite slightly undermining the *Begay*/*Chambers* rationale, the Court recognized the intentional, active, and destructive nature of vehicular flight and noted that the *Begay* analysis is “an addition to the statutory text” and “[i]n many cases . . . will be redundant . . . .” As Justice Scalia

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63. *Id.* at 2273 (quoting *James v. United States*, 550 U.S. 192, 203 (2007)) (holding vehicular flight was violent felony because it created significantly more risk of physical injury to others than risk presented by similar enumerated offense). See *Runyon*, *supra* note 38, at 459–60 (citing *Sykes*, 131 S. Ct. at 2274) (comparing statistics resulting in physical injury during burglaries with statistics resulting in physical injury during vehicle flights). Of 7,737 police pursuits, 313 injuries to police and bystanders occurred, a rate of more than 4 injuries to non-suspects per 100 pursuits. See *Sykes*, 131 S. Ct. at 2274. Of the average 3.7 million annual burglaries, 118,000 resulted in physical injuries to innocent third parties, or 3.2 injuries for every 100 burglaries each year. See *id*.

64. See *id.* at 2275 (indicating *Begay*’s “purposeful, violent, and aggressive” test should be limited).

65. See *id.* at 2275–76 (“The phrase ‘purposeful, violent, and aggressive’ has no precise textual link to the residual clause.”). For a discussion of why this test/phrase in *Begay* could not have been intended for solely reckless, or non-purposeful crimes, see *infra* note 66 and accompanying text.

66. See *Sykes*, 131 S. Ct. at 2285 (Scalia, J., dissenting) (explaining scope of *Begay*’s purposeful, violent, and aggressive analysis). Although the Court alleges *Begay* was intended solely for non-purposeful offenses, Justice Scalia correctly notes that such an interpretation “makes no sense.” See *id.* at 2285 (reasoning that if *Begay* test was to apply to only unintentional crimes, “it would be recast as the ‘purposeful’ test, since the last two adjectives (‘violent, and aggressive’) would do no work”).

67. *Id.* at 2276 (majority opinion) (emphasis added) (noting that comparing risk level of offense at bar to enumerated offense provides manageable approach when considering intentionally committed offenses). Nevertheless, the Court goes on to state that this approach “suffices to resolve the case before us.” See *id.* (emphasis added) (implying it is not only approach courts may use, and suggesting approach is not dispositive).

68. See *id.* at 2275 (describing nature of felony vehicular flight). The opinion certainly articulated the nature of the conduct at issue, describing felony vehicular flight as “entail[ing] intentional release of a destructive force dangerous to others” and consisting of a “provocative and dangerous act.” See *id.* at 2273–75 (asserting *Begay* test will not be necessary or dispositive analysis in most cases because “crimes that fall within the [Begay] formulation and those that present serious potential risks of physical injury to others tend to be one and the same”). But see *id.* at 2285
added in his dissent, the Begay test “has been neither overlooked nor re-nounced in today’s tutti-frutti opinion.”

The Supreme Court’s slightly inconsistent analyses have created a spectrum that courts must consider when determining whether an offense falls within the residual clause. On the left of the spectrum is the purposeful, violent, and aggressive standard proclaimed in Begay, which also requires the crime to be “similar in kind” to the enumerated offenses. On the right of the spectrum, the only consideration is whether a crime poses substantial risk of physical injury to others and whether the risk posed by the present offense is comparable to the “closest analog” of the enumerated offenses. Chambers successfully balanced these two competing ideologies by considering the comparative nature of the offense as well as the comparative risk to others during its commission. The Court’s decision in Sykes, however, leaned right and emphasized the risk posed by vehicular flight comparatively to the enumerated offenses. Nevertheless, the opinion implicitly considered the comparative nature of the offense, leaving lower courts and scholars inconsistently applying Chambers and Sykes.

(Scalia, J., dissenting) (“That seems to be the case here—though why, and when it will not be the case, are not entirely clear.”).

69. See id. at 2285 (Scalia, J., dissenting) (acknowledging Court failed to clarify impact of Begay analysis going forward).

70. For a discussion of the spectrum that the Supreme Court has created with regard to the residual clause analysis, see infra notes 71–78 and accompanying text.

71. For a discussion of Begay and the Court’s analysis, see supra notes 46–51 and accompanying text.

72. See Sykes, 131 S. Ct. at 2271, 2273, 2275 (“In general, levels of risk divide crimes that qualify from those that do not.”). Not within the spectrum is Justice Thomas’s suggested analysis catalogued in his Begay dissent as well as his Sykes concurrence: “[t]he only question” is whether conduct in an ordinary case “presents a serious potential risk of physical injury to another.” Sykes, 131 S. Ct. at 2278 (Thomas, J., concurring) (quoting 18 U.S.C. § 924(e)(2)(B)(ii) (2006)) (advocating courts should essentially ignore enumerated offenses, and as long as offense presents serious potential risk to another, it should fall within scope of residual clause); see also United States v. Begay, 555 U.S. 137, 156 (2008) (Alito, J., dissenting) (same). This approach is inconsistent with principles of statutory interpretation because had Congress intended that all offenses possessing a risk of injury to others be included they would not have enumerated the offenses of burglary, arson, and use of explosives as guidance; these words would be superfluous. See Begay, 555 U.S. at 142 (acknowledging enumerated offenses were meant to limit reach of residual clause). Justice Thomas’s suggested interpretation is off to the far right of the spectrum and is not further discussed because it does not comply with principles of statutory interpretation and ignores congressional intent. See id. (same).

73. For a discussion of Chambers and the Court’s analysis, see supra notes 52–56 and accompanying text.

74. See Sykes, 131 S. Ct. at 2276 (asserting that if offense is “similar in risk” to enumerated offenses it presents sufficient potential risk to others to classify it as crime of violence).

75. See United States v. Mobley, 687 F.3d 625, 633 (4th Cir. 2012) (Wynn, J., dissenting) (acknowledging that “no [Supreme Court] case overrule[d] a prede-
Lower courts that have chosen to read Sykes broadly have improperly disregarded the enumerated offenses’ primary characteristic—conduct that is aggressive, violent, and intentional. The test outlined in Begay was meant to direct courts to focus on the nature of the offense as well as the degree of risk posed. The Sykes court, however, may have opened the door once again—as it was pre-Begay—to crimes that are “wholly divergent” from the crimes enumerated in the statute.

76. See, e.g., United States v. Perez-Jiminez, 654 F.3d 1136 (10th Cir. 2011) (holding that possession of knife in prison is violent felony under residual clause). Courts such as Perez-Jiminez overlooked the enumerated offenses when attempting to follow Sykes. See Sykes, 131 S. Ct. at 2273 (explaining enumerated offenses “provide guidance” in determining whether offenses present serious potential risk of physical injury to another). The following hypothetical demonstrates the problem inherent in failing to consider the nature of the enumerated offenses:

Imagine that the residual clause requires the ACCA’s sentencing enhancement to be applied to red hippopotamuses because the color red is associated with conduct that poses a substantial risk of physical injury to others. Moreover, this requirement is immediately preceded in the same subsection by a clause listing four blue hippos with red spots, named Bergman, Arnold, Edmund, and Urban. Bergman, Arnold, Edmund, and Urban are blue because the color blue is associated with crimes typically committed by intentional and aggressive conduct toward property. Intentional and aggressive conduct toward property also typically creates a risk of physical injury to others; thus, the four named hippos have red spots.

This hypothetical violent felony provision would read: the “sentencing enhancement shall apply to Bergman, Arnold, Edmund, or Urban, or otherwise to red hippopotamuses.” The Court’s current residual clause analysis focuses on the named hippos’ red spots—symbolizing the risk of physical injury to others—which is their secondary and more unusual characteristic. But, being blue—symbolizing intentionally aggressive acts toward others’ property—is the named hippos’ primary and readily identifiable characteristic. The Court’s use of the secondary characteristic to connect the residual clause to the enumerated felonies frustrates the sensible guidance the enumerated felonies could provide for the residual clause. It would be more reasonable to interpret the statute so that the residual clause only encompasses other blue hippos with red spots, rather than hippos of any color with a splotch or two of red.

77. For a discussion of the Court’s analysis in Begay, see supra notes 46–51 and accompanying text.

78. See Runyon, supra note 38, at 466 (explaining courts, since Sykes, have considered offenses that were properly disposed of in Chambers and Begay). The Eleventh Circuit, in a decision preceding Begay, upheld a lower court’s holding that carrying a concealed weapon was a violent felony. See United States v. Hall, 77 F.3d
IV. THE SENTENCING COMMISSION AMENDS THE COMMENTARY AND OVERLY EXPANDS SCOPE OF RESIDUAL CLAUSE

The Supreme Court has yet to hear a case involving mere possession of a prohibited weapon or a case involving an offender carrying a concealed weapon. As a result, lower courts have struggled to achieve consistency in light of vague congressional drafting and "tutti-frutti" Supreme Court precedent. The closest established precedent seems to be Chambers, which dealt with a passive, non-active, and non-violent offense. Nevertheless, some recent circuit court decisions have relied more heavily on Sykes, ignored Chambers, and limited the scope of Begay beyond the Court's intent due in large part to the Sentencing Commission's confusing directive in its commentary.

On November 1, 2004, the Sentencing Commission amended the commentary of the Sentencing Guidelines to expressly provide that "[u]nlawfully possessing a firearm described in 26 U.S.C. § 5845(a) (e.g., a sawed-off shotgun or sawed-off rifle, silencer, bomb, or machine gun) is a 'crime of violence.' Since the amendment, courts analyzing the statu-

398, 401–02 (11th Cir. 1996) (relying on Begay to reach conclusion that mere possession of concealed weapon was not sufficient to enhance sentencing), abrogated by United States v. Archer, 531 F.3d 1347, 1352 (11th Cir. 2008). Prior to Begay, other dissimilar offenses were categorized as crimes of violence, and now also seem to meet the right-leaning, narrow criteria advocated in Sykes. See, e.g., United States v. Eastin, 445 F.3d 1019, 1021–22 (8th Cir. 2006) (holding incest was residual clause violent felony); United States v. Brown, 273 F.3d 747, 751 (7th Cir. 2001) (finding pandering to be residual clause violent felony).

79. See Mobley, 687 F.3d at 628 (recognizing most relevant Supreme Court decisions as Sykes, Chambers, and Begay). For a complete discussion of relevant Supreme Court case law, see supra notes 36–69 and accompanying text.

80. See Sykes, 131 S. Ct. at 2285 (Scalia, J., dissenting) (explaining lower courts' failure to interpret Supreme Court precedent is ultimately Supreme Court's fault); see also Montgomery, supra note 10, at 736 (advocating Supreme Court should hold statute invalid for vagueness, forcing Congress to amend it in more definite terms); Sykes, 131 S. Ct. at 2284 (Scalia, J., dissenting) (explaining Supreme Court precedent has produced "four[ ] ad hoc judgment[s] that . . . sow further confusion.

81. See Chambers v. United States, 555 U.S. 122 (2009) (holding failure to report to penal institution was "far cry" from purposeful, aggressive, and violent conduct that statute was meant to target). For a full discussion of Chambers, see supra notes 52–56 and accompanying text.

82. For a discussion of lower courts applying Supreme Court precedent to offenses of mere possession, see infra notes 146–51 and accompanying text.

83. See U.S. SENTENCING GUIDELINES MANUAL app. C, amend. 674 (2011) (describing possession offenses that amount to crimes of violence in commentary). Section 5845 of the United States Code subjects specific weapons to regulation or prohibition and defines "firearms" as:

1) [A] shotgun having a barrel or barrels of less than 18 inches in length; (2) a weapon made from a shotgun if such weapon as modified has an overall length of less than 26 inches or a barrel or barrels of less than 18 inches in length; (3) a rifle having a barrel or barrels of less than 16 inches in length; (4) a weapon made from a rifle if such weapon as modified has an overall length of less than 26 inches or a barrel or barrels...
tory language of the Sentencing Guidelines have been bound to classify possession of such firearms as crimes of violence in light of the Supreme Court’s decision in Stinson v. United States.84 Stinson held that the commentary interpreting the Sentencing Guidelines is authoritative “unless it violates the Constitution . . . or is inconsistent with, or a plainly erroneous reading of, that guideline.”85 Although the Guidelines as a whole are only advisory after United States v. Booker,86 they still remain highly influential when determining the sentencing range for a particular conviction.87

Many courts have also relied on the Sentencing Guidelines’ commentary to interpret the language in the ACCA—notwithstanding that the

of less than 16 inches in length; (5) any other weapon, as defined in subsection (e); (6) a machinegun; (7) any silencer (as defined in section 921 of Title 18, United States Code); and (8) a destructive device. The term “firearm” shall not include an antique firearm or any device (other than a machinegun or destructive device) which, although designed as a weapon, the Secretary finds by reason of the date of its manufacture, value, design, and other characteristics is primarily a collector’s item and is not likely to be used as a weapon.

26 U.S.C. § 5845(a) (2006). Nevertheless, the amended commentary only directly applies to the Sentencing Guidelines, not the ACCA because no provision or commentary in the ACCA mandates that certain possession offenses receive enhanced sentencing. See 18 U.S.C. § 924(e)(2)(B) (2006) (illustrating what constitutes “violent felony” in ACCA). As previously discussed, however, the statutory analysis is virtually identical due to the reciprocal language in the statutes. For a discussion of courts treating the analyses as identical, see supra note 32 and accompanying text.

84. 508 U.S. 36 (1993) (holding commentary that defines Guidelines more precisely is “authoritative”).

85. See id. at 38 (directing courts to consider commentary enacted by Sentencing Commission as authoritative unless it is “inconsistent” with statutory interpretation).

86. 543 U.S. 220 (2005) (holding Sentencing Guidelines are advisory, not mandatory, when considering proper sentencing range). A sentencing court is required to “consider [the] Guidelines ranges, but permit[ed] . . . to tailor the sentence in light of other statutory concerns.” Id. at 222 (internal citation omitted).

87. Id. (acknowledging Guidelines remain highly influential); see also United States v. Schwartz, 408 Fed.Appx. 868, 871 (6th Cir. 2010) (explaining that although courts must still apply definitions that are proscribed in Guideline’s commentary under Stinson, this does not mean that sentencing range resulting from that calculation is mandatory). Pre-Booker, courts were bound by the definitions set forth in the commentary and by the range such Guidelines imposed; thus, the commentary essentially had the full force and effect of the Guidelines’ themselves, which allowed the Sentencing Commission the power to “make law without the participation of Congress.” See Ira Bloom, The Aftermath of Mistretta: The Demonstrated Incompatibility of the United States Sentencing Commission and Separation of Powers Principles, 24 AM. J. CRIM. L. 1, 10 (1996) (explaining amended commentary now has same effect as “statutorily prescribed” method after Stinson); see also Joseph W. Luby, Reining in the “Junior Varsity Congress”: A Call for Meaningful Judicial Review of the Federal Sentencing Guidelines, 77 WASH. U. L.Q. 1199, 1204 (1999) (suggesting Sentencing Commission should be subject to greater transparency and judicial review).
commentary is not directly applicable to the ACCA. For example, the Fifth Circuit held that possession of a pipe bomb constituted a crime of violence because by its nature, possessing a pipe bomb creates a substantial risk of physical injury. The court reasoned that there is no lawful or legitimate purpose for possession of a pipe bomb such as use for sport or self-defense. Ultimately, these courts have concluded that the inherent danger associated with the character of the weapon implied that possession would inevitably result in use and violence.

Courts analyzing the ACCA that have opted not to follow the commentary have recognized that mere possession of a "firearm" under Section 5845(a) lacks the overt, violent conduct contemplated by the enumerated offenses. Even when considering the comparative risk of firearm possession with the risk posed by the enumerated offenses (the test emphasized in \textit{Sykes}), "[c]ommon-sense tells us that possession of a dangerous item does not pose the same or similar degree of risk as the use of"

\begin{itemize}
  \item \textbf{88.} See, e.g., \textit{United States v. Lillard}, 685 F.3d 773, 777 (8th Cir. 2012) (explaining possession of short shotgun is "roughly similar to the listed offenses within the ACCA"); \textit{United States v. Vincent}, 575 F.3d 820, 826–27 (8th Cir. 2009) (holding possession of sawed-off shotgun was sufficient to constitute crime of violence because commentary was applicable).
  \item \textbf{89.} See \textit{United States v. Jennings}, 195 F.3d 795, 798 (5th Cir. 1999) (focusing on nature of weapon, not circumstances surrounding possession); cf. \textit{Staples v. United States}, 511 U.S. 600, 611–12 (1994) (explaining that possession of Section 5845(a) "firearms" presents significant risk of physical injury to others because of their "quasi-suspect character").
  \item \textbf{90.} See \textit{Jennings}, 195 F.3d at 798 (explaining that unlike handguns, pipe bombs have no recreational, legitimate uses such as hunting or "engag[ing] in target practice"). The court also recognized that self-defense, a legitimate and lawful purpose for possessing a weapon, would be "quite difficult" and wholly unrealistic with a pipe bomb. See \textit{id.} (explaining possession of pipe bombs have "no peaceful purpose"); cf. \textit{United States v. Drapeau}, 188 F.3d 987, 990 n.4 (8th Cir. 1999) (discussing inherent dangerousness of pipe bomb itself); \textit{United States v. Dempsey}, 957 F.2d 831, 834 (11th Cir. 1992) (recognizing pipe bombs have no legitimate purpose and have potential to "kill indiscriminately, without warning, and with less chance that the perpetrator will be caught").
  \item \textbf{91.} See \textit{Jennings}, 195 F.3d at 799 (reasoning possession of inherently dangerous pipe bomb will "inevitably . . . result in violence"). Courts have suggested that mere possession of these weapons is sufficient to trigger sentencing enhancement under the residual clause because of the weapon’s violent nature, without considering whether the weapon was ever used or intended to be used. See \textit{United States v. Golding}, 332 F.3d 838, 842 (5th Cir. 2003) (holding machine guns are "firearms" as defined in Section 5845, possession of which constitutes crime of violence). The court added that such firearms are "highly dangerous offensive weapons" that are regulated "in the interest of public safety." See \textit{id.} (quoting \textit{United States v. Freed}, 401 U.S. 601, 609 (1971)).
  \item \textbf{92.} See, e.g., \textit{United States v. McGill}, 618 F.3d 1273, 1279 (11th Cir. 2010) (holding possession of short-barreled gun is not violent felony because it is not "similar in kind" to enumerated offenses (quoting \textit{Begay v. United States}, 553 U.S. 137, 143 (2008))); \textit{United States v. Haste}, 292 Fed. App’x 249, 250 (4th Cir. 2008) (per curiam) (holding possession of "weapon of mass destruction" is not violent felony under ACCA).
\end{itemize}
that item."93 Concluding otherwise confuses offenses that may, by their nature, enable violence or the threat of violence with offenses that actually involve violent and aggressive conduct.94 The residual clause was only intended to target the latter, thus, the commentary has been more of a source of confusion rather than one of clarity.95

V. Possession of Prohibited Weapons in Prison: United States v. Mobley

On July 13, 2012, the Fourth Circuit issued a decision declaring that passive possession of a homemade knife in prison constituted a “crime of violence” under the Sentencing Guidelines in United States v. Mobley.96 The court relied heavily on similar federal circuit opinions and analogized the possession of a knife to the possession of a weapon of mass destruction, such as a bomb, machine gun, or explosive.97 Despite the Supreme Court dispelling non-active crimes a “far cry” from the types of offenses the Guidelines intended to cover, Mobley adds to the confusion surrounding residual clause interpretation by considering the circumstances surrounding the weapons possession rather than the nature of the weapon itself.98

A. Facts and Procedural Background

Jermaine Mobley was an inmate at a Federal Correctional Institution near Raleigh, North Carolina, and was serving a 151-month sentence for possession with intent to distribute.99 On September 14, 2009, Mobley sought medical treatment at the prison infirmary, complaining of soreness

93. United States v. Bradford, 766 F. Supp. 2d 903, 910 (E.D. Wis. 2011) (explaining ACCA targets potential risk associated with use of dangerous weapons, not merely possession of them). See McGill, 618 F.3d at 1279 (realizing that targeting possession of weapons is beyond scope of residual clause). Such an interpretation would effectively read the word “use” out of the statute. See id. (implicating each word in statute).

94. See United States v. Vincent, 575 F.3d 820, 830 (8th Cir. 2009) (Gruender, J., dissenting) (concluding that possession of dangerous weapon may enable violence, but offense of possessing prohibited weapon does not involve violent conduct).

95. See James G. Levine, supra note 32, at 545 (acknowledging that Congress’s intent was to keep society safer by targeting those relatively small number of habitual offenders that were “responsible for a large fraction of crimes”).

96. 687 F.3d 625 (4th Cir. 2012). For a discussion of the background and the holding in Mobley, see infra notes 96–107 and accompanying text.

97. For a discussion of the reasoning employed in Mobley, see infra notes 108–12 and accompanying text.

98. For a discussion of the ramifications of the Mobley decision, see infra notes 113–41 and accompanying text.

99. See Mobley, 687 F.3d at 626 (explaining background of prior sentence for possession with intent to distribute heroin).
and numbness in his feet. 100 The physical therapist picked up Mobley’s
right shoe to examine its insole and found a concealed shank inside. 101
Mobley immediately attempted to hide the knife under the examination
table, but the prison staff soon recovered it. 102

Mobley pled guilty to possession of a prohibited object in prison
under Title 18 of the United States Code. 103 Under Title 18, a “prohib-
ited object” is defined as “an object that is designed or intended to be used
as a weapon or to facilitate escape from a prison.” 104 Subsequently,
Mobley was labeled a “Career Offender” under the Sentencing Guidelines
because he had two prior felony convictions for controlled substance of-
fenses, and the district court found that Mobley’s instant offense consti-
tuted a “crime of violence.” 105 Although Mobley objected to this
designation, the district court overruled his objection and found “there is
no passive possession of a weapon in a prison setting.” 106 Mobley ap-
pealed the court’s designation as a “Career Offender” to the Fourth Cir-

100. See id. (describing Mobley’s condition that prompted him to seek medi-
cal treatment).

101. See id. at 626 n.1 (citation omitted) (explaining shanks are homemade
knives made from bits and pieces of metal and sharpened against concrete).

102. See id. at 626 (describing passive nature of Mobley’s possession).
Mobley’s active attempt to hide the knife from the prison guards is evidence that
he was not attempting to use or threaten to use the knife in any respect. See
United States v. Chapple, 942 F.2d 439, 442 (7th Cir. 1991) (explaining defen-

da’s attempt to hide weapon from officers who were approaching indicates that he
“in no way attempted to use the weapon to prevent his arrest”).

103. See Mobley, 687 F.3d at 626 (describing Mobley’s guilty plea); 18 U.S.C.
§ 1791(a)(2) (2006) (detailing offense of inmate in possession of prohibited ob-
ject in prison).

104. 18 U.S.C. § 1791(d)(1)(B) (2006). Nevertheless, the definition of a
“prohibited object” is broad, and also encompasses objects such as controlled sub-
stances, currency, and telephones. See id. § 1791(d)(1) (defining “prohibited
object”).

105. See Mobley, 687 F.3d at 627 (discussing how Mobley’s base level offense
for instant crime rose four levels because court ruled that instant offense was crime
of violence, subjecting Mobley to “Career Offender” sentencing enhancement).
Mobley’s sentencing range would have been an additional twenty-four to thirty-
seven months had the “Career Offender” sentencing enhancement not been ap-
plied; instead, the sentencing range increased to thirty-seven to forty-six months
for his instant offense. See id. (explaining factual background). Under Section
4B1.1 of the Sentencing Guidelines, a convicted defendant is a career offender if:

(1) the defendant was at least eighteen years old at the time the defen-
dant committed the instant offense of conviction;

(2) the instant offense of conviction is a felony that is either a crime of
violence or a controlled substance offense; and

(3) the defendant has at least two prior felony convictions of either a
crime of violence or a controlled substance offense.

U.S. SENTENCING GUIDELINES MANUAL § 4B1.1(a) (2012). For a further discussion
of Section 4B1.1 and the statutory language, see supra notes 28–29 and accompany-
ing text.

106. Mobley, 687 F.3d at 627 (holding possession of homemade knife in prison
was crime of violence).
circuit, asserting that mere possession of a shank in prison does not constitute a crime of violence under the Sentencing Guidelines. 107

B. The Majority’s Reasoning

The Fourth Circuit began its analysis by briefly considering the Supreme Court opinions in Begay and Sykes, and merely citing Chambers without explaining its precedent. 108 Subsequently, the court declined to follow a factually-similar Third Circuit’s case, which held that possession of a knife in prison did not constitute a crime of violence. 109 Relying almost exclusively on decisions in the Fifth, Eighth, and Tenth Circuits, the court found that “‘[t]here is no legitimate purpose’ for possessing a knife in prison, and therefore, such possession is “similar in kind to the offense of possessing a [sawed-off shotgun] outside of prison[,]’” which is recognized as a crime of violence under the commentary of section 4B1.2. 110 The court determined the offense was “similar in kind and degree of risk posed to the enumerated offenses” and consisted of “purposeful, violent, and

107. See id.

108. See id. at 628 (dedicating small paragraph to explaining prior Supreme Court precedent on residual clause analysis). Ultimately, the court briefly explained that Sykes “focused on the question of whether the offense of intentional vehicular flight was comparable in degree of risk to the enumerated offenses.” See id. (citing Sykes v. United States, 131 S. Ct. 2267, 2273 (2011)).

109. See Mobley, 687 F.3d at 629–30 (citing United States v. Polk, 577 F.3d 515, 519 (3d Cir. 2009)) (asserting mere possession does not rise to level of violent and aggressive conduct). Polk recognized that the enumerated offenses all involve “overt, active conduct that results in harm to a person or property” and mere possession of a prohibited object in prison does not. Polk, 577 F.3d at 519. The Mobley court gave little reasoning for why it rejected Polk in favor of “[t]hree other of our sister circuits . . . [that] have addressed the same issue and reached a different conclusion.” Mobley, 687 F.3d at 629–30 (justifying result by relying on other circuit court opinions).

110. Mobley, 687 F.3d at 631 (quoting United States v. Perez-Jiminez, 654 F.3d 1136, 1143 (10th Cir. 2011)) (analogizing possession of weapon in prison with possession of prohibited “firearms” in Section 5845(a) because “both of these crimes prohibit the possession of dangerous weapons in contexts where they have no lawful purpose”). The court relied on three alternative circuit court opinions that concluded possession of a prohibited object in prison constituted a crime of violence. See Perez-Jiminez, 654 F.3d at 1143 (reasoning “confines of prison preclude any recreational uses for a deadly weapon . . . . [and] [t]he only reason to carry such a weapon is to use it to attack another or to deter an attack” (quoting United States v. Romero, 122 F.3d 1334, 1341–43 (10th Cir. 1997)); United States v. Boyce, 635 F.3d 708, 711–12 (8th Cir. 2011) (explaining that possession of weapons in prison is “similar, in kind as well as degree of risk posed” to enumerated offenses and involved “violent and aggressive” conduct); United States v. Marquez, 626 F.3d 214, 222 (5th Cir. 2010) (noting possession of weapons in prison inevitably results in face-to-face confrontation, much like burglary). Nevertheless, the Mobley court admitted that the Tenth Circuit decision in Perez-Jiminez was the only decision that was on “all fours” with the case at issue besides the Third Circuit’s decision in Polk, which was rejected. See Mobley, 687 F.3d at 630 (agreeing with Tenth Circuit’s reasoning).
aggressive’” conduct. Thus, mere possession of a prohibited weapon in prison “present[ed] a serious potential risk of physical injury to another” and was subject to Career Offender sentencing enhancement.

VI. THE RAW END OF THE SHANK

The Mobley court’s determination that passive possession of a homemade knife in prison constituted a crime of violence is difficult to justify. The court’s interpretation of the Sentencing Guidelines’ commentary and misapplication of Supreme Court precedent improperly enhanced Mobley’s sentence beyond the statute’s intent. It is imperative that future courts “hesitate[] to greatly expand the list of offenses . . . to any offense that creates a public risk.”

A. Mobley Misapplied Supreme Court Precedent

The Supreme Court decisions interpreting the residual clause have been difficult for district courts and circuit courts to consistently apply, and Mobley is no exception. Mobley correctly considered the Begay test but incorrectly applied it by reasoning that possession of a knife in a prison constituted a purposeful, violent, and aggressive offense. Mobley failed to recognize that the Supreme Court decision in Chambers had already determined that crimes of inaction are a “far cry” from the purposeful, violent, and aggressive conduct inherent in the enumerated

111. Mobley, 687 F.3d at 630–31 (quoting Begay v. United States, 553 U.S. 137, 145 (2008)) (reasoning possession of weapons in prison “obviously facilitates violence” and therefore, such conduct is similar in kind as well as degree to the enumerated offenses).

112. Mobley, 687 F.3d at 631–32 (quoting U.S. SENTENCING GUIDELINES MANUAL § 4B1.2 (2012)) (concluding possession of homemade knife in prison constituted crime of violence). But see id. at 634 (Wynn, J., dissenting) (agreeing with Polk that there is fundamental difference between active, violent, aggressive conduct exemplified by enumerated offenses and “the passive crime[ ] of mere possession” (alteration in original) (quoting Polk, 577 F.3d at 519)).

113. For a discussion of why the Mobley court’s reasoning is difficult to justify, see infra notes 131–41 and accompanying text.

114. For a discussion of how the court did not correctly apply Supreme Court precedent, see infra notes 115–26 and accompanying text. For a discussion of the court’s misplaced reliance on the commentary to the Sentencing Guidelines, see infra notes 128–41 and accompanying text.


116. For a discussion of the inconsistencies inherent in the Supreme Court’s interpretation of the residual clause, see supra notes 67–78 and accompanying text.

117. Mobley, 687 F.3d at 630–31 (citing Begay v. United States, 553 U.S. 137, 144–45 (2008)) (applying Begay analysis). For a discussion of why the Begay test is still appropriate in light of Sykes, see supra notes 68–69 and accompanying text.
offenses.\textsuperscript{118} Mere possession of a prohibited object cannot be “similar in kind” to the enumerated offenses because it does not involve affirmative, active, and violent behavior—the primary characteristics of the enumerated offenses.\textsuperscript{119} Even if the \textit{Mobley} court analyzed the offense through the narrower \textit{Sykes} approach, possession does not pose a “similar degree of risk” because mere possession of a weapon cannot possibly pose the same risk as the use of that weapon.\textsuperscript{120} The \textit{use} of explosives subjects the offense to sentencing enhancement, and suggesting that possessing explosives or similarly dangerous weapons suffices completely “read[s] the word ‘use’ out of the . . . statute.”\textsuperscript{121}

Moreover, when a penal statute is ambiguous, courts are “obliged to apply the rule of lenity and resolve the conflict in the defendant’s favor.”\textsuperscript{122} The rule of lenity requires “ambiguity concerning the ambit of

\textsuperscript{118} See Chambers v. United States, 555 U.S. 122, 128 (2009) (holding failure to report to penal institution and passive crimes do not constitute crimes of violence); United States v. Polk, 577 F.3d 515, 519 (3d Cir. 2009) (reasoning that although possessing prohibited objects is purposeful, the “‘act of possession does not, without more . . . , involve any aggressive or violent behavior’” (quoting United States v. Archer, 531 F.3d 1347, 1351 (11th Cir. 2008))).

\textsuperscript{119} See, e.g., \textit{Polk}, 577 F.3d at 519 (holding possession of weapon in prison was not similar in kind to enumerated offenses of burglary, arson, extortion, or use of explosives). For a discussion of the enumerated offenses primary characteristic, see \textit{supra} note 76 and accompanying text.

\textsuperscript{120} See \textit{Begay}, 553 U.S. at 142 (articulating that statute covers only “similar crimes, rather than every crime that ‘presents a serious potential risk of physical injury to another’” (quoting 18 U.S.C. § 924(c)(2)(B)(i) (2006))). Dangers inherent in possessing a weapon only comes to fruition when the weapon is used. \textit{See Serafin v. United States, 562 F.3d 1105, 1115 (10th Cir. 2009) (“[T]he use or risk of force is not implicated in [defendant’s] possession of the unregistered rifle, rather it is the risk [the defendant] would commit another crime to obtain or retain possession.”).}

\textsuperscript{121} United States v. McGill, 618 F.3d 1273, 1279 (11th Cir. 2010) (explaining reluctance to classify possession of dangerous weapon offense as violent felony when statute “speaks only to the use of another”); \textit{see also} United States v. Flores, 477 F.3d 431, 436 (9th Cir. 2007) (acknowledging that statute enumerates \textit{use} of dangerous weapons rises to level of violent felony but possession does not). \textit{But see United States v. Lillard, 685 F.3d 773, 777 (8th Cir. 2012) (holding possession of short shotgun presents same type of danger involved in use of explosives).}

\textsuperscript{122} United States v. Munn, 595 F.3d 183, 194 (4th Cir. 2010) (establishing when rule of lenity should be applied); \textit{see also} United States v. Santos, 553 U.S. 507, 515 (2008) (explaining court should not “play the part of a mindreader” and apply rule of lenity in favor of defendants when faced with ambiguous criminal statutory language); \textit{Mobley}, 687 F.3d at 635 (Wynn, J., dissenting) (stressing court’s obligation to apply rule of lenity); United States v. Cutler, 36 F.3d 406, 408 (4th Cir. 1994) (explaining rule of lenity is applicable in the context of Sentencing Guidelines). The rule of lenity is a “necessary safety valve” to protect defendant’s due process rights and was properly revitalized in the Supreme Court’s decision in United States v. Santos. \textit{Note, Rule of Lenity, 122 Harvard L. Rev. 475, 475–76 (2008) (illustrating importance of Santos decision and application of rule of lenity); see also Definition of “Violent Felony”, 121 Harvard L. Rev. 345, 346 (2007) (criticizing Supreme Court’s decision in James because it failed to give enough deference to rule of lenity).}
criminal statutes [to] be resolved in favor of lenity."\footnote{Rewis v. United States, 401 U.S. 808, 812 (1971) (explaining rule of lenity ensures that criminal statutes will provide fair warning before enhancing offenders’ sentences).} At the very least, the Career Offender provision and the residual clause in particular are ambiguous, as demonstrated by the plethora of inconsistencies in their application.\footnote{See Sykes v. United States, 131 S. Ct. 2267, 2284 (2011) (Scalia, J., dissenting) (insisting residual clause is so ambiguous it amounts to “a drafting failure” and Supreme Court should “declare it void for vagueness”); see also Mobley, 687 F.3d at 636 (Wynn, J., dissenting) (explaining due to residual clause’s “ambiguity and the confusion experienced, and created, by the courts, inmates lack sufficient notice that simple possession of a shank constitutes a crime of violence”); Montgomery, supra note 10, at 739 (advocating Congress should amend residual provision due to constant inconsistencies in application). The dissenting opinion in Mobley further acknowledges that “varying judicial interpretation” among the circuits is evidence that the residual clause fails to provide “sufficient notice to the public.” See Mobley, 687 F.3d at 636 (Wynn, J., dissenting) (discussing why rule of lenity must be applied in Mobley).} Mobley failed to address the rule of lenity and ignored the “fundamental principle that no citizen should be held accountable for a violation of a statute whose commands are uncertain.”\footnote{Santos, 555 U.S. at 514 (finding correct application of rule of lenity also “places the weight of inertia upon the party that can best induce Congress to speak more clearly and keeps courts from making criminal law in Congress’s stead”); see Reavis, supra note 39, at 330 (explaining that “ACCA levies too harsh a penalty to be applied with anything less than the caution demanded by the categorical approach”).} The court also made no effort to support its conclusion with the introduction of statistical data, an analytical tool that was recently endorsed by the Supreme Court in \textit{Chambers} and \textit{Sykes}.\footnote{But see Holman, supra note 35, at 251 (arguing that even if statistics are used accurately, “chosen metric for the ‘ordinary case’ shifts from judge to judge”); cf. Jin Woo Oh, Note, United States v. Chambers: Noncustodial Escapes Do Not Always Constitute a Violent Crime for Purposes of the Armed Career Criminal Act, 4 DUKE J. CONST. L. & PUB. POL’Y SIDEBAR 363, 373 (2009) (explaining that it may not be realistic or possible for studies to be done on every offense, and requiring such “might stymie the sentencing enhancement process and hurt the ACCA’s fundamental purpose of getting violent, recidivist criminals off the street”). The result has been a plethora of inconsistent lower court opinions that hinge on arbitrary, statistical lines that vary depending on the presiding judge. See Holman, supra note 35, at 253 (explaining “[g]oalposts move, depending on the court or the judge”). The Seventh Circuit held that “a two percent incidence of violence during the commission of [an offense]” was a “‘sufficient risk of injury’” to trigger sentencing enhancement. Id. at 253–54 (quoting United States v. Templeton, 543 F.3d 378, 381 (7th Cir. 2008)) (explaining even at low frequencies offense still possesses “serious” risk of physical injury to others). Nevertheless, the problem with relying on a statistical analysis is that it does not provide other courts with a workable framework in determining whether an offense is legally violent. See id. at 254 (criticizing Templeton,} By failing to apply the rule of lenity, misinterpreting the Court’s decisions in \textit{Begay}, and ignoring the rationale in \textit{Cham-
bers, the Mobley decision effectively added to the confusion surrounding residual clause case law and unjustly classified Mobley’s offense as a crime of violence.127

B. A Misplaced Reliance on the Commentary: Transforming a Knife into a Machine Gun

The Mobley decision attempted to buttress its reasoning by equating possession of a knife in prison with possession of an inherently dangerous weapon as defined in 26 U.S.C. § 5845(a), which includes sawed-off shotguns, bombs, and machine guns.128 Courts have recognized that these weapons, by their nature, all have the capability of killing indiscriminately and “lack usefulness except for violent and criminal purposes.”129 Use for sport or self-defense could not conceivably be the primary purpose for possessing any of the listed weapons in Section 5845(a); thus, the commentary directs courts to categorize possession of these weapons as crimes of violence.130

and acknowledging that if two percent incidence of violence is sufficient, then “perhaps any likelihood greater than zero will qualify the crime as legally violent”).

Statistics also do not provide offenders with additional notice as to what conduct is violent enough to trigger sentencing enhancement. See id. (explaining lack of uniformity in application of statistics results in inconsistent and arbitrary sentencing enhancement, unbeknownst to offenders). The concurring opinion in Chambers, written by Justice Alito and Justice Thomas, emphasized that the use of statistics was just another way that the Court has led “us further and further away from the statutory text.” See Chambers, 555 U.S. at 134 (Alito, J., concurring) (encouraging Congress to amend ACCA’s residual clause because of constant inconsistencies in application).

127. For a discussion of why the court’s holding unjustly enhanced Mobley’s sentence, see supra notes 128–41 and infra notes 127–40 and accompanying text.

128. See Mobley, 687 F.3d at 631 (asserting that “offense of possessing a shank in prison is similar in kind to the offense of possessing a Section 5845(a) weapon outside of prison”).

129. United States v. Vincent, 575 F.3d 820, 825–26 (8th Cir. 2009) (quoting United States v. Childs, 403 F.3d 970, 971 (8th Cir. 2005)) (describing violent nature of sawed-off shotguns); see also United States v. Jennings, 195 F.3d 795, 798 (5th Cir. 1999) (finding no “non-violent or lawful uses for a pipe bomb”). Courts’ analyses have also suggested that because of the violent nature of weapons described in Section 5845(a), there is a “virtual inevitability that such possession will result in violence.” Id. at 799; see also United States v. Golding, 332 F.3d 838, 843 (5th Cir. 2003) (explaining nature of weapon suggests it lacks lawful or legitimate uses). But see Mobley, 687 F.3d at 634 (Wynn, J., dissenting) (reasoning that even acts that are “categorically unlawful” are not transformed into “dangerous and provocative act[s]” that [themselves] endanger[ ] others” (citing Sykes, 131 S. Ct. at 2273)). The dissent in Mobley further recognized the failure to report for confinement in Chambers “cannot be accomplished in any lawful manner; but the Supreme Court nevertheless declared it to be non-violent.” Id. (citing Chambers, 555 U.S. at 128).

130. See Jennings, 195 F.3d at 798 (recognizing that it would be “quite difficult to protect oneself or one’s family with a pipe bomb”). Weapons categorized as “firearms” under Section 5845(a) are “primarily weapons of war and have no appropriate sporting use or use for personal protection.” Id. at 799 n.4 (citation omitted). But see Baron-Evans, supra note 25, at 62 (recognizing exception to pos-
A makeshift knife constructed from bits and shards, however, could be possessed primarily for self-defense and may be the least violent means of protecting oneself in a prison setting. The constitutional right to self-defense is not “diminished by one’s imprisonment.” Rather, the right should be afforded greater protection considering inmates are stripped of “virtually every means of self-protection[,]” including “access to outside aid.” To assume Mobley’s possession was predatory by nature ignores prison’s “state of nature” atmosphere, where the “strong will exploit the weak, and the weak are dreadfully aware of it.”

Furthermore, the court improperly expanded Begay because the test was only meant to apply to offenses “similar in kind” to the statutory offense of Section 5845(a) firearms if weapon is “a collector’s item”). For a further discussion of the impact of the Sentencing Guideline’s commentary, see supra notes 79–95 and accompanying text.

131. See James E. Robertson, “Fight or F. . . “ and Constitutional Liberty: An Inmate’s Right to Self-Defense When Targeted by Aggressors, 29 IND. L. REV. 339, 339 (1995) (acknowledging “staff cannot or will not protect [inmates] from rape, assault, and other forms of victimization”). Although it is possible to use a sawed-off shotgun or machine gun in self-defense, it undoubtedly would not be the least violent weapon or means to achieve that goal. See United States v. Golding, 332 F.3d 838, 842 (5th Cir. 2003) (explaining machine guns are “highly dangerous offensive weapons” (quoting United States v. Freed, 401 U.S. 601, 609 (1971))). Further, Mobley attempted to hide the shank when the physical therapist discovered it in his shoe, and nothing in the case indicates that Mobley was ever charged with use of the weapon while incarcerated. See Mobley, 687 F.3d at 626–27 (describing Mobley’s passive possession of knife); see also United States v. Chapple, 942 F.2d 439, 442 (7th Cir. 1991) (reasoning that possession of concealed weapon with nothing more did not present “serious potential risk of physical injury to another”).

132. Robertson, supra note 131, at 358 (alleging contemporary “Hobbesian prison” makes self-defense “more worthy of constitutional protection” in prison setting than “the exercise of self-defense in civil society”).

133. Farmer v. Brennan, 511 U.S. 825, 833 (1994) (describing prison guards’ duty to attempt to keep inmates safe). “In the outside world, a person who is verbally or physically harassed can call the police or seek legal assistance to deter the harasser. In prison, there is no one to call. Consequently, there is little choice but to engage in self-help in the settling of disputes.” Matthew Silberman, A WORLD OF VIOLENCE: CORRECTIONS IN AMERICA 75 (1995).

134. Robertson, supra note 131, at 358–59 (quoting Paul W. Keve, PRISON LIFE AND HUMAN WORTH 54 (1974)) (describing prison atmosphere). The weak have little recourse for self-defense or protection because “vulnerable inmates cannot run from predators” and inmates must sometimes arm themselves to avoid victimization. Id. at 361; see also Hudson v. Palmer, 468 U.S. 517, 526 (1984) (asserting that “[i]nmates have necessarily shown a lapse in ability to control and conform their behavior to the legitimate standards of society by the normal impulses of self-restraint”); Gonzales v. Martinez, 403 F.3d 1179, 1186 (10th Cir. 2005) (illustrating that prisons present unique problems because they are “‘necessarily dangerous places [because] they house society’s most . . . violent people in close proximity with one another’” (quoting Farmer, 511 U.S. at 858 (Thomas, J., concurring))).
fenses such as burglary and arson.\textsuperscript{135} It was not meant to apply to offenses that are “similar in kind” to the offenses enumerated by the commentary, among which are possession of a machine gun or a bomb.\textsuperscript{136} Nothing in the commentary suggests that the circumstances surrounding the weapons’ possession are relevant in determining its inclusion.\textsuperscript{137} Rather, the commentary recognized that possession of some weapons, based on their offensive and violent nature, are dangerous enough to constitute a crime of violence, such as the “weapons of war” listed in Section 5845(a).\textsuperscript{138} Not surprisingly, a homemade knife is not among them.\textsuperscript{139} Although possessing a knife in some circumstances outside of prison may create a potential risk of physical injury to others, the existence of such circumstances does not transform a homemade knife into a dangerous weapon capable of mass destruction.\textsuperscript{140} The \textit{Mobley} decision not only improperly assumed that the possession of the shank was not for self-defense purposes, but also

\textsuperscript{135} See \textit{Begay v. United States}, 553 U.S. 137, 143 (2008) (explaining that offenses only fall within residual clause if they are “roughly similar, in kind as well as in degree of risk posed, to the examples themselves”).

\textsuperscript{136} See id. at 142 (explaining that “the provision’s listed examples—burglary, arson, extortion, or crimes involving use of explosives—illustrate the kinds of crimes that fall within the statute’s scope”). The \textit{Mobley} court improperly equated offenses the commentary had ruled were crimes of violence—possession of sawed-off shotguns, machine guns, etc.—with offenses that the statute enumerated as crimes of violence, i.e., burglary, arson, or use of explosives. \textit{See Mobley}, 687 F.3d at 631 (using \textit{Begay}’s “similar in kind” rationale to compare homemade knives to other weapons, such as sawed-off shotguns). Nevertheless, the \textit{Begay} test was only meant to apply to the enumerated, statutorily defined offenses. \textit{See Begay}, 553 U.S. at 143 (explaining that offenses only fall within residual clause if they are “roughly similar, in kind as well in degree of risk posed, to the examples themselves”).

\textsuperscript{137} See U.S. \textit{SENTENCING GUIDELINES MANUAL} § 4B1.2 cmt. 1 (2012) (asserting that possession of any weapon listed under Section 5845(a), i.e., a sawed-off shotgun, machine gun, etc., constitutes crime of violence). For a discussion of why possession of Section 5845(a) weapons constitutes a crime of violence under the commentary, see \textit{supra} notes 89–91 and accompanying text.

\textsuperscript{138} See \textit{United States v. Jennings}, 195 F.3d 795, 799 n.4 (5th Cir. 1999) (discussing Congress’s expansion of scope of National Firearms Act to include weapons such as bazookas, sawed-off shotguns, machine guns, and bombs, which have no lawful purpose and are “weapons of war”).

\textsuperscript{139} For a discussion of the full list of the enumerated weapons that constitute a violent “firearm” under Section 5845(a), see \textit{supra} note 83.

\textsuperscript{140} See \textit{United States v. Serna}, 435 F.3d 1046, 1047 (9th Cir. 2006) (explaining that almost “any object—a car, a golf club, even a pair of nail clipper—can be used to cause physical injury”); \textit{United States v. Chapple}, 942 F.2d 439, 442 (7th Cir. 1991) (explaining that “possession of any weapon—brass knuckles, black jacks, knives [or] chains” increase risk of physical injury to others, but possessing them is not necessarily crime of violence); \textit{State v. McKnight}, 19 P.3d 64, 65 (Idaho Ct. App. 2000) (illustrating offense where defendant beat victim with golf club until he bled profusely). Virtually any object can be used to cause physical injury; thus, courts must determine whether the object, by its nature, presents a “serious potential risk” of physical injury. \textit{See Serna}, 435 F.3d at 1047 (citation omitted) (describing focus of courts). For a discussion of when possessing a knife or a gun outside of prison may pose a serious potential risk of physical injury to others but would still not be considered a crime of violence, see \textit{infra} notes 167–69 and accompanying text.
improperly analogized a shank to a dangerous “firearm” by considering the circumstances surrounding the possession rather than the nature of the weapon itself.141

VII. GETTING BACK ON TRACK: CORRECTLY INTERPRETING SUPREME COURT PRECEDENT AND ACHIEVING LEGISLATIVE INTENT CONSISTENTLY

Courts in all jurisdictions have struggled to find the appropriate scope of the residual clause due to inconsistent commentary, which is incompatible with current Supreme Court precedent.142 The following two solutions suggest ways to create a workable residual clause framework for future courts that encourages consistency.143 The first is to amend the commentary so that it is consistent with current Supreme Court precedent.144 The second solution is to judicially limit the reach of possession offenses to those explicitly enumerated as dangerous firearms in Section 5845(a).145

A. Amending the Commentary to Achieve Consistency with Supreme Court Precedent

Greater consistency in residual clause interpretation can be achieved by amending the commentary to dictate that possession, without more, cannot be classified as a crime of violence that justifies sentencing enhancement.146 Generally, it is well catalogued that possession does not amount to a crime of violence unless it is coupled with an overt act indicating or implying use.147 The Seventh Circuit has recognized that

141. See, e.g., United States v. Golding, 332 F.3d 838, 843 (5th Cir. 2003) (focusing on dangerous nature of machine gun). According to the commentary, dangerous “firearms” under Section 5845(a) constitute a crime of violence, however, Section 5845(a) does not include any type of residual provision suggesting that ordinary weapons may fall into the “firearm” category depending on circumstances surrounding their possession. See 26 U.S.C. § 5845(a) (2006) (explicitly enumerating what weapons qualify as dangerous “firearms”). The analysis in Begay was not meant to broaden the scope of the commentary, but rather to identify which types of offenses the statutes’ residual clause provisions intended to target. See Begay, 553 U.S. at 142–43 (explaining that offenses similar in kind to statutorily defined enumerated offenses are also crimes of violence because residual clause provision exists).

142. For a discussion of why the commentary is inconsistent with the statutory language, see infra notes 146–62 and accompanying text.

143. For a discussion of the first proposed solution, see infra notes 146–62 and accompanying text. For a discussion of the second proposed solution, see infra notes 162–71 and accompanying text.

144. For a full discussion of the first proposed solution, see infra notes 146–62 and accompanying text.

145. For a full discussion of the second proposed solution, see infra notes 163–72 and accompanying text.

146. For a discussion of why mere possession of any weapon should not amount to a crime of violence, see infra notes 147–51 and accompanying text.

147. See United States v. Chapple, 942 F.2d 439, 441 (7th Cir. 1991) (holding that possession of gun in waistband of pants is not crime of violence without overt
despite the obvious dangers of convicted felons possessing firearms, it is quite a stretch to contend that simple possession alone constitutes a crime of violence.”

Several other circuits have applied similar logic, recognizing that burglary, arson, and use of explosives are illustrative examples that involve “affirmative and active conduct that is not inherent in the crime of carrying a concealed weapon.” Moreover, the “statute provides that the use—rather than the possession—of explosives is conduct act of attempting to use gun); United States v. Williams, 892 F.2d 296, 304 (3d Cir. 1989) (holding possession of gun and firing it is crime of violence), superseded by statute on other grounds, U.S. SENTENCING GUIDELINES MANUAL amend. 433 (2003), as recognized in Stinson v. United States, 508 U.S. 36 (1993); United States v. Thompson, 891 F.2d 507, 511 (4th Cir. 1989) (holding possessing gun and pointing it at someone was crime of violence). Simple possession does not “fit easily” within the literal definition of the statute because it lists “specific examples—burglary, arson, extortion, use of explosives—and then adds, ‘or otherwise involves conduct that presents a serious potential risk of physical injury to another.’” See United States v. Doc, 960 F.2d 221, 224 (1st Cir. 1992) (quoting 18 U.S.C. § 924(e)(2)(B)(ii) (2006)) (acknowledging specific statutory language requires active conduct). Although the statute criminalizes possession of a “controlled substance,” sentencing enhancement is not applicable unless the possession is coupled with “intent to manufacture, import, export, distribute, or dispense.” U.S. SENTENCING GUIDELINES MANUAL § 4B1.2 (2012) (describing situations that require sentencing enhancement when defendant possesses controlled substances). For a full definition of a controlled substance offense, see supra note 28.

148. United States v. Alvarez, 914 F.2d 915, 918–19 (7th Cir. 1990) (“There is a wide expanse of possibilities that fall between firing a gun and merely possessing one. Some of these involve a substantial threat of force; others do not.”), superseded by statute on other grounds, U.S. SENTENCING GUIDELINES MANUAL amend. 433 (2003), as recognized in Stinson v. United States 508 U.S. 36 (2011). Thus, the possession of Mobley’s knife outside of prison would not constitute a crime of violence, as it would be analogous to the possession of an unregistered firearm, except less dangerous. See United States v. Whitfield, 907 F.2d 798, 800 (8th Cir. 1990) (explaining that although “carrying an illegal weapon may involve a continuing risk to others, the harm is not so immediate as to ‘present[] a serious potential risk of physical injury to another’”) (alteration in original) (quoting 18 U.S.C. § 924(e)(2) (B)(ii) (2006)). But see Jeffrey C. Bright, Violent Felonies Under the Residual Clause of the Armed Career Criminal Act: Whether Carrying a Concealed Handgun Without a Permit Should Be Considered a Violent Felony, 48 Duq. L. Rev. 601, 636 (2010) (arguing importance of categorizing possession offenses by felons as crimes of violence because carrier is probably “a person with poor judgment”).

149. United States v. Flores, 477 F.3d 431, 436 (6th Cir. 2007) (explaining difference between mere possession offenses and violent, active, characteristics of enumerated offenses); see also United States v. Archer, 531 F.3d 1347, 1352 (11th Cir. 2008) (holding that carrying concealed firearm was not crime of violence). The Archer court relied on the Begay analysis for support. See id. at 1350 (explaining presence of enumerated examples “indicates that the statute covers only similar crimes, rather than every crime that ‘presents a serious potential risk of physical injury to another’”) (quoting Begay v. United States, 553 U.S. 137, 142 (2008))). Had Congress intended mere possession be subject to sentencing enhancement, as well as all other possible crimes that present a serious potential risk of physical injury, it is “hard to see why it would have needed to include the examples at all.” Begay, 553 U.S. at 142 (emphasizing importance of giving meaning to every word in statute). More importantly, to read the statute broadly in order to cover possession offenses “would also bring within the statute’s scope a host of crimes that do not seem to belong there.” See Doe, 960 F.2d at 225 (explaining that “[t]o include
that rises to the level of a violent felony.” Thus, “the risk of force,” in cases dealing with mere possession, “is at least one step removed from the underlying crime.”

The commentary has expanded the scope of the statute beyond its original purpose and it is at odds with several Supreme Court decisions requiring offenses to be similar in kind and degree of risk posed to the enumerated offenses. Only a few courts have reasoned that mere possession of a dangerous weapon and use of that same weapon pose identical risks to others. Doing so assumes inevitability of use, and courts have understandably been reluctant to enhance a defendant’s sentence based on the possibility of future criminal action. The commentary, however, possession, one would have to focus upon the risk of direct future harm that present conduct poses”.

150. Flores, 477 F.3d at 436 (explaining if Congress had intended possession of explosives to be sufficient, they would not have required their use).

151. United States v. Serafin, 562 F.3d 1105, 1115 (10th Cir. 2009) (reasoning use of weapon would result in separate offense that could, potentially, be categorized as crime of violence; however, mere possession of that weapon is not what creates substantial risk of physical injury).

152. See Sykes v. United States, 131 S. Ct. 2267, 2277 (2011) (asserting offense must pose similar degree of risk as enumerated offenses); Begay, 553 U.S. at 143 (explaining enumerated offenses were meant to limit offenses that fall under residual clause because they must be similar to enumerated offenses); see also Levine, supra note 32, at 545 (describing purpose of Career Offender sentencing enhancement was to make society safer by incarcerating repeat offenders for longer periods of time). The dissent in Mobley recognizes, “nothing indicates that prisoners who possess shanks are career offenders engaged in violent crimes, as opposed to, e.g., ordinary inmates in jail on non-violent drug charges with a crude weapon made for self-defense purposes only.” United States v. Mobley, 687 F.3d 625, 635 (4th Cir. 2012) (Wynn, J., dissenting) (explaining disagreement with majority opinion).

153. See, e.g., United States v. Lillard, 685 F.3d 773, 777 (8th Cir. 2012) (reasoning that possession of short shotgun poses same risk as use of explosives). But see United States v. McGill, 618 F.3d 1273, 1279 (11th Cir. 2010) (explaining it would be improper to classify possessing one type of [unlawful] weapon as a violent felony when the ACCA speaks only to the use of another. To do so would read the word ‘use’ out of the ACCA statute”); Serafin, 562 F.3d at 1115 (expressing danger of unlawful possession is “inherent to its use, not merely in its possession”); United States v. Bradford, 766 F. Supp. 2d 903, 910 (E.D. Wis. 2011) (“Common-sense tells us that possession of a dangerous item does not pose the same or similar degree of risk as use of that item.”).

154. See Serafin, 562 F.3d at 1115 (acknowledging that “[i]t can hardly be said” individuals possessing unlawful weapons will inevitably use them against others); United States v. Oliver, 20 F.3d 415, 418 (11th Cir. 1994) (“[The enumerated] offenses each manifest affirmative, overt and active conduct in which the danger posed to others extends beyond the mere possession of a weapon, and is far more threatening in an immediate sense.”); United States v. Alvarez, 914 F.2d 915, 919 (7th Cir. 1990) (“There is a wide expanse of possibilities that fall between firing a gun and merely possessing one.”), superseded by statute on other grounds, U.S. SENTENCING GUIDELINES MANUAL amend. 433 (2003), as recognized in Stinson v. United States 508 U.S. 36 (2011); Bradford, 766 F. Supp. 2d at 908 (suggesting that equating possession with use “confuses the risk of injury that may result from the offense conduct with the violent/aggressive nature of the conduct itself”).
forces courts’ hands when defining the terms enumerated in Guidelines, and has a similar effect in cases analyzing the ACCA because the two analyses have historically been identical.\textsuperscript{155}

Case law interpreting the residual clause was still developing when the commentary was amended to include possession of dangerous firearms in 2004.\textsuperscript{156} Since the adaptation of the commentary, the Supreme Court has dispelled passive, non-active crimes as a “far cry” from the enumerated offenses.\textsuperscript{157} Additionally, the Court has required offenses be “similar in kind” and possess an equivalent degree of risk as the enumerated offenses.\textsuperscript{158} Courts have applied the standard consistently for carrying concealed weapon offenses but have struggled with respect to dangerous “firearms” under Section 5845(a) due in large part to the commentary’s confusing directive.\textsuperscript{159}

Simplifying residual clause case law begins with applying Supreme Court precedent and dispelling the commentary as inconsistent with the Guidelines’ statutory language in light of recent Supreme Court decisions.\textsuperscript{160} The commentary must be amended so that it only subjects a defendant to sentencing enhancement when possession of a weapon is

\textsuperscript{155} See Stinson v. United States, 508 U.S. 36, 38 (1993) (holding commentary interpreting sentencing guidelines “is authoritative unless it violates the Constitution or a federal statute, or is inconsistent with, or a plainly erroneous reading of, that guideline”). For a discussion of the similar authority and analysis of the Sentencing Guidelines and the ACCA, see supra notes 31–32 and accompanying text.

\textsuperscript{156} For a discussion of the evolution of Supreme Court precedent, see supra notes 36–78 and accompanying text.

\textsuperscript{157} See Chambers v. United States, 555 U.S. 122, 128 (2009) (holding defendant’s failure to report to penal institution was too dissimilar to enumerated offenses that all exhibit active and violent characteristics). For a full discussion of the Chambers rationale, see supra notes 52–56 and accompanying text.

\textsuperscript{158} See Sykes v. United States, 131 S. Ct. 2267, 2276 (2011) (emphasizing offense must pose similar or equal risk to closest analog enumerated offense); Begay v. United States, 553 U.S. 137, 143 (2008) (explaining enumerated examples limit crimes that fall within residual clause). For a full discussion of Sykes, see supra notes 57–69 and accompanying text. For a full discussion of Begay, see supra notes 46–51 and accompanying text.

\textsuperscript{159} Compare supra notes 147–51 and accompanying text (discussing courts application of precedent with regards to possession of handguns and carrying concealed weapons), with supra notes 88–95 (discussing courts application of precedent with regard to possessing firearms under Section 5845(a)).

\textsuperscript{160} See Stinson, 508 U.S. at 38 (holding commentary interpreting sentencing guidelines “is authoritative unless it violates the Constitution or a federal statute, or is inconsistent with, or a plainly erroneous reading of, that guideline”). Nevertheless, “commentary that is broader than the guideline it interprets is invalid.” Baron-Evans, supra note 25, at 88 (“If it were otherwise, the Commission could change the meaning of a guideline through commentary, which Congress does not review.”). If the commentary for a sentencing enhancement “does not reflect the seriousness of the offense, promote respect for the law or provide just punishment for the offense” the commentary must not be applied. United States v. Handy, 570 F. Supp. 2d 437, 480 (E.D.N.Y. 2008) (holding two-level strict liability sentencing enhancement invalid). Not only is the commentary inconsistent with recent Supreme Court decisions, it is also inconsistent and incompatible with the concrete language of the statute that was enacted by Congress. See United States v. McGill,
coupled with indicated or implied use of the weapon. Such an amendment would provide stability among the Federal circuit courts, be consistent with Supreme Court precedent, and be analogous to the statutory requirement for a controlled substance offense.

B. Judicial Limitation of the Commentary: Avoiding Further Chaos in Residual Clause Interpretation

If the current commentary remains authoritative when considering what offenses qualify as crimes of violence, it is imperative that courts limit its reach by considering sentencing enhancement for possession offenses only if the weapon is a dangerous firearm enumerated in Section 5845(a). Nothing in the commentary or the Sentencing Guidelines indicates that courts should consider the circumstances surrounding the possession of the weapon and doing so has led to inconsistent results.

618 F.3d 1273, 1278 (11th Cir. 2010) ("Congress included only the use, but not the possession of explosives among the ACCA's example crimes.").

161. See United States v. McNeal, 900 F.2d 119, 123 (7th Cir. 1990) (reasoning offense requires some overt act in addition to possession when defendant is carrying concealed weapon or is felon in possession of firearm in order to constitute crime of violence); United States v. Williams, 892 F.2d 296, 304 (3d Cir. 1989) (holding possession of firearm without firing it is not crime of violence), superseded by statute on other grounds, U.S. SENTENCING GUIDELINES MANUAL amend. 433 (2003), as recognized in Stinson v. United States, 508 U.S. 36 (1993); United States v. Thompson, 891 F.2d 507, 511 (4th Cir. 1989) (holding possession of firearm and pointing it at suspect is crime of violence); see also United States v. Alvarez, 914 F.2d 915, 918 (7th Cir. 1990) (noting that although danger in possession of weapons exists, it is "quite a stretch" to imply that simple possession equates to use or threatened use of that weapon), superseded by statute on other grounds, U.S. SENTENCING GUIDELINES MANUAL amend. 433 (2003), as recognized in Stinson v. United States 508 U.S. 36 (2011). But see United States v. Phillips, 732 F. Supp. 255, 262–63 (D. Mass. 1990) (holding mere possession of firearm is crime of violence).

162. See Chambers, 555 U.S. at 128 (acknowledging non-active and non-aggressive offenses are "a far cry" from enumerated offenses exemplified in statute). Requiring possession offenses to be coupled with a form of intent or intended use would be more consistent with Chambers, consistent with the common law notion that possession alone cannot constitute a crime of violence, and would create a universal framework for analyzing residual clause cases that would achieve greater consistencies among circuit courts. See id. Furthermore, the guidelines treat illegal substance offenses in the same way. See U.S. SENTENCING GUIDELINES MANUAL § 4B1.2 (2012) (defining “controlled substance offense” in pertinent part as “possession of a controlled substance (or a counterfeit substance) with intent to manufacture, import, export, distribute, or dispense”). For a further discussion on how “controlled substance offense” requires an additional overt act accompanying possession, see supra note 28 and accompanying text.

163. For a discussion of the importance of limiting the residual clause commentary, particularly the section designating possession of a Section 5845(a) firearm as a crime of violence, see infra notes 163–72 and accompanying text.

164. See United States v. Perez-Jiminez, 654 F.3d 1136, 1142–43 (10th Cir. 2011) (examining circumstances surrounding possession of weapon in prison is different because they are “inherently dangerous places and they present unique problems”’ (quoting United States v. Vahovick, 160 F.3d 395, 397 (7th Cir. 1998))). But see United States v. Polk, 577 F.3d 515, 520 (3d Cir. 2009) (explaining
The commentary directs courts that possessing certain “firearms” amounts to a crime of violence because the nature of the weapon suggests it could not be possessed for any legitimate or lawful purposes. This reasoning, however, was only meant to justify the result; it does not necessarily follow that possession of a weapon or object that has “no legitimate use” under certain circumstances should be classified as a crime of violence.

For example, courts have categorically held that carrying a concealed weapon is not a crime of violence even though there seems to be no lawful or legitimate purpose for possessing a handgun at a bar. Possession of a firearm in those circumstances could not conceivably be used for recreational purposes and could only be used to attack or deter attacks. Thus, possession of shank in prison presents dangers but that does not, alone, “transform a mere possession offense into one that is similar to the crimes listed”). Courts have properly refrained from considering the circumstances surrounding possession of an unlawful weapon in any other context. See United States v. Vincent, 575 F.3d 820, 826 (8th Cir. 2009) (explaining sawed-off shotguns are capable of inflicting “indiscriminate carnage[,]” regardless of circumstances); United States v. Jennings, 195 F.3d 795, 798–99 (5th Cir. 1999) (discussing inherent dangerous nature of pipe bombs).

See U.S. SENTENCING GUIDELINES MANUAL § 4B1.2 cmt. 1 (2012) (explaining “[u]nlawfully possessing a firearm described in 26 U.S.C. § 5845(a) (e.g., a sawed-off shotgun or sawed-off rifle, silencer, bomb, or machine gun) is a ‘crime of violence’”). Courts applying the commentary’s directive have further reasoned that Section 5845(a) firearms are inherently dangerous weapons that have no legitimate or lawful use under any circumstances. See, e.g., United States v. Golding, 332 F.3d 838, 842 (5th Cir. 2003) (explaining that weapons such as bombs, machine guns, short-barreled shotguns and rifles “are primarily weapons of war and have no appropriate sporting use or use for personal protection” (quoting Jennings, 195 F.3d at 799 n.4)).

See Polk, 577 F.3d at 520 (reasoning that circumstances surrounding possession do not “transform” possession offense into violent, active, and aggressive crime exemplified in statute). The circumstances surrounding the possession offense also do not transform the object possessed into an inherently dangerous “weapon [of war].” See Golding, 332 F.3d at 842 (quoting Jennings, 195 F.3d at 799 n.4) (describing firearms under Section 5845(a)); see also United States v. Mobley, 687 F.3d 625, 635 (4th Cir. 2012) (Wynn, J., dissenting) (noting shanks are not included under Section 5845(a), but are also “entirely dissimilar to the weapons that are included”).

See, e.g., United States v. Flores, 477 F.3d 431, 435 (6th Cir. 2007) (holding that carrying concealed weapon does not amount to crime of violence under residual clause); see also Stinson v. United States, 508 U.S. 36, 47 (1993) (holding that amended commentary stating that unlawful possession of firearm by felon is not crime of violence was binding on courts interpreting residual clause). Despite the seemingly consistent understanding that mere possession of a standard weapon or object is not an offense that rises to the level of a crime of violence, the reasoning in Mobley clouds that principle because there are some circumstances where possession would be “quasi-suspect” and have no “legitimate purpose.” See Clayton E. Cramer, Violence Policy Center’s Concealed Carry Killers: Less Than It Appears 19 (June 28, 2012), available at http://ssrn.com/abstract=2095754 (explaining that carrying concealed handgun at bar while intoxicated is already criminal offense under North Carolina law).

See Mobley, 687 F.3d at 631 (reasoning that possessing prohibited object in prison has no lawful use because “the only reason to carry such a weapon [while in prison] is to use it to attack another or to deter an attack” (quoting Perez- jiminez,
following the reasoning in *Mobley* may lead courts to consider enhancing simple possession offenses outside of prison if the weapon had no legitimate purpose at the time it was being possessed.169

Extending the reach of the residual clause by considering the specific circumstances surrounding possession not only strains the categorical approach established in *Taylor*, but also opens the flood gates to include possession offenses involving ordinary weapons or objects as crimes of violence.170 *Mobley* expands the residual clause beyond statutory intent and Supreme Court precedent, thereby creating further inconsistencies and confusion.171 The likelihood of achieving consistent residual clause interpretations hinges on the willingness of courts to limit the reach of the commentary when considering possession offenses to those weapons explicitly enumerated as dangerous firearms, or better yet, to hold that the commentary is inconsistent with the statute in light of recent Supreme Court precedent, the rule of lenity, and appropriate statutory interpretation.172

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654 F.3d at 1143)). Even if this were the case, prisoners still retain their constitutional right to self-defense. For a discussion of prisoners’ right to self-defense, see *supra* notes 131–34 and accompanying text.

169. See *Mobley*, 687 F.3d at 634 (Wynn, J., dissenting) (“The mere fact that an act is categorically unlawful does not necessarily render it a ‘dangerous and provocative act’ that . . . endangers others.” (quoting *Sykes* v. United States, 131 S. Ct. 2267, 2273 (2011))). For example, “failure to report to one’s penal confinement cannot be accomplished in any lawful manner; but the Supreme Court nevertheless declared it to be non-violent.” *Id.* Implementing *Mobley’s* reasoning would distort consistent case law where possession of the weapon served no legitimate or lawful purpose at the time it was possessed. For a further discussion of how *Mobley’s* reasoning contradicts case law, see *supra* notes 116–27, 165–69 and accompanying text.

170. See *Taylor v. United States*, 495 U.S. 575, 602 (1990) (directing courts to consider risk posed by ordinary commission of offense and not to consider circumstances surrounding offense). For a full discussion of the categorical approach announced in *Taylor*, see *supra* notes 36–45 and accompanying text.

171. See *Chambers*, 555 U.S. at 128 (holding passive, inactive, offenses do not pose similar risks to others and are not classified as crimes of violence); Jenny W.L. Osborne, Note, *One Day Criminal Careers: The Armed Career Criminal Act’s Different Occasions Provision*, 44 J. MARSHALL L. REV. 963, 973 (2011) (suggesting that applying sentencing enhancement for mere possession of firearms “strays from the original idea of targeting offenders who repeatedly use firearms during the commission of a robbery or burglary” (emphasis added)).

172. For a discussion of why the commentary is inconsistent with the principles of statutory interpretation and Supreme Court precedent, see *supra* notes 156–62 and accompanying text. Courts facing the challenge of applying the residual clause to possession offenses in the future should apply the rule of lenity, due to the prior inconsistent interpretations and vague congressional drafting. For a further discussion of why courts should apply the rule of lenity, see *supra* notes 122–25 and accompanying text. For a discussion of why it is imperative that courts disregard the circumstances surrounding the possession of the weapon, as the court failed to do in *Mobley*, see *supra* notes 167–71 and accompanying text.
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