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The Background of Modern American Business Law

William J. Carney
Charles Howard Candler Professor of Law Emeritus
Emory University

Introduction

This is an attempt to explain how common-law jurisdictions developed the distinctive notions of equity that are largely absent from civil law and to outline the major differences in business entity law in the U.S. compared to civil codes. Oddly, the origins of equity lay in “uses,” that evolved into the trust, that came from Saxon and Norman concepts, but later disappeared from civil law. The use originated as a tax planning device, designed to avoid the tax imposed by kings who required payment for “livery of seisin,” upon transfer of a deceased noble’s estate and title, by vesting title in perpetuity in trustees for the use and benefit of heirs. It also served as a device for caretaking of estates when owners went off to the crusades.

Because legal ownership left the hands of the grantor, so did the power to monitor and sanction deviations from the instructions in the indenture. Kings designated Chancellors to handle petitions for righting wrongs not covered by the common law forms, who evolved into the Court of Chancery, with its unique notions of duties such as care and loyalty, and its unique and flexible remedies where damages were inadequate.

The jurisdiction of the Chancery Court, the origin of the recognition of trusts, gradually expanded into a more general jurisdiction over common law subjects, and at some point the concept of a “quasi trustee” developed to regulate the behavior of directors and agents. As law and equity merged the concepts were fully incorporated in Anglo-American law.

The final mystery is how concepts of use and the Saxon “Salman,” a concept related to the Roman trusts, failed to develop on the continent in the same way, and notions of fiduciary duties disappeared. My speculation at this time is that civil codes were thought to occupy the law-making field, in the absence of a tradition of judicial law-making in the common law courts.

A brief review of the basic difference between continental and American approaches to corporate flexibility is included, noting that the problems of prescriptive “one size fits all” rules were solved by contracting for deviations that were tolerated by the courts.

\footnote{I thank the participants at the Emory - University of Georgia summer workshop for their helpful comments.}
Other types of entities are described primarily for the purpose of illustrating how their origins and character differ from civilian counterparts with similar names.

The final section describes the basics of U.S. securities regulation, and will not offer much of interest to American scholars or lawyers.

I. Equity: The Special Feature of Common Law Systems

One of the unique features of the development of a legal system in England was its division between law and equity. In the fourteenth century there developed separate systems of justice in England.¹ The first and older one involved royal courts. The first of them, the Common Bench, had exclusive jurisdiction on all actions that existed before 1215, the date of the Magna Carta, the great treaty between the King and the nobles that limited the King’s arbitrary power. This was the home of most of the common law actions, which were narrowly drawn, and had to be strictly complied with in order to plead a case. The second, the Coram Rege, heard mostly criminal cases, while the third, the Court of the Exchequer, heard mostly tax cases. Until the middle of the fourteenth century, there were no actions for civil harms to individuals. The old writ of trespass only covered acts that breached the King’s peace by force and arms. By the middle of this century, the writ was basically expanded into “trespass on the case,” to cover special cases for court relief, and included what we would call a tort, or negligence. Eventually this led to actions for breach of contract, called assumpsit at the time. One writer believes the related action for an accounting was the source of the duties we now call fiduciary duties, although other accounts, described below, reach different conclusions.²

The common law writs did not cover all possible complaints.³ The common law was a primitive legal system, with strict pleading requirements – as was early Roman law.⁴ As a result, there were many grievances for which there was no legal remedy. Roman law developed the concept of Aequitas, which gave judges known as Praetors discretion to do justice when no legal authority provided assistance.⁵ English citizens with grievances could petition the King for relief. By the late 14th century plaintiffs were seeking relief from the Chancellor, the King’s chief highest ranking officer, in lieu of direct petitions to

¹ Much of this is drawn from Charles Donohue, Jr., What Happened in the English Legal System in the Fourteenth Century and Why Would Anyone Want to Know?, 63 SO. METHODIST L. REV. 949 (2010).
⁵ Id. at §4.
the King. The Chancellor appointed justices to carry out this work, who constituted the Chancery Court. Most of these justices were clerics as well as trained in the law. They were also generally familiar with Roman law and its principles of equity. This led to the establishment of a court of Chancery under his supervision. It represented the “King’s conscience,” and it was said (recalling the divine right of kings) that the King could do no wrong. The Chancery had jurisdiction over all matters of equity, including trusts, land law, the administration of the estates of lunatics and the guardianship of infants, as well as other wrongs for which there was no adequate remedy at common law. Thus the Court of Chancery had a far greater power than the common law courts, whose decisions it had the jurisdiction to overrule for much of its existence, and was far more flexible.

A. The Development of the Trust

The most important legal concept that developed in the fourteenth century was the concept of a “use,” which we now call a “trust.” Its origins are difficult to trace, with some referring to Roman notions of the *fidelicommissio* (the functional equivalent of the modern trust), and related concepts of *fiducia* and *commendatio.* Others attribute it to a Germanic idea, the *Salman,* which Germanic tribes apparently inherited from the Romans and brought to Britain through conquest in the early middle ages. The Roman church also was thought to play a role, through the development of ecclesiastical ideas about how church property was owned, and what duties such ownership entailed. The concept of *utilitas ecclesiae* was used for the concept of ownership of church property by a bishop or an abbot, who had no beneficial rights, where property passed automatically to a successor upon the death of the cleric, which evolved into the Gallic “*al os*” and “*uses*” at the time of William the Conqueror in the 11th century. The idea of a use in secular law may have originated during the Crusades of the 12th century, when noblemen traveled abroad to fight in the Holy Land. As they would be away for years at a time it was vital that somebody could look after their land with the authority of the original owner. What we now call a deed or indenture was then called a “feoffment,” and it was used to convey title to land to one person for the benefit of another. The common law of England did not provide for a way to dispose of land held by feudal tenure through wills, and instead *uses* were applied, which allowed a landowner to give his land to one or more feoffees for the use of the grantor, to dispose of it or treat it as the original

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10 Id. at 228-29.
The common law courts were hostile to this concept and would not recognize the use. Disputes arose over the transferee’s performance (he was then called the “feoffee”) and were the subject of petitions to the Chancery. Once the concept of a separation of legal ownership from the benefits of property was established in trusts and administration of estates, it was clear that the beneficial owners had no legal power to control the conduct of the feoffee or trustee, but needed the aid of the courts. And so the Chancery Court became active in the supervision of the good behavior of feoffees, trustees, and administrators.

Because the common law courts did not recognize trusts, it fell to equity and to the Court of Chancery to deal with them, as befitting the common principle that the Chancery's jurisdiction was for matters where the common law courts could neither enforce a right nor administer it. The Chancery Court would enforce the duties of the feoffees, or trustees, as the grantor had intended. The use of trusts and uses became common during the 16th century. Indeed, it was used to evade royal taxation, by appointing a self-perpetuating committee of trustees to hold property as directed, until the middle of the 16th century, when the statute of uses banned this use. The trust, with more active management, replaced this form. The Chancery Court's sole jurisdiction over trusts lasted until its dissolution in 1873 through merger with the law courts. Thereafter the English courts were unified, and had the full powers of both the law courts and the Chancery Court.

The United States inherited this system with independence in 1776. To this day, there are separate Chancery Courts in some states, which are courts of equity in the English tradition. The most notable is the Delaware Chancery Court, but similar courts exist in a number of other states. Delaware’s is the most notable because of its jurisdiction over corporate disputes, and Delaware’s dominance of incorporation of large publicly-traded corporations in the United States. Most states have merged their law and equity courts

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11 The use frustrated the King’s ability to collect taxes on death, through “livery of seisin” granting title to the deceased’s heirs. King Henry VIII, in dire need of more revenues, got Parliament to ban perpetual uses in the Statute of Uses in 1536. 27 Hen 8 c 10.


14 “Inheritance” is not entirely accurate. Most states simply adopted the common law of England, including adopting the English system of a court of equity and the concept of a trust. Bogert, supra note 3 §6, at 30-31.

15 Mississippi, New Jersey and Tennessee also retain separate chancery courts, while Cook County, Illinois has a Chancery Division in its Circuit Court. http://www.bing.com/search?q=State+Chancery+Court&form=MSNH14&pc=U146D&refig=a05b549451204142874e5d335963d06d&pq=state+chancery+court&sc=0-13&sp=-1&qs=n&sk= (last visited Dec. 31, 2013).
into a single system, and the United States merged its federal law and equity systems in 1938. In contrast with the early law courts, which were bound by strict forms of action, the Chancellors were bound by no law, but only by the demands of justice as they saw it.\footnote{16}

**B. Expansion of Equitable Jurisdiction**

From its foundation, the Court of Chancery could administer estates, due to its jurisdiction over trusts. Here it supervised decedents’ personal representatives in the administration, and notions of specific duties of these agents developed - what we now call fiduciary duties. But it developed concurrent jurisdiction with the law courts, especially where legal remedies were inadequate.\footnote{17} Because partnerships and their extensions, joint stock companies, were not recognized as entities at common law, but as aggregations of individuals, common law courts did not take jurisdiction over claims within the partnership or company. “The appearance of a plaintiff on both sides of the record forced the common law courts to say that the action was impossible, because no man could be both plaintiff and defendant.”\footnote{18} Over time the Chancery Court expanded its jurisdiction, and developed - probably from administering estates, the notion of an “accounting.” One writer describes the action as extended “to all cases where the taking of accounts was necessary to determine mutual rights and obligations.”\footnote{19} At some time this action was extended to any agent, who was “bound to keep a regular account of his transactions, and always to be ready therewith, and that he ought to be willing faithfully, diligently, and accurately to account, without suppression, concealment, or overcharge, when called upon to do so.”\footnote{20} One early nineteenth century case involved the purchase by an auctioneer of property he was obligated to sell at auction. His purchase was challenged, and the Court of Exchequer set aside the sale, based on the “well-known and established rule of equity that persons who are in any way invested with a trust or an employment to be performed by them to the advantage of their cestui que trust or principal are, prima facie, virtually disqualified from placing themselves in a situation incompatible

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\footnote{16} “Equity is a roguish thing. For Law we have a measure, know what to trust to; Equity is according to the conscience of him that is Chancellor, and as that is larger or narrower, so is Equity. ’T is all one as if they should make the standard for the measure we call a ”foot“ a Chancellor’s foot; what an uncertain measure would this be! One Chancellor has a long foot, another a short foot, a third an indifferent foot. ’T is the same thing in the Chancellor’s conscience.” John Selden, TABLE TALK, 43 (Pollock ed., 1927)

\footnote{17} Pomeroy, supra note 3 at §§ 173-189, 216-22.


\footnote{19} D. M. Kerly, AN HISTORICAL SKETCH OF THE EQUITABLE JURISDICTION OF THE COURT OF CHANCERY, 148 (1890).

with the honest discharge of their duty.” While no authority is cited, the opinion assures the reader that there are “very many authorities” in support of this doctrine. One suspects that lawyers with experience in the Chancery Court assumed that other relationships of trust, albeit not involving a formal conveyance, would be subject to the same doctrine.

C. The Development of the Derivative Action

The derivative action addresses the problem of who can address wrongs to a corporation when its affairs are controlled by those accused of wrongdoing – the directors. With respect to royally chartered corporations, the sovereign initially reserved the right of visitation (inspection) of these entities, while ecclesiastical and charitable corporations were subject to visitation by the bishop or the founder. By the 16th century, the Charitable Gifts Act provided the Chancellor with a mandate to inquire into corporate affairs on the complaint of an aggrieved party. One case reasoned that if the King could visit his creations and enforce against wrongdoing, then by implication so could founders of private charities or someone nominated by the founder. This was followed by a holding extending the right of action to members of corporations. Here the justification given was the absence of an adequate remedy at law. The next step was the creation of a right of action on behalf of themselves and all other shareholders – the derivative action – designed to protect the entire corporation, rather than individual shareholders.

While these developments occurred in England, similar developments were occurring in the United States. The first such case appears to be Robinson v. Smith, where shareholders of a joint stock company sued the directors for diverting corporate funds to unauthorized uses, which caused the company a great loss. In finding that the stockholders could bring such a suit alleging injury to the company, Chancellor Walworth, relying on English authorities, stating the reason for his ruling as follows:

... since the introduction of joint-stock corporations, which are mere partnerships, except in form, the principles which were formerly applied to charitable corporations in England may be very appropriately extended to such companies here. The directors are the trustees or managing partners, and the stockholders are the cestuis que trust, and have a joint interest in all the property


22 This account is taken generally from Lynden Grigg, The Statutory Derivative Act: Lessons that May be Learnt from its Past, 6 U. W. Sydney L. Rev. 63, 68-69 (2002).

23 43 Eliz. 1, c. 4.


26 Grigg, supra note , at 690-71.
and effects of the corporation. See Wood, Inst. bk. 1, chap. 8, p. 110; 11 Co. 98, b. And no injury the stockholders may sustain by a fraudulent breach of trust can, upon the general principles of equity, be suffered to pass without a remedy.27

D. Concurrent Jurisdiction and Remedies.

How fiduciary duties moved from the concepts of trusts to other legal relationships in the law courts is a neglected subject.28 One author notes that over time chancellors were appointed more from the common law bar than from the clergy, which led to more systematization of the ad hoc concepts of justice employed by earlier chancellors.29 After the Bubble Act of 1720 prohibited trading in the shares of joint stock companies in England, corporate attributes of a separate legal personality, such as the power to convey business property without the consent of all investors (partners) in the company were achieved to a large extent by the creation of trusts to hold the business property, with the directors as trustees.30 The use of the trust form implied the same fiduciary duties that Chancery was accustomed to applying to trustees in other contexts, and may explain the continuing application of these duties to directors of other corporations. Eventually the Chancery assumed jurisdiction over many common law causes of action, with its reliance on general principles of justice and its more flexible remedies.31 Pomeroy characterizes directors as quasi-trustees, because of the power and responsibilities placed on them.32 He also reports that the common law courts rejected the ancient principles of Roman law, thus leaving Chancery to develop principles of equity and justice for all of English law.33

According to Finn, the fiduciary duty concept reached the law reports in the mid-19th century.34 I was surprised to learn during my research that some authorities claim the concept of fiduciary duties of agents developed not in the Court of Chancery, but in the common law courts.35 Pomeroy describes suits against directors and officers of

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27 3 Paige Ch. 222, 1832 N.Y. LEXIS 72, *20 (1832).
31 Pomeroy, supra note 4 at §§ 32-38; Grigg, supra note 22 at 69-71.
32 Pomeroy, supra note 4, at §1089.
33 Pomeroy, supra note 4, at § 38.
34 Finn, supra note 28.
35 Oliver v. Court, supra note 21 was decided in the Court of Exchequer, not the Chancery. Mark Fortier, THE CULTURE OF EQUITY IN EARLY MODERN ENGLAND, 71-73 (2005). Fortier cites Edward Hake,
corporations as within the jurisdiction of courts of equity as well. Pomeroy also
describes directors and managers as being “quasi trustees” who are subject to fiduciary
duties. In some cases, involving joint stock companies, they were actual trustees. To
avoid the procedural difficulties of having to join all partners or members in any
litigation, these organizations often used the trust to hold the company’s assets to avoid
procedural difficulties. The fiduciary duties developed in exactly the same manner as
they did for trustees and administrators of estates, which I surmise happened either
because notions of fiduciary duties had become customary law, or because of the
jurisdictional competition between Chancery and the common law courts. They were
applied to relationships which involved trust, but did not meet the formal requirements
of a trust - a deed or indenture. There are three elements to these fiduciary duties: “(1)
entrustment of property or power, (2) entrustors’ trust of grantees, and (3) risk to the
entrustors emanating from the entrustment.” The common law courts followed with
similar rules for other fiduciaries, such as directors of corporations recognized as
chartered by the King. The Delaware Chancery Court plays an active role in supervising

Eplekeia: A Dialogue on Equity in Three Parts (1953) for the proposition that equity arises in
common law from the flexibility of judges to exercise reasonable discretion in applying laws.
36 IV Pomeroy, supra note 4, §1089; V Pomeroy, supra note 4, §1411.
37 I Pomeroy, supra note 4, §157.
38 Turner, supra note 18, at 9.
39 Fortier argues that the concept of equity permeated English culture in the 17th century. Fortier, supra
note 35 at 2.
40 Finn, supra note 28 at 1.
42 See Victor Morawetz, Morawetz on Corporations, 2d ed. §516 (1886), citing, inter alia, Hoyle v.
Plattsburgh &c R. R. Co., 54 N.Y. 314, 328 (1873) where Judge Johnson wrote:
Whether a director of a corporation is to be called a trustee or not, in a strict sense, there can be
no doubt that his character is fiduciary, being intrusted by others with powers which are to be
exercised for the common and general interests of the corporation, and not for his own private
interests. He falls, therefore, within the great rule by which equity requires that confidence shall
not be abused by the party in whom it is reposed, and which it enforces by imposing a disability,
either partial or complete, upon the party intrusted to deal, on his own behalf, in respect to any
matter involved in such confidence.

It is revealing that none of the cases cited involved corporate directors. Two of the cases were in the High
Court of Chancery, and only one in the law courts. Ex parte Lacey, 31 Eng. Rep. 1228, 6 Vesey 625 (1802),
involves the purchase of a bankrupt’s property by the trustees in bankruptcy. Gibson v. Jeyes, 31 Eng.
Rep. 1044, 6 Vesey 266 (1801), involved an attorney with a power of attorney to sell a client’s securities
purchasing for himself. (“Every principle applying to trustees applies equally to attorneys.”) Greenlaw v.
King, 49 Eng. Rep. 19, 3 Beavens 47 (Rolls Court, 1840), involves a loan by a bishop charged by statute
with supervising the financing of a parish rectory furnishing money to the rector in exchange for an
annuity. In setting aside the transaction, the Master of the Rolls stated:
“The simple question, however, ... is, whether such a transaction as this is can, consistently with the rules of
law, be allowed to stand. I am of opinion that it cannot, because it is a clear violation of those rules which
have been established for the defense of those whose interests and property have been committed to the
protection of persons placed in a fiduciary situation. . . .” 3 Beavens at 62. (Emphasis added.)

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the internal affairs of corporations incorporated there. This court, in response to management’s defense that it had acted in a manner authorized by the statute, stated that “[t]he answer to that contention, of course, is that inequitable action does not become permissible simply because it is legally possible.”

This broad charge to courts of equity left chancellors free to ignore laws where to enforce them would lead to fraud or injustice. When law and equity merged, this concept was available to all judges. It led to activist judges, who felt free to do justice regardless of law. I have criticized the Delaware courts for their aggressive use of this power. Civil codes in Europe eradicated the concepts of trust, or holding for the benefit of another, that influenced English law - the German *Salman*, and the French *nese*. Because the civil codes were both rule-based and presumably exclusive and comprehensive, the concepts of trust and fiduciary obligations did not exist in the absence of a statute. Consequently, civil law judges felt constrained by specific rules, and not at liberty to “do justice” in the same manner.

II. The Historic Role of the Sovereign in Corporate Chartering

A. Treatment of Entity Status as Privilege

We turn from the dominant mode of judicial review of the actions of actors in trusts and business enterprises, which even governs relatively new U.S. forms such as the Limited Liability Company, to the evolving role of the sovereign in England and the United States.

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45 Carney & Shepherd, supra note 37.


47 There is one (minor?) qualification. Many civil codes state the principle of equity and good faith. David Schmid, (Do) We Need a European Civil Code (?), 18 Ann. Surv. Int’l & Comp. L. 263, 280-81 (2012) citing the German Civil Code, but arguing that implementation of such open and general language will vary widely from nation to nation, depending on cultural habits and values. This appears to be the only survival of the concept of Aequitas from Roman law. I Pomeroy, supra note 4, §2.

Much of English commerce was accomplished through the joint stock company, which was not an incorporated entity, but essentially a partnership structured by contract in a corporate form of management and control. This meant personal liability for shareholders.\textsuperscript{49} One particular problem was that the law did not recognize these companies as separate legal entities. They could not sue and be sued in their own names. All partners were indispensable parties to suits on behalf of partnership. It was generally necessary, in suits on a contract, for plaintiffs to join all partners, since liability was joint, not joint and several.

“Corporation” had a somewhat different meaning in 16\textsuperscript{th} and 17\textsuperscript{th} century England. There were municipal corporations such as the city of London, charitable and educational corporations (Oxford University, etc.), corporations sole (bishops in their office, who held title to church property by virtue of their office) and finally, trading corporations (or so-called private corporations). Note the mixed uses of the corporation - public, private, religious, and charitable.\textsuperscript{50}

The unique feature of the corporation was that the law recognized it as a separate legal entity. It could sue and be sued in its own name. It could hold and convey property in its own name. At the same time the Crown wanted to monopolize power over business. Lord Coke, when he was Chancellor of England in early 17th Century, asserted that only the Crown could create a corporation. He wasn’t bothered by evidence that law recognized as corporations some ancient entities for which there was no evidence of a royal charter. He made up the “lost grant” theory to explain this.\textsuperscript{51}

Early private business corporations were usually given a monopoly privilege, in exchange for performing colonizing and governance services for the crown. The British East Indies Company was given a monopoly on trade with India, in exchange for administering government in conquered lands. Hudson’s Bay Company was given similar privileges in trade with Canada. Many American colonies were founded by royally chartered companies. Thus two kinds of companies existed at the same time in England and in the colonies - unincorporated joint stock companies, and royally chartered corporations.

In 1719 the Crown chartered the South Seas Company, with a monopoly on trade with South America. Other unincorporated joint-stock associations were created at the same time for many of the same purposes. They competed for capital with the South Seas Company, and a speculative bubble developed. Stock in the South Seas Company was originally offered for £125 per share; within 6 months it was trading at £1,000; six


\textsuperscript{50} William Blackstone, COMMENTARIES ON THE LAW OF ENGLAND, Book I, Chap. 18, pp. 457-459 (1765).

\textsuperscript{51} Id., Chap. 18, at 460-61.
months later it was back to £125. This was called the “great South Seas Bubble.” To prevent such speculation, and to protect the position of royally chartered corporations, in 1720 Parliament passed the “Bubble Act,” which prohibited trading in shares of joint stock companies. But trading never stopped; the law was never obeyed, but it wasn’t repealed until 1825.

Parliament acted in 1844 to recognize the separate legal personality of joint stock companies. This act only required companies to register & publicize their members. It wasn’t until 1855 and 1856 that Parliament gave shareholders limited liability. The important difference here was that England simply recognized that the incorporated partnership was a separate legal entity. But English law still thought of its origins in contract and partnership law. Thus, it took two or more persons to incorporate a company. This was similar to the Civil Law concept of a company.

In the U.S. colonies, Blackstone’s Commentaries on the Laws of England stated that only the King could create a corporation, in contrast to civil law countries. American lawyers, who often only had Blackstone as authority, apparently took this literally. Thus American lawyers thought that only the sovereign could create a corporation, with a separate legal personality. The result was that during the 17th and most of the 18th century all corporations were created either by Parliament or colonial legislatures, as agents of the sovereign. Most chartered corporations were given monopoly powers - toll roads, canals, bridges, mills. Industrial businesses generally weren’t incorporated, but used the joint-stock company form. (American Express remained a joint-stock company until the 1960s.)

In 19th century, as industries grew during the industrial revolution, they began to seek charters from the state legislatures. The annual session laws of the states were filled with these charters. Since a corporate charter granted the special privilege of limited liability,

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52 6 Geo I, c 18.
53 Carney, Limited Liability, supra note 49, at 663-64.
54 Blackstone, supra note 50, Chap. 18, at 462.
55 Of the 317 special charters granted from 1780 to 1801 in the states, nearly two-thirds were for transportation enterprises, 20 percent for banks and insurance companies, 10 percent for local public service enterprises such as water supply, and less than 4 percent for general business enterprises. James Willard Hurst, The Legitimacy of the Business Corporation in the Law of the United States, 1780-1970, at 17.
56 The presumption of a grant of monopoly power inherent in a special charter ended with Charles River Bridge v. Warren Bridge, 36 U.S. (11 Pet.) 536 (1837), where the U.S. Supreme Court held that a grant by a state was to be strictly construed, and no grant of monopoly could be implied from legislative silence.
58 Professor Dodd reported "that by 1830, ... the New England states alone had chartered some 1900 business corporations, of which nearly 600 were manufacturing and mining companies." E. Merrick Dodd, Jr., American Business Corporations until 1860 (1954) at 123. Hurst indicates that of the 317 special
corruption developed in many legislatures, where bribes were required to get a charter.\textsuperscript{59} In the 1840s and 1850s many states passed general incorporation statutes, so special legislation was no longer required.\textsuperscript{60} These laws were intended to attract new capital investment into local businesses in the states.

American law took the grant from the sovereign as the source of corporate powers, rather than the notion of contract. Perhaps because of this, limited liability was accepted more readily in the U.S. The New England states retained personal liability for shareholders until Massachusetts repealed it in 1830 (the last state to do so). The earliest American corporate law treatise, by Angell and Ames, in 1836, described limited liability as the general rule.\textsuperscript{61} The American attitude that corporate characteristics could only be obtained from the sovereign, which was more freely granted by state legislatures, explained why limited liability was more common. In other ways English law was more flexible than American, because of its contractual and partnership origins.\textsuperscript{62} In contrast, because of the evolution of the joint stock company in England and in civil law countries, the consent of the owners (analogous to partners) was seen as the source of power. Thus American statutes have generally granted boards of directors exclusive power over the management of the business, in contrast to both British and civil law, which allow shareholders at the general meeting to take action on business matters.

American law viewed the creation of the corporate person as a privilege, to be surrounded by whatever requirements the legislature thought appropriate. But in \textit{Trustees of Dartmouth College v. Woodward}, 17 U.S. (Wheat.) 518 (1819), Chief Justice Marshall held that the grant was also a contract:

\begin{quote}
“This is plainly a contract to which the donors, the trustees, and the crown (to whose rights and obligations New Hampshire succeeds) were the original parties. It is a contract for the security and disposition of property.” 17 U.S. (Wheat.) at 643-44.
\end{quote}

charters granted from 1780 to 1801 in the states, nearly two-thirds were for transportation enterprises, 20 percent for banks and insurance companies, 10 percent for local public service enterprises such as water supply, and less than 4 percent for general business enterprises. Hurst, \textit{supra} note 58, at 17. The rapidity with which railroad charters were granted is indicated in Morton J. Horwitz, \textit{The Transformation of American Law}, 1780-1860, at 137, where he pointed out that while Massachusetts had only chartered two insignificant railroad roads by 1829, in the next six years it authorized 15 new lines, while New York, with only two in 1829, authorized 48 more in the next five years.


\textsuperscript{60} Only three states - New York, New Jersey and Connecticut had passed general corporation laws prior to 1845. \textit{Id.} at 143.


This meant that the state of New Hampshire could not unilaterally amend a charter. But Justice Story showed the states the way out of their future contractual obligations:

“Unless a power be reserved for this purpose, the crown cannot, in virtue of its prerogative, without the consent of the corporation, alter or amend the charter, or divest the corporation of any of its franchises, or add to them, or add to, or diminish, the number of its trustees, or remove any of the members, or change, or control the administration of the charity, or compel the corporation to receive a new charter.” 17 U.S. (Wheat.) at 675.

This reservation of power to amend is reflected in Model Business Corporation Act §1.02, and in the law of every state.

B. The Shift from Mandatory to Enabling Statutes

Until well into the twentieth century most American corporation laws took a “one size fits all” approach and mandated the relationships among officers, directors and shareholders. These statutes generally had the large publicly held corporation as their model. By mid-twentieth century it became apparent that this model did not fit smaller corporate enterprises, especially those with a few shareholders, most or all of whom were active in the business. Unlike civil law nations, the individual states lacked a separate statute for closely held enterprises. Beginning in the 1950s Professor F. Hodge O’Neal began his landmark work on closely held corporations.63 His treatise on the special issues raised by closely held corporations was first published in 1956.64 He focused his early writing on the unique governance and stock transfer issues of these entities, and suggested drafting solutions for some of them.65 At the same time Delaware recognized the need for special statutory provisions for close corporations, and adopted a special subchapter covering them.66

Delaware’s provisions were optional: an eligible company had to opt into them by filing with the Secretary of State as a close corporation covered by the statute. It expressly authorized restrictions on the transfer of shares, to emulate the partnership model.67 It also permitted agreements limiting the discretion of directors, and even permitting direct

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63 See generally Dorsey D. Ellis, A Tribute to F. Hodge O’Neal, 66 WASH. U. L. Q. xi (1988). Professor O’Neal’s prolific work in this field can be found in a bibliography at id. viii.
64 F. Hodge O’Neal, CLOSE CORPORATIONS: LAW AND PRACTICE (1956).
67 Id. at §347.

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stockholder management.\textsuperscript{68} In intracorporate disputes, which could lead to deadlock in two-shareholder corporations, it authorized court appointment of provisional directors to break such ties,\textsuperscript{69} and specifically provided that informal operation that deviates from the corporate norms does not invalidate its corporate status.\textsuperscript{70} Finally, rather than require majority shareholder consent to dissolve, the close corporation was permitted to contract about dissolution, so that any one shareholder might be permitted to dissolve, a situation close to that of partnerships, where withdrawal of a partner dissolves the firm.\textsuperscript{71}

Many courts struggled with allowing such informality and departures from the prescribed statutory model in the absence of such a special subchapter dealing with close corporations.\textsuperscript{72} A close corporation chapter was added to the American Bar Association’s Model Business Corporation Act in 1984.\textsuperscript{73} It was eliminated in later revisions of the Model Act because it was not being used by practitioners with any frequency. To a civil law observer, that must seem strange. But American statutes had evolved over the years from prescriptive to enabling. Voting provisions could vary from the statutory norms in many cases. These enabling provisions were merely default rules, in the absence of contrary choices by drafters of articles of incorporation and bylaws. In 1989 Georgia’s version of the Model Act contained at least 38 instances of express authorization of deviations from the prescribed rule.\textsuperscript{74} Even before the introduction of special provisions for close corporations, American lawyers were familiar with ways to tailor articles and bylaws, and draft shareholder agreements that deviated from prescribed norms, and were so comfortable with these methods that many saw no need for a special article governing close corporations.

III. The Collapse of State Monopoly Power in Chartering

I mentioned that states began to enact general incorporation statutes in the middle of the 19\textsuperscript{th} century. These statutes provided general powers for all corporations using the statute, and only required some filings and payment of small fees to incorporate. One must ask why state legislators gave up their power to accept bribes in exchange for a corporate charter and the privilege of limited liability. How could competition develop if each state retained a monopoly?

\textsuperscript{68} Id. at §§ 350-351.
\textsuperscript{69} Id. at §353.
\textsuperscript{70} Id. at §354.
\textsuperscript{71} Compare id. at §355 with Uniform Partnership Act §31(1)(b) (1916).
\textsuperscript{72} See, e.g., McQuade v. Stoneham, 189 N.E. 234 (N.Y. 1934) (invalidating a shareholder agreement covering election and salaries of officers). In contrast, Delaware allowed such agreements even before the close corporation provisions were enacted. Ringling Bros.-Barnum & Bailey Combined Shows v. Ringling, 53 A.2d 441 (Del. 1947).
\textsuperscript{73} American Bar Ass’n, Committee on Corporate Laws, REV. MODEL BUS. CORP. ACT (1984) (Chapter 9).
\textsuperscript{74} William J. Carney, Changes in Corporate Practice under Georgia’s New Business Corporation Code, 40 Mercer L. Rev. 655, 657, fn. 7 (1989).
A. The Real Seat Rule as a Barrier to Competition

Until recently civil law countries generally followed the “real seat” rule of recognition of corporate entities. All European countries, except the Netherlands, Switzerland, Denmark, Ireland and Great Britain, held that the law governing a company's existence and internal affairs is that of its real seat, or siege social. The European rule was that a corporation will be governed by the laws of the state where it has its real location or "seat." Its primary effect, then, was as a rule of nonrecognition of pseudo-foreign corporations. While the real seat rule has been described as the dominant rule in Europe, Buxbaum & Hopt questioned this. They characterized the real seat doctrine as being for the special case of local capital seeking to use foreign corporate statutes – pseudo foreign corporations. That, of course, is the focus of this section.

Under the real seat rule the pseudo-foreign corporation will not be recognized as a legal entity in the state where the real seat is located, with the result that its participants will face personal liability for corporate debts. Some nations characterized the use of a

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79 Richard M. Buxbaum and Klaus J. Hopt, LEGAL HARMONIZATION AND THE BUSINESS ENTERPRISE: CORPORATE AND CAPITAL MARKET HARMONIZATION POLICY IN EUROPE AND THE USA (1988) at 70 (hereinafter “Harmonization.”). The characterization is mine; the authors put it somewhat differently: In short, one can make the argument that the law of the state or country of incorporation is normally the law governing the internal affairs of European as well as American corporations. The concept of the siege social is designed for the special case only; and not for the special case of simple corporate mobility in the sense of interstate business activity but for the special case of pseudo-foreign corporate distortion (local capital claiming foreign status).
80 Hay, supra note 77 at 755, n. 468 cites Weber c. Societe Generale Anglaise et Francaise, 1907 Journal de Droit International Prive 765, where the Commercial Court of Nancy, France held that the defendant company's incorporation in England was fictitious, since no head office was maintained in England, and that the Company had therefore been created in violation of French law, with the result that the company was not recognized, and its owners were personally liable for its contracts. See also Bouvet, Laubier & Richard c. Societe anonyme Francaise des mines de fer, 1913 Gazette du Palais (2d sem.), 113. Cf. Union des Polonais c. Societe immobiliere de la Rue Faidherbe, 44 Revue Critique de Droit International Prive 103 (1955), cited by Hay, id. Italy departs somewhat from this rule, permitting the shareholders to provide for a foreign central office by charter amendment. Hay, id., text at n. 472, citing Italian Civil Code art. 2437. See also Elvin R. Latty, Pseudo-Foreign Corporations, 65 Yale L. J. 137, 171 (1955), citing Caro & Cie
pseudo-foreign corporation by a local business as a "fraud on the law." Italy took a different approach, treating such companies as Italian companies, and requiring compliance with Italian law. Correspondingly, the state of incorporation may hold that since the real seat is now in another state, dissolution should result under the law of the state of incorporation.

The real seat rule has been described by commentators as an effort by French authorities to avoid loss of chartering business to competing jurisdictions - first to England and then to Belgium. England was the Delaware of Europe in the second half of the nineteenth century. French entrepreneurs were apparently attracted by the absence of a requirement of an appraisal of property contributed for stock, and the notion of authorized shares for which no subscriptions were received at the time of organization. One of the companies which attempted to take advantage of English liberality was one of the most quintessentially French enterprises of the 19th century - the Parisian cabaret, Moulin Rouge. The anticompetitive nature of the doctrine is best demonstrated by the French reaction when French entrepreneurs incorporated in England and named

v. Societe Franco-Belge de Panification Integrałe, Tribunal de Commerce de Bruxelles, March 2, 1901, 29 Clunet 883 and note (France 1902).
81 See Hay, supra note 77 at 755; Kozyris, supra note 76, at 52, citing a landmark German decision treating a U.S. corporation with a board of directors that controlled the company from Germany as non-existent, because it had failed to follow German incorporation procedures. The French take the same approach, calling such a situation "fraud a la loi." See E. Rabel, THE CONFLICT OF LAWS: A COMPARATIVE STUDY, 43-44 (U. Drobnig, ed., 2d ed. 195). The argument that use of a foreign corporation to conduct a local business is a fraud on the law was rejected in several U.S. courts. State ex rel. Brown Contracting & Building Co. v. Cook, 181 Mo. 596, 80 S.W. 929 (1904); Demarest v. Flack, 128 N.Y. 205, 28 N.E. 645 (1891); Lancaster v. The Amsterdam Improvement Co., 140 N.Y. 576, 35 N.E. 964 (1894). See also 2 J. Beale, J. CONFLICT OF LAWS 775(1935) ("It is no fraud or evasion of the laws of a State for its citizens, intending to act only in their own State, to form themselves into a corporation under the laws of another State").

83 Hay, supra note 77 at 755. See Queen v. H.M. Treasury & Commissioners of Inland Revenue, ex parte Daily Mail and General Trust PLC, 1988 E. Comm. Ct. J. Rep. 5483, 5503, where Mr. Advocate General Darmon stated:

Generally, in most of the Member States, the transfer of the central management of the company, in the sense of its real head office, may take place only through the winding-up of the company and its reconstitution in the host Member State.

That solution, the "legal death" of the company, involves the settlement of its tax position ... [capital gains are thus taxed even though no disposition of assets has taken place.

84 Latty, supra note 74 at 166, n. 130.
85 Id.
86 Id. at 166, n. 130.
London as their "statutory" seat of business. France simply required that as to foreign corporations doing business in France, "the nominal seat be real - i.e., French".87

One of the difficulties with the doctrine is that location of the real seat can be as difficult as location of domicile.88 The effect, regardless of how the rule is described, is to prevent local businesses from reincorporating in other jurisdictions. Only in recent years has the European Court of Justice ruled that such exclusion is unlawful under the Treaty of Rome.89

This barrier to competition gave European company laws a flavor quite different from their English and American counterparts. European company laws featured much more elaborate protections for interest groups other than stockholders - notably creditors and employees. One can only guess what forms of bribery or political support generated such provisions.90

While recent court rulings in the European Union have eliminated many of these statutory barriers, there are still language barriers that prevent lawyers and clients in many member states from freely incorporating under the laws of another member state. Those changes are relatively recent, and the overall shapes of modern laws are subject to path dependence, so change is often glacial.

B. Recognition of Foreign Entities in England and the U.S.

Prior to the 1850s American business corporations were sufficiently local that it was assumed or required that they would confine their activities to the state of incorporation, and that a new entity would be required to do business in another state.91 As a result, the question of recognition of foreign entities remained a bit murky. In the early 19th century courts generally deferred to the law of the state of incorporation and to its courts when an intracorporate dispute arose.92 When a Georgia Bank sued an Alabama debtor in Federal Court in Alabama, the U.S. Supreme Court held that if Alabama statutes didn't forbid foreign corporations from coming into the state, Federal courts would presume that Alabama recognized them. This was under general principles of comity among

87 Buxbaum & Hopt, Legal Harmonization, supra note 79, at 69, citing Latty, supra note 80 at 169-70 and 2 Rabel, supra note 77 at 38 & n. 20G.
88 Kozyris, supra note 78, at 52-53.
90 Carney, Political Economy, supra note 75.
91 Butler, supra note 59 at 150-51.
nations. But that was not a definitive ruling on whether a state was required to recognize them, or admit them to do business locally. That was not decided until \textit{Paul v. Virginia} in 1869.\textsuperscript{94} The direct holding of the case was that the state of Virginia could impose different restrictions on a foreign corporation than on local insurance companies, but the negative implication was that foreign corporations had a right to carry on interstate business within the state.\textsuperscript{95} This denial of the right to exclude opened the floodgates to state competition to secure charters for companies that might do business anywhere.

Perhaps the most remarkable feature of American corporate law has been the willingness of the several states to recognize the separate legal entity of corporations chartered by other states. The courts of the various states gradually recognized the power of foreign corporations to bring suit in local courts, to own property, and to enter into contracts.\textsuperscript{96} The earliest American treatise took the English rule as given: that once a corporation proves that it has been regularly incorporated, it was entitled to bring suit outside its jurisdiction.\textsuperscript{97} It was but a short move from that rule to a conclusion that the logic of the rule applied within the United States:

"But every argument in favor of entertaining, in American courts, suits by corporations created by the laws of a country not forming part of the American confederacy, applies with still greater force to corporations of the States composing the confederacy. It was with much truth said by Judge Cabell, in a case before him respecting the power of a foreign corporation to sue abroad, "It is rendered doubly necessary by the intimacy of our political union, and by the freedom and frequency of our commercial intercourse."\textsuperscript{98}

The judicial response seems to have been consistent during the 19th century, apparently relying heavily on English and early American precedent. In 1813 the Massachusetts Supreme Judicial court rejected an argument for non-recognition of foreign corporations, saying:

The principle suggested by the plea in this case ... has no foundation in any maxim, or in any argument of public convenience or policy, or in any positive

\textsuperscript{94} 75 U.S. (8 Wall.) 168.
\textsuperscript{95} That states could not discriminate against or prohibit foreign corporations from engaging in interstate commerce with citizens of the state was established earlier in Gibbons v. Ogden, 22 U.S. 1, 231-32, 239 (1824) (Johnson, J., concurring).
\textsuperscript{96} Edwin Merrick Dodd, AMERICAN BUSINESS CORPORATIONS UNTIL 1860, 54-56 (1954).
\textsuperscript{97} Joseph K. Angell and Samuel Ames, \textit{TREATISE ON THE LAW OF PRIVATE CORPORATIONS AGGREGATE} §372, 414-15 (11th ed. 1882). It was also the case that England recognized foreign entities, such as limited partnerships, with origins in the Italian \textit{commenda} used for trading firms that were unknown to English law.
\textsuperscript{98} Id., §373, at 415.
provision of any statute. Our legislature recognize [sic] in many instances, and to many purposes, corporations existing by foreign laws, particularly those created by laws of any of the United States.99

There seemed to be general agreement in the early cases that the powers of a corporation extended beyond the boundaries of its state of incorporation, with reliance on English and American treatises.100 Thus the ruling of the Supreme Court in Bank of Augusta v. Earle in 1839, that the federal courts would presume that the states would observe principles of comity among nations, and recognize entities created by other states, in the absence of a contrary expression by the legislature, was simply a recognition of the existing law.101 Judicial attitudes apparently spilled over to influence legislation. In 1807 the New York legislature proposed to bar foreign insurance corporations from maintaining offices in the state. The Council of Revision, a body composed mainly of judges, objected on the ground that it was beneficial for New York residents if foreign insurers were permitted to compete with local corporations.102

Beginning in 1852, the states gradually adopted laws that resemble modern statutes dealing with qualification of foreign corporations to do business locally.103 These statutes put questions of recognition of foreign entities beyond debate in American jurisprudence, by implicitly recognizing foreign entities upon satisfaction of simple conditions. Typically these laws required a foreign corporation to obtain a certificate of authority to transact business locally, which would issue on condition that the corporation make fundamental disclosures comparable to those of domestic corporations, appoint a local agent for service of process, and pay local franchise fees. These statutes were not adopted grudgingly, but as a means of assuring that local citizens could obtain jurisdiction over such corporations, should disputes arise.104 Such a rule could be partially explained as interest group legislation to benefit local lawyers, since they would be the most likely candidates to prosecute claims against foreign corporations.

99 Portsmouth Livery Co. v. Watson, 10 Mass. 91, 92 (1813).
100 Bank of Washtenaw v. Montgomery, 2 Scamm. 423-424 (Ill. 1840) (citing 1 Blackstone's Commentaries 475, 2 Kent's Commentaries 277, and Angell and Ames, supra note 91 at 209; Bank of Edwardsville v. Simpson, 1 Mo. 184-85 (1822); Williamson v. Smoor, 7 Martin (Old Series) 31 (La. 1819); Guaga Iron Co. v. Dawson, 4 Blackford 202 (Ind. 1836); Savage Mfg. Co. v. Armstrong, 17 Me. 34 (1840).
102 Dodd, supra note 90 at 53.
104 See Walker, id. at 12, arguing that the decision in Pennoyer v. Neff, 95 U.S. 714 (1877), requiring local service in order to obtain in personam jurisdiction, accelerated the adoption of these statutes. Prior to the Pennoyer decision, approximately 16 states had such laws. Within 20 years the number was 35. In some states these statutes provided that foreign corporations would be treated as if they were domestic corporations, and thus "domesticated" them, apparently as a means of preventing these corporations from removing litigation to the federal courts on the ground of diversity of citizenship. See Comment, Multiple Incorporation as a Form of Railroad Organization, 46 Yale L. J. 1370, 1371-72 (1937) (hereinafter "Multiple Incorporation").
in local courts.\textsuperscript{105} Until passage of such laws, foreign corporations had the ability to sue in the local courts, but their liability to be sued there was much more limited.

Frederick Tung takes the position that this recognition of local businesses that choose to incorporate elsewhere is an accident of history:

When courts first began to articulate the doctrine in the 1860s, firms had little choice about where to incorporate: they incorporated in their home states. Shopping for a corporate charter across multiple states was not an option, since a state typically expected or required its domestic corporations to maintain economic ties with the state. This expectation comported with the local nature of most businesses. Firms transacted primarily if not exclusively in local product, labor and capital markets. A firm typically had an identifiable “center of gravity” in one state, and it incorporated there. Each state legislature effectively enjoyed a captive market for its corporate law, which was restrictive in nature. Courts generally agreed that jurisdiction over corporations’ internal affairs lay exclusively with the courts of the incorporating state. This doctrine served as a jurisdictional bar to courts outside the incorporating state and not merely a choice of law rule - though the courts of the incorporating state invariably applied local law to resolve internal affairs disputes. This deference to the incorporating state recognized each state’s territorial sovereignty over its corporate entities. Initially, this judge-made rule was consistent with legislators’ rent-seeking interests. It assured each legislature that sister states would not interfere with the legislature’s existing state monopoly on corporate law. Ironically, the doctrine promoted market-sharing among states with respect to corporate law, and not competition.\textsuperscript{106}

The remarkable feature of the development of American law in this area was its openness, and the willingness of the states to permit foreign corporations to enter the state and conduct a local, as opposed to an interstate, business. American corporate laws did not become balkanized.\textsuperscript{107} Indeed the typical U.S. corporation law permits any

\textsuperscript{105} I can personally attest that such motivations are sometimes used to persuade legislators to allow foreign entities to qualify to do a local business. See, e.g., Ga. Laws 1992, p. 1865 §1 (requiring foreign limited liability companies to qualify to do business in Georgia, but at the same time recognizing their status as entities, and providing for appointment of a local agent for service of process).

\textsuperscript{106} Tung, supra note 86, at 44-45.

\textsuperscript{107} Professor Conard argues that enterprisers commonly formed local corporations in each state, so that a corporation simultaneously became a corporation of more than one state. None of the literature he cites establishes this proposition. Alfred F. Conard, The European Alternative to Uniformity in Corporation Laws, 89 Mich. L. Rev. 2150, 2157, n. 37 (1991), citing Foley, Incorporation, Multiple Incorporation, and the Conflict of Laws, 42 Harv. L. Rev. 516 (1929) and Comment, Multiple Incorporation, supra note . The comment describes multiple incorporation primarily as a device used by railroads in the era of special chartering, and offers an explanation specific to that era and form of chartering to explain it: that forms of
foreign corporation, whether incorporated in another state or nation, to qualify to do business in the state on the same terms as local corporations. This provides support for the hypothesis that constitutional provisions mandating a common market (the “negative commerce clause”) constrained the states in this arena.


A. The Internal Affairs Doctrine

For jurisdictional competition to exist, there must be freedom of choice of law for incorporators, regardless of the physical location of the business. The internal affairs doctrine, which honors that choice of law, is thus a necessary condition for competition. The internal affairs doctrine has been defined as involving "relations inter se of the corporation, its shareholders, directors, officers or agents". The U. S. Supreme Court has recently defined and stated the rationale for the doctrine as follows:

The internal affairs doctrine is a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation’s internal affairs - matters peculiar to the relationship among or between the corporation

combination were limited, and took approval by both legislatures, usually in the form of authorization of consolidation of operations. Further, domestication, which was not always a form of multiple incorporation, was a device used by states to deny foreign corporations access to the federal courts on diversity grounds. It is not surprising that railroad corporations may have been chartered in multiple jurisdictions, since this may have been a regulatory requirement of the states involved, and, in addition, may have been required in order to gain local power of eminent domain. Insurance companies, another form of business that operated across state lines at an early stage, also were subject to special regulation that may have required local chartering.


Where the act complained of affects the complainant solely in his capacity as a member of the corporation, whether it be as stockholder, director, president, or other officer, and is the act of the corporation, whether acting in stockholders' meeting, or through its agents, the board of directors ... then such action is the management of the internal affairs of the corporation....

See also Kozyris, supra note 70 at 15; 2 J. Beale, J. CONFLICT OF LAWS 893-98 (1935); R. Leflar, AMERICAN CONFLICTS LAW § 255 (3d ed. 1977).
and its current officers, directors and shareholders - because otherwise a corporation could be faced with conflicting demands.111

The doctrine is widely accepted, and has become enshrined in the Revised Model Business Corporation Act as a statutory choice of law rule.112 Confusion surrounds the question of precisely what local rules are the subject of the internal affairs doctrine.113 Reese and Kaufman make a useful distinction between those acts which can be performed by individuals, and those which are peculiar to corporations, necessarily involving relations \textit{inter sese}.114 Latty dismissed it as "a mere misnomer for \textit{forum non conveniens}".115 The Restatement provides a list of those items covered by the doctrine.116

In the 19th century some courts took the notion of the chartering state as the source of all authority so seriously that they held they even lacked jurisdiction to decide disputes arising with respect to internal affairs.117 More recently some courts have used the doctrine of \textit{forum non conveniens} to avoid such decisions,118 but modern American courts will generally accept jurisdiction over such disputes, applying the law of the incorporating state.119

During the second half of the twentieth century choice of law was influenced by new scholarship that suggested that the state with the greater “interest” in a dispute should

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112 MBCA, supra note 108, §15.01(a), provides that the law of the incorporating jurisdiction governs its internal affairs.
113 Justice Cardozo once stated that to undertake an enumeration of when the doctrine applied "would be a difficult and hazardous venture." Travis v. Knox Terpezone Co., 215 N.Y. 259, 264, 109 N.E. 250, 251 (1915).
115 Latty, supra note 17 at 144.
116 Among the items covered are "the original incorporation, the election or appointment of directors and officers, the adoption of by-laws, the issuance of corporate shares, preemptive rights, the holding of directors' and shareholders' meetings, methods of voting including any requirement for cumulative voting, shareholders' rights to examine corporate records, charter and by-law amendments, mergers, consolidations and reorganizations and the reclassification of shares." Restatement, supra note 110, §302, Comment a.
117 Kaplan, supra note 110 at 443; Latty, supra note 80 at 143-44; 17 William M. Fletcher, CYCLOPEDIA PRIVATE CORPORATIONS §8425 (Perm ed. 1933); Restatement, supra note 110, §§ 196-97 (1934); Rogers v. Guaranty Trust Co., 288 U.S. 123, 130 (1933) (courts will leave to the state of domicile suits concerning the internal affairs of a corporation); \textit{but see} Williams v. Green Bay & Western R.R. Co., 326 U.S. 549 (1946), where the Supreme Court rejected the doctrine that when the internal affairs of a corporation are involved, a court must decline to hear the case. It treated the problem in terms of the doctrine of forum non conveniens.
118 Restatement, supra note 110, §84 Comment d; \textit{cf} Williams v. Green Bay & Western R.R. Co., supra note 117; Note, Forum Non Conveniens as a Substitute for the Internal affairs Doctrine, Colum. L. Rev., 58, 234 (1958).
119 Kaplan, supra note 110, text at note 24.
apply its law, rather than deferring automatically to the incorporating jurisdiction, introducing the possibility of considerable uncertainty into this area of law.\textsuperscript{120} American jurisdictions, with the notable exceptions of California and New York, have rejected the opportunity to change their conflicts rules in light of the new conflicts jurisprudence. While conflict of law doctrines have evolved in a flexible manner in other areas of law, that change has had little impact on the choice of corporate law, although noted commentators suggested during the 1950s that local law should be applied to pseudo-foreign corporations.\textsuperscript{121} The new jurisprudence rejected mechanical choice of law rules in favor of an examination of which jurisdiction had the most significant contacts with the transaction, in order to allow that jurisdiction to further its own public policies and provide protection for its citizens.\textsuperscript{122} The Restatement invited application of this approach to corporate conflicts questions,\textsuperscript{123} but thus far the invitation has not been taken up, whether because of statutory enactments such as the Model Business Corporation Act or the reluctance of courts to ignore a traditionally recognized contractual choice of law.\textsuperscript{124} One author notes that no serious attempt has been made to reexamine the internal affairs doctrine in light of the new conflicts methodology, asking:

Are the constitutional strictures too tight or the merits of the rule so obvious and weighty that a reconsideration would be superfluous? Do commentators find the subject too treacherous and unrewarding or are the courts and legislatures too overburdened or tradition-bound to pursue this demanding and complex task? There is probably some truth in all of these possibilities.\textsuperscript{125}

With the advent of modern contractarian approaches to corporate law in the United States that suggest the corporation is a nexus of contractual relationships,\textsuperscript{126} there is even

\textsuperscript{120} Restatement, \textit{supra} note 110, §§ 302, 303-306, and 309. Section 302(2) provides:

"(2) The local law of the state of incorporation will be applied to determine such issues, except in the unusual case where, with respect to the particular issue, some other state has a more significant relationship to the occurrence and the parties, in which event the local law of the other state will be applied."


\textsuperscript{121} Latty, \textit{supra} note 80; Reese & Kaufman, \textit{supra} note 114; \textit{see also} Donald Baraf, The Foreign Corporation - A Problem in Choice-Of-Law Doctrine, 33 Brooklyn L. Rev., 219 (1967); Note, Limited Liability of Shareholders in Real Estate Investment Trusts and the Conflict of Laws, 50 Calif. L. Rev. 696 (1962).

\textsuperscript{122} Eugene Scoles and Peter Hay, \textit{CONFLICT OF LAWS}, 16-46 (1982).

\textsuperscript{123} Restatement, \textit{supra} note 110, §§ 302, 303-306, and 309.

\textsuperscript{124} Kozyris, \textit{supra} note 76 at 17-26.

\textsuperscript{125} \textit{Id.} at 46.

\textsuperscript{126} Michael C. Jensen and William Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. Fin. Econ. 305 (1976) at 310.
less jurisprudential reason for courts to upset the choice of law made by the parties when incorporating.  

In England and the United States the subject of foreign corporations was treated quite differently from the civil law, as outlined above. Both England and the United States have recognized foreign entities. In the Anglo-American system, the concept of choice of law was reserved for the issue of what law would be applied to recognized foreign entities. The ability of foreign corporations to do an interstate business with residents of other states is protected by the so-called “negative commerce clause,” which prevents discrimination by a state against residents of other states. But that does not necessarily protect a local business that wishes to incorporate in another state.

B. Jurisdictional Competition in the United States

The story of the beginnings of jurisdictional competition starts with the American Civil War (1861-1865). The Northern part of the war was financed by the individual states, which raised their own militia, equipped and paid them. As with any war, much of the financing was with state borrowings, in the form of bonds. New Jersey struggled to pay off its bonds for several decades thereafter. It was only when an entrepreneurial New York lawyer approached the governor of New Jersey that things began to change. It was pointed out that America now possessed many great industries, but that state corporation law had not kept up with the changes. These laws often restricted the amount of capital that a corporation could raise, required legislative approval for mergers, and prohibited corporations from owning shares in other corporations. Tung attributes the change to the great merger movement in the U.S. at the end of the 19th century, which created entities that were national in scope, with no dominant local ties. Lawyers had developed elaborate techniques for coping with these restrictions, mostly involving the use of the business trust to hold shares. But New Jersey adopted the first modern “enabling” corporation law in 1890, which ended restrictions on raising capital, owning shares and mergers, among other things. Most major corporations reincorporated in New Jersey, which was able to charge high franchise fees, enabling it

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128 Tung, supra note 92 at 45.
to repay its Civil War debt. Delaware duplicated New Jersey’s statute, hoping to capture some of these fees, but New Jersey was the first mover, had captured the lucrative franchising business, and corporations saw no need to move to Delaware.

Woodrow Wilson was a populist governor of New Jersey who abhorred the new laws, and saw to their repeal in 1913. The result was a move of most major corporations to Delaware, which then had the most modern and flexible corporate law. Delaware sought to assure that it would never lose this advantage. It assigned jurisdiction over corporate law disputes to its Chancery Court, which enabled a small group of judges carefully chosen from the corporate bar to specialize and become experts in corporate law. Delaware publishes the reports of the Court of Chancery, an unusual occurrence for trial courts, to educate attorneys on the current developments in the law. The Delaware constitution requires 2/3 vote to amend Delaware’s General Corporation Law, a bond that it will not radically change its laws to disadvantage Delaware corporations. Delaware obtains 15-20% of state revenues from franchise fees, which is also a bond that it won’t change its law radically. Because Delaware is a small state, these revenues are critical to its government in a way they would not be in a larger state. As a result, Delaware has long been the dominant choice for large corporations. Over 50% of New York Stock Exchange firms are incorporated in Delaware.

Officials in other states have frequently complained about the tyranny of Delaware, which leads to the flight of local corporations and the prospective loss of franchise revenues for states that provide greater benefits to interest groups through corporate law. One attempt at uniformity illustrated the power of competitive forces to dictate the shape of state laws. The Corporation Law Committee of the American Bar Association's Section of Corporation, Banking and Mercantile law submitted a draft Model Business Corporation Act in 1946, which followed the pattern of the recently adopted Illinois Business Corporation Act, not the Delaware law. By 1955 it had been adopted by only two states and the District of Columbia, although it is now the

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130 Because corporate disputes are often complex, litigants generally prefer a hearing before a judge rather than a jury, and Delaware grants the Court of Chancery jurisdiction over interpretation of corporate instruments, 8 Del. C. §111, and jurisdiction over all matters in equity, 10 Del. C.§341, or where there is no adequate remedy at law, 10 Del. C. §342.
131 Kaplan, supra note 110 at 436, quotes the Governor of Michigan in 1921, explaining to the Michigan Legislature that it was useless to pass a stringent corporation act because "all of our corporations will come back to us as foreign corporations", citing Mich. H. R. J. 37 (1921). See also id. at 437, for other writings denouncing this phenomenon.
dominant model.\(^\text{133}\) During the period 1996–2000, 58% of all publicly held firms and 59% of the Fortune 500 Industrial firms were incorporated in Delaware.\(^\text{134}\) During the period 1978–2000, 56% of all initial public offerings (“IPOs”) involved Delaware corporations.\(^\text{135}\) Delaware’s share of IPOs listed on the New York Stock Exchange increased during the 1990s, reaching 73–77% during parts of that decade.\(^\text{136}\)

The Model Act itself proclaimed that it was not written to "appeal to a state soliciting corporate business".\(^\text{137}\) While there was earlier writing that criticized the development of enabling statutes as the result of competitive pressures from Delaware,\(^\text{138}\) it was not until William Cary's famous article about Delaware's race to the bottom\(^\text{139}\) that a flood of writing claimed that such a competition had occurred, to the detriment of investors and shareholders.\(^\text{140}\) The debate has evolved over the years, after Ralph Winter argued that a state offering a law that was unfriendly to investors would not attract incorporations, because they would be less attractive to investors.\(^\text{141}\) Early reincorporation studies were inconclusive, showing, at best, that there were no significant losses from moving to Delaware.\(^\text{142}\) The debate generally rejected the race to the bottom hypothesis, because
these studies do not produce negative price movements. The nature of the debate changed when Robert Daines employed Tobin’s Q to measure value in Delaware corporations versus others.\textsuperscript{143} He found that incorporation in Delaware added approximately 5% to the value of a firm. Other studies have disagreed,\textsuperscript{144} although one study, which found a negative correlation between Delaware incorporation and value employed different samples, time periods, and control variables.\textsuperscript{145} The most recent study, by Guhan Subramanian, finds that Delaware firms were worth approximately 3% more than non-Delaware firms in 1991-93, and 2% more in 1994-96. Thereafter, the Delaware difference is statistically insignificant, and even turned negative in 1998-99.\textsuperscript{146} The results over twenty-five years of empirical work thus remain inconclusive.\textsuperscript{147}

V. Sources of Corporate Law

It has been said that imitation is the sincerest form of flattery. Roberta Romano found that when any state adopted a new and useful provision in its corporate law, it was quickly imitated by other states, and that Delaware was generally an early adopter.\textsuperscript{148} State bar committees on corporate law meet regularly in many states to review these innovations, and to recommend what they consider advantageous to their own legislatures.\textsuperscript{149} The Committee on Corporate Laws of the American Bar Association, composed of experienced corporate lawyers from across the country, regularly reviews corporate law developments with an eye to amending the Model Business Corporation Act, the most widely followed model. The American Law Institute, a national membership organization of lawyers and judges with the goal of clarifying and improving the law through its Restatements of various common law subjects, such as Torts, Agency, Property and Contracts, to name a few, undertook a similar project for corporate law in the 1980s, which did not have a similar impact.\textsuperscript{150} The National Conference of Commissioners on Uniform State Laws (“NCCUSL”) has served a similar function on other business entity laws, discussed below.

\begin{itemize}
  \item 1\% rise on announcement date, following significant rise preceding that date); Jeffry Netter and Annette Poulsen, State Corporation Laws and Shareholders: The Recent Experience, 18, No. 3 Fin. Mgt. 28 (Autumn 1989) (positive returns around announcement date).
  \item Lucian Bebchuk, Alma Cohen and Allen Ferrell, \textit{Does the Evidence Favor State Competition in Corporate Law?}, 90 Cal. L. Rev. 1775, 1784-86 (2002) note that Daines’ results are not consistent across the period studied.
  \item Paul A. Gompers, et al., \textit{Corporate Governance and Equity Prices}, 118 Q. J. Econ. 107 (2003).
  \item Guhan Subramian, \textit{The Disappearing Delaware Effect}, 46 J. L. Econ. & Org. 32 (2004).
  \item A recent review of the theory and evidence, arguing that the evidence fails to fit the contractarian theory of the corporation is found in Michael Klausner, \textit{Fact and Fiction in Corporate Law and Governance}, 65 Stan. L. Rev. 1325 (2013).
  \item Romano, \textit{Law as a Product}, \textit{supra} note 142.
  \item Carney, \textit{The Production of Corporate Law}, \textit{supra} note 133.
  \item For a critical review, see Carney, Section 4.01 of the American Law Institute's Corporate Governance Project: Restatement or Misstatement?, 66 WASH. U. L. Q. 239 (1988).
\end{itemize}
VI. Types of Business Organizations

A. Partnerships

Partnerships are the most ancient and universal form of organization. Under U.S. law it is the default form: that is, absent formation under a specific statute, individuals carrying on business together as co-owners are partners.\footnote{151} The National Conference of Commissioners on Uniform State Laws (“NCCUSL”), a body with representatives appointed by each state, has promulgated a variety of forms of uniform laws for adoption by those states that choose to do so. The Uniform Partnership Act has been widely adopted, and has gone through revisions over time. One of the features of this act is that it contains default provisions, that can be contracted around, but provide an inexpensive set of rules for internal governance that are generally intuitive.\footnote{152} Partners are generally subject to unlimited liability for firm debts,\footnote{153} and have equal voices in firm governance, with the majority prevailing in disputes,\footnote{154} and equal authority to carry on the business in the usual way.\footnote{155} Because of the potential for personal liability, new partners can only be admitted by unanimous consent.

One of the benefits of a partnership in the U.S. is that the entity is not taxed on its income - only the partners are, who must declare their proportionate share of partnership income on their individual income tax returns, whether or not they receive their share of the profits in cash. The price for this benefit, of course, was unlimited personal liability. In the late 1970s entrepreneurial lawyers persuaded one state, Wyoming, to authorize a new form of entity which could avoid personal liability, but be eligible for tax pass-through status - the Limited Liability Company, described below (not to be confused with the civil law entity often bearing the same name). In response, lawyers in other states persuaded their legislatures to authorize partnerships to have limited liability for their members - the Limited Liability Partnership, or “LLP.” Obtaining this status involves a simple name change to indicate the limited nature of liability to third parties, and a filing with a local official.\footnote{156}

B. Limited Partnerships

Limited partnerships were unknown at common law in England, and thus unknown in the U.S. They are derived from the Italian commenda, a device used to avoid the usual rules of unlimited liability in commercial ventures. The en commandite partnership was legalized in France in 1671, in Ireland in 1782, elsewhere on the Continent and, in a few

\footnote{151} Uniform Partnership Act (1916) (hereinafter “UPA”, §6.}
\footnote{152} UPA §18.}
\footnote{153} UPA §15.}
\footnote{154} UPA §18.}
\footnote{155} UPA §9.}
states in the U.S.A. in the early 19th century. The Uniform Limited Partnership Act ("ULPA") was promulgated in 1916 by NCCUSL, with later revisions as the Revised Uniform Limited Partnership Act ("RULPA"), with revisions in 1976, 1985, 1997 and 2001, reflecting dynamic changes in the law.

Formation requires a formality - a public filing that identifies who are the general partners. RULPA §201. A general partner has unlimited liability for firm debts, but other partners do not - they are only subject to loss of their capital. The default rule is that the general partner controls the business, but this is subject to variation by agreement to give limited partners more control.

C. Limited Liability Companies

Until Georgia revised its version of the Uniform Limited Partnership Act in 1988, section 7 of the 1916 Act imposed personal liability on a limited partner if he “takes part in the control of the business.” The 1976 revision had softened the rule, but had not completely eliminated the risk if the limited partner “participates in the control of the business.” The Georgia revision of RULPA §303 provided that “a limited partner does not become liable [for the obligations of the limited partnership] by participating in the management or control of the business.” Ultimately the 2001 version of RULPA followed Georgia’s lead. But until that time many investors found the limited partnership act unattractive because limited partners had no power over control of the business. In the late 1970s entrepreneurial lawyers in Wyoming obtained passable of a new act allowing creation of limited liability companies - not to be confused with entities with similar names in civil law countries.

This new form of LLC was specifically designed to allow investors to participate in control of the entity while obtaining the advantage of pass-through treatment for income tax purposes. Accordingly, the default rules provided the features that the U.S. Internal Revenue Service found important in distinguishing partnerships from corporations: decentralized management by the members, no continuity of existence when a member died or withdrew, no free transferability of shares, and personal liability of members for firm debts. Under Revenue Service rules in effect at the time, entities could have two of these partnership features and still be treated as pass-through entities. The statute permitted all of these features to be varied by contract, to obtain the most desirable corporate attributes, which always included limited liability for members.

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157 A general partner’s liability may be limited by using a corporation as the general partner, subject to some limitations beyond the scope of this article.
158 Revised Uniform Limited Partnership Act (1976) §303(b) in 6B UNIF. L. ANNO. 181-82.

(2017) J. Juris. 121
The Revenue Service approved this form in 1986, and other states rushed to adopt similar statutes. Somewhat later, the Revenue Service simply ruled that any non-corporate entity could choose pass-through status, so the original purpose of creating LLCs became irrelevant. What is more important is the freedom to contract out of those fiduciary duties the members may find inappropriate. Delaware’s statute express allows such contracting out.\textsuperscript{161} Some businesses find this particularly attractive. Orbitz was a joint venture of major U.S. airlines that allowed a search of all their web sites for a complete list of scheduled flights and prices that consumers can use. At the same time, each airline maintained its own web pages that are in direct competition with Orbitz and each other. Orbitz was originally formed as a Delaware LLC in order to contract away from the fiduciary duty of member airlines not to compete with Orbitz.\textsuperscript{162} Recently proposed changes in corporate laws will clarify the ability of corporate participants to contract out of the business opportunity doctrine.\textsuperscript{163}

D. Corporations

In most respects U.S. corporations are similar to those throughout the world. The great advantage of the corporate form is its ability to raise capital from many investors to allow it to engage in larger enterprises. Shareholders benefit from limited liability, risking only the capital invested in the corporation’s shares. The price paid is so-called “double taxation” - the corporation is taxed on its profits (currently at a rate of 35% for larger corporations), and, in turn, shareholders are taxed on dividends when they are paid.\textsuperscript{164} When corporate profits are reinvested to grow the enterprise and its profits, thus making the shares more valuable, the capital gains on shareholders’ appreciated values are not taxed until the shares are sold. There is no separate statute for organizing closely held corporations with only a few shareholders. Some statutes contain a few provisions that a corporation can elect to be covered by, but in most cases special needs are addressed in a shareholders’ agreement. Most corporate statutes contain “default” provisions that can be contracted around, either in the articles of incorporation, bylaws or a shareholders’ agreement.

1. Formation

\textsuperscript{161} Del. Code Ann., Title 6, §18-1101(c).


\textsuperscript{163} See Changes to the Model Business Corporation Act, infra note 180.

\textsuperscript{164} Corporations with a small number of shareholders and a single class of stock may elect to be taxed like a partnership, with corporate earnings allocated to the shareholders whether dividends are paid or not, under Subchapter S of the Internal Revenue Code.
Corporations are formed with a simple filing with the Secretary of State in the jurisdiction chosen for formation. These filings include a copy of the articles of incorporation, and are updated annually to disclose a registered office and registered agent authorized to receive process within the state. There are no minimum capital requirements, and one person can form a corporation and own all its shares. Corporations may be formed for any lawful business purpose, or the organizers may specify narrower purposes if they choose, in the charter. The only limits here are equitable – a corporation may not engage in a business for which it has unreasonably small capital without rendering the shareholders personally liable for its debts - piercing the corporate veil.\textsuperscript{165} There are some special purpose corporations that must be formed under special statutes, with banks being a typical example. Most states (except Delaware) provide separate statutes for not for profit corporations.

2. Directors

Like all nations, U.S. law provides for a board of directors to provide centralized management, an essential trait where there are many shareholders. Unlike civil law, U.S. law provides the board of directors with exclusive power to manage the business and affairs of the corporation. This contrasts with civil law, where shareholders have the power at the general meeting to take action on business matters. Shareholder power to remove and replace directors may be limited in several ways. Most states allow the terms of directors to be staggered in two or three classes, with only one class being elected annually. This means it is difficult if not impossible for shareholders to change a majority of the board in any one year. While directors may be removed by the shareholders, there are complications. Under the Model Business Corporation Act ("MBCA") the statute grants shareholders the power to remove directors with or without cause, but the articles of incorporation may permit removal only for cause.\textsuperscript{166} Delaware law provides a similar rule, but also restricts removal to "for cause" if the board is classified.\textsuperscript{167} While election of directors is generally governed by a plurality vote (recognizing that more than two candidates might compete), activist shareholders in the U.S. have been pressing corporations to require a majority vote for election.

3. Duties of Directors

American corporate laws are not very specific about most duties of directors - many provide simply that directors shall act with the care that a person in like position would act.\textsuperscript{168} Delaware law contains no provisions on directors’ standard of care. The courts

\textsuperscript{165} Carney, Limited Liability, supra note 49 at 668-69.
\textsuperscript{166} American Bar Association, Committee on Corporate Laws, Model Business Corporation Act ("MBCA" or "Model Act") §8.08.
\textsuperscript{167} DEL. CODE ANN. tit. 8, §141(k).
\textsuperscript{168} Model Act §8.30(b).
drew analogies from the rules governing trustees and agents, and stated that directors had duties of care. At the same time, the courts developed rules of deference to directors’ decisions, even when they turned out badly. Some courts held that they were ill-suited to judge business decisions. Others simply stated that it was unfair to second-guess honest decisions that turned out badly. Finally, at least one judge stated that directors were paid to make risky choices about the future, and should not be punished when these decisions turned out badly.\textsuperscript{169} Delaware’s courts have held that a plaintiff must show more than ordinary negligence to hold a director liable – the standard is “gross negligence.”\textsuperscript{170} Collectively, this deference to directors became known as the Business Judgment Rule, and is applied in virtually every state. One writer stated that his research found no cases in which directors of an industrial corporation were held liable for ordinary negligence.\textsuperscript{171}

In more recent years there has been pressure from critics for a more rigorous standard of review of directors’ decisions, often based on the idea that directors have duties to monitor for law violations by corporate employees,\textsuperscript{172} and that directors must affirmatively demonstrate that they had considered what a court views, in hindsight, an adequate amount of information in making their decisions.\textsuperscript{173} Some of these decisions have been vigorously criticized, but they have had some influence on the shape of corporate law. In a legislative response to court decisions holding directors liable for breaches of the duty of care, most states responded with statutes allowing corporate charters to protect directors from liability for breaches of the duty of care, carefully leaving directors liable for other breaches of their duties (discussed below).\textsuperscript{174}

Directors’ duties of loyalty are drawn from the trust analogy. This means directors cannot deal with corporate property for their own profit, cannot take advantage of corporate opportunities,\textsuperscript{175} cannot compete with the corporation,\textsuperscript{176} or disclose its

\textsuperscript{169} Joy v. North, 692 F.2d 880 (2d Cir. 1982).
\textsuperscript{170} Aronson v. Lewis, 473 A.2d 805 (Del. Supr. 1984).
\textsuperscript{173} Smith v. Van Gorkom, 488 A.2d 858 (Del. Supr. 1985); Revlon, Inc. v. McAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. Supr. 1985). In C&J Energy Services, Inc. v. City of Miami General Employees’ and Sanitation Employees’ Retirement Trust, 2014 WL 7243153 (Del.), the Delaware Supreme Court substantially modified most attorneys’ understanding of these two cases, holding that a reasonable effort to secure the best price may involve one-on-one negotiations, followed by announcement of an agreement that provides a reasonable time for others to place higher bids, without an active search by the selling corporation.
\textsuperscript{174} Model Act §2.02(b)(4); Del. Code Ann. tit. 8, §103(b)(7).
\textsuperscript{175} Guth v. Loft, 23 Del. Ch. 255, 5 A.2d 503 (1939).
confidential information to outsiders. Strictly interpreted, directors would not be able to set their own compensation, since all directors would have a conflict of interest in doing so. Some statutes expressly authorize this power, and most statutes have “safe harbors” for directors seeking to engage in a transaction that involves either dealing with the corporation or seizing what might be a corporate opportunity. These statutes generally require the director to make full disclosure in advance of the transaction, and to obtain approval either from the disinterested directors or the disinterested shareholders. In the absence of such independent approval, the burden of proof falls on the conflicted directors to show the entire fairness of their actions. Some state laws have authorized advance permission for directors to take advantage of specified business opportunities without bringing them before disinterested directors or shareholders, and the Model Business Corporation Act has been amended to include such provisions.

As previously mentioned, shareholders’ voting power in U.S. corporations is quite limited. Most laws simply provide that the business and affairs of the corporation shall be managed by the board of directors. This has been interpreted to give the board exclusive control of these matters. As a result, shareholders can only advise the board on these questions, rather than take direct action themselves or require the board to do so. A recent example involves popular (or populist) concerns that top executives are often overpaid, whether in comparison to lower level employees or in comparison to the performance of the company. In 2010 Congress adopted the Dodd-Frank Act in response to the 2008 financial crisis. This added a new section to the Securities Exchange Act of 1934, which governs disclosures of all publicly traded companies, to require an advisory vote on executive pay. Congress recognized that state laws do not allow shareholders to manage company affairs, so this vote is only advisory to the board of directors.

4. Shares

177 Model Act §8.11.
178 Model Act §§ 8.60-8.63, 8.70; DEL. CODE ANN. tit. 8, §144.
179 Del. G.C.L. §(a)(3); Model Act §8.61(b).
181 Model Act §8.01(b); DEL. CODE ANN. tit. 8, §141(a).
Generally U.S. corporations are not required to authorize any particular number of shares of stock, and there are no upper limits on the numbers that may be authorized in the charter (although state franchise taxes may impose some practical limits). No shares need be subscribed for at the time of incorporation, and shares need not have any “par” or stated value that sets a minimum on the price to be paid for them. A corporation must have what is generally called “common stock,” which has full voting rights to elect directors and approve charter amendments, and the right to receive all profits, either in the form of dividends or distributions upon liquidation. Because these shares are the riskiest form of investment in the firm, receiving the residue after all creditors and senior classes of stock have been paid, they must have full voting rights in most states, although the Model Act only provides that some class of shareholders must have these rights, whether alone or jointly with other classes. Shares in U.S. corporations are held of record, rather than in bearer form. Notices of meetings must be sent to all shareholders of record. Even when shares are held by nominees such as brokers or banks, these nominees are required by SEC regulation to pass such notices to the beneficial owners.

Corporations are authorized to issue other classes of stock, generally called preferred stock. If the charter so provides, the board of directors may be authorized to determine the rights and preferences of a previously authorized class, or to create a series within a class, at the time of issuance, rather than in the charter (“blank shares” or “blank check shares”). The voting rights of each class are generally a matter of contract - in the form of the charter or the board resolution specifying the rights or a class or series.

Corporations have the power to repurchase their own shares, subject to leaving sufficient assets to protect creditors, or in some cases to leave sufficient capital to cover “legal” or “stated” capital. Such “legal capital” provisions have been disappearing from most statutes, to be replaced by requirements that sufficient capital remain to cover all debts and to continue in business. Some states, notably Maryland, have special statutes that allow shares to be redeemable at the will of the shareholder, to accommodate open-end mutual funds.

184 Model Act §6.01(a); Del. Code Ann. tit. 8, §151(a).
185 Model Act §6.01(b) provides only that some class of shares must have unlimited voting rights, and that some class must have unlimited distribution rights upon liquidation. The author knows of no instance where separate classes have these rights - common stock appears to have unlimited distribution rights in all cases of public corporations. Delaware has no such provision. Del. Code Ann. tit. 8, § 170 simply provides authority to pay dividends “on shares,” while §212 (a) provides that each share shall have one vote unless the charter provides otherwise.
188 Del. Code Ann. tit. 8, §151(a); Model Act §6.02.
189 Model Act §§ 6.31 and 6.40.
191 Model Act § 6.40.
5. Shareholders

Shareholders’ liability for corporate debts is generally limited to the amount they commit to pay for shares. There are exceptions for fraud on creditors, which can take the form of confusing creditors about whether they are dealing with the individual shareholder or his or her corporation, where shareholders receive corporate funds that leave the corporation unable to pay its debts, or where the shareholder uses the corporation as an agent to carry on business for the shareholder’s benefit at the expense of the corporation.

Most states allow articles of incorporation to provide for preemptive rights of shareholders to buy their proportionate share of any new offering of shares. These provisions are rarely used by publicly held corporations, but can be a useful protection for shareholders against favorable treatment of a controlling shareholder which might otherwise buy new shares at a bargain price and dilute the value of the others’ investments. Some statutes codify judicially developed exceptions and modifications of these rights.

One of the unique features of U.S. law is the shareholders’ derivative action. This was an innovation of courts of equity. When a board has engaged in wrongdoing that injures the corporation, the board, which normally has full power to manage the business and affairs of the corporation, will not be willing to have the corporation sue the directors to remedy the harm. In these circumstances a shareholder can stand in the shoes of the corporation, generally after making a demand on the board to bring the action.

Some controversy surrounds derivative actions, notably whether they benefit and are controlled by the shareholders or principally by the lawyers who bring the suits, and expect to be compensated by the corporation if the suit is won or settled.

6. Shareholder Voting

An annual shareholders meeting for the election of directors is required. Special meetings may be held on the call of a specified percentage of outstanding shares or of the board of directors. Generally statutes require the presence, in person or by proxy, of holders of at least a majority of all shares entitled to vote. These quorum requirements may be increased and in some states reduced in either the articles of incorporation or bylaws. Delaware, for example, allows quorums to be set as low as one-third of the voting shares. The Model Act, in contrast, only permits quorum increases if approved.
by the greater vote required under the proposed amendment. Supermajority quorum and voting requirements are also permitted, and may be set for specified events, such as votes on mergers.

Statutes authorize cumulative voting for directors. This means that if there are three positions open on the board, shareholders may cast all of their votes for a single candidate, which creates the potential for representation of minority shareholders on a board. Cumulative voting is almost never seen at publicly traded corporations, but it can be a useful protection for minorities in closely held firms, especially if coupled with supermajority voting on some issues, to give the minority a veto power. Federal securities laws require forms of proxies (powers of attorney) be made available to all shareholders of publicly traded companies, to facilitate their participation in corporate governance.

7. **Shareholders’ Duties**

Shares of stock are private property and can be sold by a shareholder at any time and at any price, unless prohibited by a shareholders agreement to which he or she is a party. Similarly, a shareholder is free to vote the shares in his or her own interest, subject to qualifications discussed below. Shareholders may enter into voting agreements in which they agree how to vote their shares. Shareholders may also give a power of attorney (“proxy”) to another to vote the shares for the owner. Typically these proxies may be revoked by the owner at any time, although there are occasions where the laws allow a proxy to be irrevocable by its terms, if the proxy holder has a sufficient legal or economic interest in the corporation.

Statutes are generally silent on duties of shareholders. What circumstances should cause courts concern over shareholder voting? Often it is the control of the board of directors by a single shareholder or a group holding a controlling interest. In these circumstances have imputed the board’s duties of loyalty to the controlling shareholder. In other cases the courts have not expressed a rationale, except their desire to achieve a fair result.

These circumstances may involve the selective issue of new shares to a controlling shareholder at a bargain price, the payment of dividends on one class of shares and not another, dealings between the corporation and another company controlled by the

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197 Model Act, §7.27.
198 17 C.F.R. §240.14a-1 to 14b-2.
200 Model Act §7.22.
201 Sinclair Oil Corp. v. Levien, 290 A.2d 717 (Del. 1971); Zahn v. Transamerica Corp., 162 F.2d 36 (3d Cir. 1947) (applying Kentucky law).
dominant shareholder, for the benefit of the other company at the expense of the first, a sale of all assets to the controlling shareholder or its wholly owned corporation at a bargain price, or a merger on terms that are more favorable to the controlling shareholders wholly owned corporation.203

Statutes deal specifically with only some of these questions. Statutes only require that directors determine in their sole discretion that the price paid for newly issued shares is “adequate,” while deferring generally to the good faith judgment of the directors.204 Charter provisions for preemptive rights can provide protection for minorities, but these provisions are rarely used by publicly held corporations. Accordingly, in the absence of preemptive rights, courts have exercised their equitable powers to impose fiduciary duties on directors to not issue new shares on unfairly favorable terms to controlling shareholders.205

Selective dividend payments are not expressly addressed in most statutes. Here courts can hold directors liable for a breach of their fiduciary duty treat all shareholders fairly.206

While boards cannot sell all the assets of a corporation without shareholder approval, no statutes prevent a dominant shareholder from approving the transaction itself. Many statutes provide shareholders with the right to dissent from the transaction and demand that they be paid the fair value of their shares.207 But some, such as Delaware, limit appraisal to mergers, leaving it to the courts in their equity role to impose fairness standards on other such transactions.208

Similarly, While boards cannot approve a merger of the corporation without shareholder approval,209 no statutes prevent a dominant shareholder from approving the transaction itself. All statutes provide shareholders with the right to dissent from the transaction and

204 Model Act §6.21(c). Delaware only requires that the price equal or exceed the par or stated value of shares. Del. Code Ann. tit. 8, §153(a). Shares without par value may be issued for any price determined by the board. Directors’ fiduciary duties require that they not discriminate among shareholders.
207 Model Act §13.02(a)(3).
208 Cf. Zahn v. Transamerica Corp., supra note 201 (where the controlling shareholder deceived a class of shareholders into redeeming their shares so the controller could liquidate the company and capture the appreciated value of its assets for itself).
209 The exception is the “short form” merger, where a board can approve a merger with a controlled subsidiary. Most states permit such mergers upon parent board approval only when the parent owns 90% or more of the shares of the subsidiary. Del. Code Ann. §253; Model Act §11.05. Delaware, after 2013 amendments, permits such mergers after a tender offer if the merging parent owns over 50% of the subsidiary’s shares. Del. Code Ann. §251(h).
demand that they be paid the fair value of their shares.\textsuperscript{210} The Delaware courts have added to that remedy a fiduciary duty claim against controlling shareholders if the transaction is deemed unfair.\textsuperscript{211}

VI. The Federal Securities Laws

A. The Predecessors: State Securities Laws

Where shares were traded on organized stock exchanges, issuing corporations were always subject to the listing rules of the exchanges, which in some cases required audited financial statements and some reporting to investors. But it was not until the early years of the 20\textsuperscript{th} century that states began to adopt laws governing the sale of securities. These laws were separate from corporation laws, and were known as securities laws, and sometimes as “blue sky laws” from the comment of an early regulator that some sellers were so unscrupulous that they would sell pieces of the blue sky in fee simple to gullible investors.\textsuperscript{212} These laws came in three forms. The first were simple laws forbidding fraud in the sale of securities. These laws could be enforced by injunction or criminal prosecution by the attorney general of a state, and some provided civil remedies for defrauded buyers. The second were “full disclosure” laws that mandated full disclosure about the issuer before shares could be sold. The full disclosure requirement was enforced through a requirement that issuers file a disclosure document (a “registration statement”) with the state’s securities commissioner, who had to approve it before shares could be sold. Like the first type, these laws also provided for enforcement by injunction or criminal prosecution, and provided for civil suits by investors to recover damages. The third type was the “merit” statute, which, in addition to the disclosure and remedy provisions of the first two types, required the state’s securities commissioner to approve the prospective offering as “fair, just and equitable” for investors. Enforcement of these laws was sometimes difficult, if the seller operated by mail from another state. Local officials had considerable difficulty establishing \textit{in personam} jurisdiction across state borders.

B. The Securities Act of 1933

The 1929 stock market collapse and the Great Depression that followed aroused the interest of the U.S. Congress. Hearings were held, and much of the blame was mistakenly placed on bankers and brokers (“Wall Street”). Modern financial studies, most notably by Milton Friedman, placed the blame on the U.S. Federal Reserve, which shrank the U.S. supply of money by one-third in the years leading up to 1929. With the

\textsuperscript{210} Model Act §13.02(a)(1); Del. Code Ann. §262. There are some exceptions to these appraisal rights not discussed here.

\textsuperscript{211} See, e.g., Weinberger v. UOP, Inc. 457 A.2d 701 (Del. Supr. 1983).

\textsuperscript{212} Hall v. Geiger-Jones Co., 242 U.S. 539 (1917), contains the first mention of this phrase by the U.S. Supreme Court.
election of Franklin D. Roosevelt in 1932, there was a call for a federal law protecting the public from fraudulent stock sales, noting the inability of state officials to enforce across state borders. Within the first 100 days of the Roosevelt administration a small group of lawyers and academics drafted the proposed Securities Act of 1933. They drew heavily from state law models, adopting the full disclosure model most common in the states. Issuers would be required to file a registration statement by section 5 of the act. The required disclosures were drawn from the best practices of reputable brokerage firms on Wall Street, which sought to protect their customers by assuring full and candid disclosure of all the strengths, weaknesses and risks of an offering. The penalty for failing to file and to secure regulatory approval of the offering documents was severe - all investors were entitled to damages or a refund of their money, and criminal penalties for wilful violations of this law were available as well. There were some exemptions from this expensive process, such as where a local corporation made an offer exclusively to residents of its own state, which could be governed by state law. Other exemptions existed for small offerings, and for offerings to sophisticated and knowledgeable investors who could obtain the information necessary to protect themselves. For 63 years Congress left the operation of state laws alone. Section 18 of the Securities Act expressly stated that it did not preempt state regulation. But state regulation was hugely costly in nationwide offerings. Paternalistic merit regulation was contrary to spirit of federal law, which only required disclosure. In 1996 Congress amended Section 18 to preempted state regulation of offerings of nationally traded securities or those that will be nationally traded after an offering. In all other respects state laws remain in effect.

C. The Securities Exchange Act of 1934

The Securities Act was limited to governing offers and sales of securities by issuers and underwriters. It did not address some of the manipulations in trading activities uncovered by Congressional hearings. In 1934 Congress returned to the subject with an act to address these activities. The Securities Exchange Act regulates the trading markets where secondary transactions occur.

1. It regulates stock exchanges, by requiring them to register with SEC, and maintain rules designed to prevent fraud and promote good business practices.

2. It regulates trading by securities dealers, not on organized exchanges.

218 15 U.S.C.A. §77d(2) and (6). See also Regulation D, 17 C.F.R. §230.500 to 508.
3. It regulates the continuing disclosures of companies whose shares are traded, so secondary markets have information as complete as initial offerings.  

4. It provides rules against fraud in trading markets, including liability rules.  

5. It provides some assurance to shareholders that they will be able to participate in corporate governance through the use of proxies to vote their shares.

The general purpose is to provide investors with a constant flow of information about companies whose shares are traded. One result of this is investor confidence in the fairness and general honesty of American markets, and wider investor participation in stock investing than in any other nation. Many non-U.S. companies find it advantageous to list their shares on American markets in order to gain the benefits of this deep and broad market.

The securities laws are administered by the Securities and Exchange Commission ("SEC"), established in 1934. It is a bipartisan independent regulatory agency that enforces these laws, subject only to review by the federal courts for acts in excess of its authority or other offenses of governing laws, such as the Administrative Procedure Act, which governs procedures at virtually all federal agencies.

The SEC has been an active and aggressive regulator over the past 80 years. Its rules are voluminous and complex, leading to the development of a specialized bar with the expertise to advice on compliance and defend against actions brought for violation of its rules. The SEC has developed its own common law, most notably in the area of Rule 10b-5, which has been used to create rules against insider trading that did not previously exist. These rules have been a rich source of litigation in the U.S., and have provided the basis for many criminal prosecutions as well. Other rules have used disclosure requirements to impose pressure on issuers to change their behavior. The Sarbanes-Oxley amendments to the ’34 Act require that all reporting companies either have a “financial expert” on the audit committee or provide an explanation for the absence of such an expert. That is effectively a mandate for all companies; explaining the absence of such an expert is like answering the question if you’ve stopped beating your wife—addressing the question is a fatal admission. Recent amendments require not only full disclosure of executive compensation, but also a comparison with the average

\[221\] 15 U.S.C.A. §78m and 78n.  
compensation of corporate employees. They also require a vote on shareholder approval of CEO compensation at least every six years.

228 17 C.F.R. §229.402. As of this writing the SEC has proposed but not yet adopted final rules on this subject. See Release Nos. 33-9452; 34-70443 (September 18, 2013).

THE STRUCTURE OF A HUMAN RIGHT IN LAW: 
SETTING THE CRITERION FOR A RIGHT LEGALLY SO-CALLED

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Abstract

Inadequate formulation of human rights provisions is idle endowment that promotes idle entitlement and idle expectations. The law must accord structure to a legislated right. This piece distinguishes human rights as species of law from human rights rhetoric, by examining the internal structure of the former. It emphasizes the significance of adequate formulation of human rights provisions while highlighting the elements that accord justiciability or legal force to an otherwise moral appeal. There is a subtle but significant distinction between human rights and human rights law. The rights discourse has to find premise within the legal discourse in order to profit from the long established compelling attributes of the law. The article also makes a case for severance of human rights norms from morality, and reveals how the state of entitlement is obliging in itself.

INTRODUCTION

The prominence of the rights discourse and the visibility of human rights as a field of law have resulted into wide-scale use of the rights language among several aspects of the society. The idea that every person anywhere in the world is entitled to certain rights, which others must respect is deeply attractive.\(^1\) Unguided reference to the subject has led to unstandardized expansion of forms of human rights and consequently diminished the value of rights. Such proliferation has further cheapened their purpose and weakened the resolve of potential enforcers.\(^2\) Many philosophers and legal theorists for example see the rhetoric of human rights as just loose talk.\(^3\) In 1791, Bentham contended that ‘natural rights are simple nonsense, rhetorical nonsense, nonsense upon stilts.’\(^4\) Hart’s apparently persuasive observation that natural rights are

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\(^2\) See Amy Gutmann and Stephen Macedo (eds), Human Rights as Politics and Idolatry (Princeton University Press, 2011) x.

\(^3\) Sen, above n 1, 315-16.

\(^4\) Ibid 316.
parents of law that inspire and motivate specific legislation\(^5\) can be qualified with the view that this parent is often disowned. When people are subjected to political authority as a result of an act of consent of their part, the social contract consequently takes them out of a state of nature.\(^6\) Their rights become negotiable. If legal consensus is required as either proof of a human right or as the foundation of it,\(^7\) the human right in question must conform to legal standards.

Authoritatively of a human right, in law, is sanctioned by legal processes such as codification and judicial proclamation.\(^8\) These procedures accord human rights legal and institutional force hence creating a category of norms that is distinguishable from moral appeals\(^9\)—also referred to as ethical demands,\(^10\) or the traditional embodiment of natural rights.\(^11\) Two discourses of human rights have subsequently emerged: human rights law; and human rights rhetoric or rights as appeal to human conscience. In the words of Jeremy Bentham ‘Right, the substantive right, is the child of law; from real laws come real rights; But from imaginary laws, from “law of nature” [can come only] imaginary rights’.\(^12\) This distinction is consequential.

Upon promulgation, a right is conditioned to a legal order or positive law and it exhibits peculiar attributes. A human right in law must be adequately and effectively formulated. The quality of articulation determines the justiciability of the right. Legality itself depends on certainty, precision and predictability. Without undermining the

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\(^7\) See natural school’s perspective that legal consensus can only ever be the proof of existence of human rights and not a foundation of human rights—Marie-Bénédicte Dembour, ‘What are human rights? Four schools of thought’ (2010) 32 *Human Rights Quarterly* 1, 6.

\(^8\) Meyerson defines a legal right as a right that is enforceable through the courts, that is granted by statute, common law and constitutional provisions—Denise Meyerson, *Jurisprudence* (Oxford University Press, 2010) 239. See also Eric Blumenson, ‘Four Challenges Confronting a Moral Conception of Universal Human Rights’ (2015) 47 *The George Washington Intl’l Law Review* 331, 331 stating that one of the elements of a right is recognition by some governments.


\(^10\) See Sen, above n 1, 319.


\(^12\) Cited by Sen, above n 1, 325.
The transformative power of human rights rhetoric, this article will focus on the nature of human rights as a species of law. It elucidates the elements of a human right legally so-called, explains the significance of each element, and alludes to the consequences of the distinctive structure of a human right in law. This discussion is not meant as exhaustive or uncontroversial.

ELEMENTS OF A HUMAN RIGHT IN LAW

A human right primarily relates to a cognisable state of being; it is a standard of wellbeing that develops into a claim upon infringement. This view differs from the perspective of a human right as a claim-right possessed in virtue of some aspect of the status of being human. In the former description, a right develops into a claim when not realised or fulfilled. While in agreement with some of the fundamentals of a human right enumerated by Reeves including (i) protected interest; (ii) duty or obligation(s); (iii) duty-bearer; another constituent, that is, (iv) a beneficiary or an interest bearer must be added to the list. The fourth component advanced by Reeves, that is, standard of conduct, correlates with the aforementioned generic description of a right as a whole; a right as a standard of wellbeing sets a standard of conduct.

Protected interest(s)

A right is based on humankind’s demand for a life in which the inherent dignity of a human being receives respect and protection. A specific right is a ‘living good’ comprising of valuable ideals. A justiciable right constitutes warranties that are worthwhile and essential to human dignity. For example, the right of everyone to an adequate standard of living includes adequate food, clothing, housing and to

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13 See Blumenson, above n 8, 329: citing examples of Martin Luther King Jr., Nelson Mandela, and Mahatma Gandhi that were able to defeat powerful and entrenched forces on the strength of human rights rhetoric. See also Sen, ibid 320 on public discussions, appraisal and advocacy as effective means of promoting human rights through creating effective social pressure.
14 Ibid. Blumenson makes a distinction of human rights traditionally as a species of justice rather than law.
16 Ibid 408.
continuous improvement of living conditions;\(^\text{18}\) the right to a fair trial includes guarantees such as information on the charges in a language that a person understands, adequate time and facilities to prepare a defence, trial without undue delay, the presumption of innocence, among others.\(^\text{19}\) The intervention of the law is justified by the risk of harm to the aforementioned warranties. It should serve to safeguard a fundamental priority interest.\(^\text{20}\) This quality reveals the functional character of a human right and distinguishes it from dreamy idleness and mundane aspiration that is of no litigable value. Thus a right that does not reveal a valuable and perceptible aspiration is vague.

Human rights provisions address the details of everyday life such as parental and spousal responsibilities,\(^\text{21}\) the status of the environment, access to health services, availability of food among others. These concerns are actual and realistic thus making the respective rights feasible to enforce.\(^\text{22}\)

**Obligation(s)**

The affirmation of a human right involves reasonable consideration of the corresponding duties.\(^\text{23}\) The duty imposed by a human right bears significantly upon its justiciability. Infringement of the protected interest, manifesting as a failure of obligation, potentially leads to a claim or legal action. Human rights formulations must therefore be specific and better indicative of which duties each right grounds or what is concretely required.\(^\text{24}\) Forms of human rights obligations include promotion, respect, protection, and fulfilment\(^\text{25}\) of the specified interest.

Human rights are commonly perceived as specifying the ways in which state officials must and must not act towards their own citizens.\(^\text{26}\) They were originally designed to

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\(^{19}\) Article 14 International Covenant on Civil and Political Rights (ICCPR).

\(^{20}\) Blumenson, above n 13, 331. See Reeves, above n 15, 403 describing human rights as ‘risk impositions to protected interests’.


\(^{23}\) Sen, above n 3, 322.

\(^{24}\) Reeves, above n 16, 405.

\(^{25}\) Ibid.

apply vertically, while creating rights for people and duties for the government.\textsuperscript{27} The aforementioned perspective is restrictive and does not envisage the horizontal application of human rights which promotes their quality as a relational tool to oneself, and among individuals. A human right should be rightly described as a guiding standard of interaction among individuals; a norm that governs human behaviour.\textsuperscript{28} Donnelly’s reference point for understanding human rights as obligation grounded in human commitments is relevant.\textsuperscript{29} A person can speak meaningfully of their rights where they can hypothesise, demand, claim, or perceive that another person has an obligation, the obligation which may arise from commitment to a legal system, a moral system, a fundamental moral principle, an ideological cause, or to respect for humanity or the fundamental humanity of each person.\textsuperscript{30} Humanity is also owed to oneself. The state as a guarantor and a ‘guard’ realistically has an oversight role in the realisation of rights but the reality that citizens threaten their own rights and those of others cannot be underestimated. The language of rights gained dominance following the Universal Declaration of Human Rights of 1948 after the Second World War which was sparked by majorly state sanctioned abuses of human dignity. State accountability was central in the subsequent decades but a contemporary holistic protection model must integrate the obligations of non-state actors such as organisations, corporations, groups and individuals. Government’s efforts alone are not enough to guarantee the wellbeing of all persons in any state. Other stakeholders must be willing and able to cooperate.

Sunstein notes that the inability of international charters and declarations to connect each presumed right holder to some specific obligation bearer leaves the content of the proclaimed rights obscure.\textsuperscript{31} This observation should not only relate to the identity but also the capability of the duty bearer. A weak state\textsuperscript{32} may not fulfil the rights of its people. Institutions are central to the realisation of human rights.\textsuperscript{33} Such provisions raise the expectations of the populace without the likelihood of being met in the near

\textsuperscript{27} Maria Green, ‘What We Talk About When We Talk About Indicators’ (2001) 23 Human Rights Quarterly 1062, 1067.


\textsuperscript{29} See Donnelly, above n 9, 82.

\textsuperscript{30} Ibid 9.

\textsuperscript{31} See Sen, above n 3, 346.

\textsuperscript{32} A state with no public coercive forces to uphold law and order, and no authorities to extract or deliver services—Samuel Larsson, Weak States: A pursuit for a weak state definition and feasible reconstruction theories’ University of Lund, 2005, 9 <https://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=1332751&fileOId=1332752>.

\textsuperscript{33} Ibid 347.
future. The concerning quality of governance among many African countries is met with bills of rights that are continually expanding.

Hart’s subtle distinction between a person ‘under an obligation’ and a person ‘having an obligation’ informs this debate. Whereas a person is under an obligation to do something where doing that thing is a necessary condition for avoiding some threatened evil, a person having an obligation is one that accepts that commitment even without a threat. The human rights discourse should promote voluntary assumption of responsibilities by all stakeholders. The state in under an obligation but every other person or entity has an obligation to respect and uphold their rights and of others.

**Duty bearer(s)**

The duty imposed by a human right should accrue to an ascertainable and “functional” entity. Blumenson describes the duty bearer as a particular addressee that is duty-bound by the right. The state-centric nature of the international human rights system is undisputable. This perspective of human rights suffices for those protections and violations that constitute the exercise of state power.

Human rights guarantees and infringements transcend the boundaries of state power. In fact, a human right is equally a ‘self-governance’ concept. In the language of the African Charter on Human and Peoples’ Rights, the enjoyment of rights and freedom also implies the performance of duties on the part of everyone. The duties are owed to one’s family and society, the state, and other legally recognised communities and the international community. While expressly introducing corresponding obligations that a rights holder owes to other significant entities, the Charter does not mention the obligation that such a person owes to him-herself. This omission is an underestimation of the potential of a human being to violate their rights or refuse to exercise their

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35 Blumenson, above n 13, 331.
38 Article 27 (1) ACHPR.
rights, in cases where positive steps are required, and as a result constrain every possibility of ensuring human dignity.

The guarantor should include the beneficiary. A rights bearer has the responsibility of safeguarding their dignity to the extent of the means available to them. A human being is born in an intrinsic state of dignity. Dignity is obliging; its maintenance requires activity from the holder. It is against this background that the first level of obligation is ‘respect’ - a restraint from violation. The leading standard of ‘respect’ presupposes that a person naturally inhabits a state of adequate wellbeing that should not be distorted. It is notable that the rights discourse has been a more effective instrument in protecting individuals against the evils of abuse, cruelty, oppression and degradation, which require restraint than as a guarantee to a better life that requires a provision role. An example is the prohibition against torture, which is a non-derogable right that also constitutes customary international law.

With regard to positive human rights obligations, the expectations of a population from their government ought to correspond to the level of facilitation offered by those people to the state. A government of a state with a wide tax base is better placed to fulfil the socio-economic rights of its people and vice versa. Even a capable governing entity agrees to a supposed right before it takes effect in its jurisdiction. Globalisation and increased circulation of information creates pressure among struggling nations as human rights are perceived as guarantors of social justice and substitutes for comprehensive conceptions of a good life. A population must be mindful of its contribution to the capacity of the state to facilitate human rights. The bottom-up dynamic is as significant as the up-bottom perspective.

**Interest bearer(s)**

A human right is an entitlement of an ascertainable natural person. An expression that ‘everyone has a right to education’ implies that the right to education is the property of somebody. The popular proclamation that ‘it is my right’ follows suit. The bearer must engage in an active process of taking ownership of the right, sustaining it or even developing it. The right derives significance from meaningful control by the bearer;

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39 See Gutmann and Macedo (eds), above n 2, x.
40 See Gutmann and Macedo (eds), above n 2, x.
41 See Taylor, above n 28, 3.
they have a role in enforcing it and they can waive it. This perspective lacks adequate expression and promotion in the human rights discourse. Much should be done about sensitising people of their role in realising their rights as there is in empowering them to demand the fulfilment of their entitlements.

The aforementioned component is also important in delineating boundaries of rights. Whereas some rights are for ‘every person’, others are restricted to specified categories of persons such as citizens, children, women, refugees, accused persons, among others.

**THE CONSEQUENCES OF THE INTERNAL STRUCTURE OF A HUMAN RIGHT IN LAW**

The rights discourse has successfully obliged the state entity as a primary guarantor of human rights of persons subject to its jurisdiction. The focus on the state has politicised the language of rights and obscured the role of other stakeholders. While advancing a right as a claim, the rights discourse has been devoid of emphasis on the significance of the contribution of the individual towards safeguarding their inherent state of dignity. The challenging result is a disproportion between the expectation of persons and the capacity of the state to meet them. This accounts for some of the enforcement gaps. The role of the rights bearer in exercising their rights cannot be underestimated. Rights are standards of equity and equity aids the vigilant. Efforts to guarantee human rights should mainstream empowerment of individuals that would in turn reinforce the capacity of the state.

A position of entitlement is one of responsibility as opposed to a state of idle endowment. The obligations corresponding to the human rights in the African Charter on Human and Peoples’ Rights are right on point. In fact, the level of enjoyment of human rights corresponds with the level at which a particular population assumes responsibilities. The internal structure of a human right advances a sacred human quality. Human dignity goes beyond the regulatory framework. Dignity is oversimplified when presented as only a political demand from policy makers or used as an excuse for dreamy idleness and idle clammer for better conditions. This position justifies the standard of progressive realisation of resource driven rights. A population

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42 Ibid.
with a lower consuming power and limited capacity to contribute to their nation’s tax base would naturally endure lower levels of progress in the realisation of socio-economic and other rights.

A right is a state of being. It develops into a claim in specified circumstances including (a) where its inherent nature involves exercise of state power or collective enjoyment such as the right to self-determination, the right to development, the right to a clean and healthy environment, and (b) where the enjoyment of the right is at risk or another party, other than the interest bearer, violates it.

**Human rights and morality**

Although rights may be grounded in morals, can lead to a morality, or embody moral norms, morality is not, and cannot be a qualifying standard for a legal human right. Morality has no propensity to do so because it is neither standardised nor universal. The legality of a human right severs it from morality as a pre-requisite. Upon promulgation in legislation, a legal right acquires the positivist character; it is what it is and not what it ought to be. The apparent mingling of moral considerations with human rights complicates the discourse of rights. A case in point is gay rights that are continually challenged on grounds of morality. A right is sometimes a personal guarantee that revolves around individual interest; to subject it to a fluid notion such as morality is to expose it to infinite possibilities from other parties. The Kantian theory that rights depend upon the idea that ‘…every person is an end in themselves and never the means for ends of others’ is credible; every person is an autonomous rational being, knowing their own interest as they do. In fact, natural scholars opine that a right is an individual’s interest and human rights are typically realised through individual enjoyment. If one wishes toascertain the rights of another, the targeted person should be asked. What is right for another cannot be assumed or imputed by analogy. The fact that voices of beneficiaries of human rights are less heard during negotiation of human

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44 Blumenson, above n 13, 331: ‘there are no moral claims when the sole referent is a legal right rather than a moral one’.
45 Blumenson refers to it as a fundamental challenge to moral universality. Blumenson, ibid, 336.
46 See H.L.A Hart, ‘Positivism and the Separation of Law and Morals’, (February 1958) 71 (4) Harvard Law Review 593, on the merits of the distinction between law as it is and what it ought to be.
47 Blumenson, above n 1, 329.
rights treaties has to be corrected. Clashes between rights and social goals are reasonably probable; rights themselves may constrain meritorious or rational social goods. It is a balancing act.

Distinctively, the African Charter on Human and Peoples’ Rights subjects the exercise of the rights and freedoms enshrined in the Charter to morality, among other standards. Morality may rightly act as a control to enjoyment of rights so as to harmonise them with other guarantees. This viewpoint differs from where the recognition of the right is subject to morality.

Moral rights exist. Such rights are justifiable regardless of whether they are legally or socially recognised. These rights can facilitate a persuasive debate despite their inability to found legal action.

CONCLUSION

The rights discourse has developed into a distinctive and significant area of the law. Initially manifesting as moral appeals, human rights have remarkably acquired legal force following legislative proclamations. Human rights as species of law or creatures of positive law are distinguishable from natural rights, which derive from the state of nature. The formulation of human rights standards in law must reflect their legal character and embody elements that actualise their purpose. A human right must be functional, valuable, attainable, realistic and essential. A legal human right without a structure is indeed rhetorical nonsense although human rights can have influence without depending on coercive legislation.

The law must render structure to a right and direct it to its purpose. An adequately formulated legal human right in law should contain the protected interest(s); the obligation(s); the duty bearer(s), and the interest bearer(s). The rights may constitute exercise of state power or diligent fulfilment of responsibilities of human life or both. A statement of a human right must stipulate what is at stake, to whom it belongs, and

49 See Jaichand, above n 36, 36
50 See Meyerson, above n 8, 248.
51 Article 27 (2), African Charter on Human and Peoples’ Rights
52 Meyerson, above n 8, 239.
53 Ibid 239-240.
54 See Sharma, above n 17, 319
55 See Sen, above n 1, 345.
who is obliged. The rights discourse has successfully obliged state entities as crucial defenders of human rights. Entitlement is responsibility. A human right is a tool for change\(^5\) and an end in itself. The human rights discourse should mainstream empowerment of individuals to take ownership, safeguard and facilitate their ‘state of proper being’ as much as they are enabled to make claims. A right facilitates self-governance as well as state governance. The standard of progressive realisation is premised on this reality.

The nature of a human right needs to be put in proper perspective. A right is primarily a state of well-being or proper being. It turns into a claim when there is an intervening factor that distorts the aforementioned state. Certain rights naturally require state action or the involvement of others; they are inherently demand oriented.

The determination of suitability of the state of being is principally subjective. The subject of the entitlement has more knowledge of the ideal. That ideal is not subject to unstandardized opinions of others such as morality. Satisfactory ideals vary among persons.

\(^{56}\) See Icaza, above n 43, p.79.
Safety from False Convictions by Boaz Sangero – Book Review

Associate Professor of Law Doron Menashe and Dr Sivan Biber

Introduction

In his new book "Safety from False Convictions" Boaz Sangero develops his thesis, that was originally conceived together with Mordechai Halpert, to view the criminal law system as a "safety-critical system", much like the aviation field and the pharmaceuticals and drugs field, where every accident could result in catastrophic damage, especially the loss of life. According to Sangero, A false conviction is no less an accident than a fighter airplane crash, because it can cause grave harm to the individual and society in general. This grave harm is manifested by the deprivation of liberty in the form of imprisonment and even loss of life through the death penalty. Sangero claims that it is therefore the state's moral duty to adopt and implement safety measures in the criminal justice system, like it does in other safety-critical fields. Sangero further argues that there is also an economic rationale for safety in the criminal justice system.

After he tries to substantiate the analogy between criminal justice system and other safety-critical systems, Sangero dwells on the fundamentals of modern system-safety. The rest of the book is dedicated to offering examples for safety principles, procedures and rules that should govern the yet unexisting field of safety in the criminal justice system, which Sangero derives from the experience accumulated in other fields. Sangero develops safety models in evidence law as well as in criminal procedure. For example, one of the most important suggestions of Sangero is to establish the Safety in the Criminal Justice System Institute (SCJSI), which will supervise the ongoing and never-ending effort to improve safety in the criminal justice system (that is, minimization of the false

1 BOAZ SANGERO, SAFETY FROM FALSE CONVICTIONS (2016).
3 SANGERO, supra note 1, at 1-2. It should be noted, in that context, that most of the criminal law does not concern serious crimes that can lead to long imprisonments, life sentences or the death penalty. For example, most traffic offences, tax offences, environmental offences will not lead to defendant's imprisonment. Sangero's opinion is that such behaviours should not be criminalized in the first place, and we tend to agree with this view, but nevertheless it should be noted that Sangero's analogy does not apply to a wide part of the current criminal law.
4 Id. at 14-19.
5 Id. at 19-22.
conviction rate), much like the FAA in the aviation field or the FDA in the area of food and drugs.\(^6\)

Sangero's effort to devise an all-encompassing theory that promotes the worthy cause of reducing false conviction rate in the criminal justice system, is praiseworthy and will surely contribute to the ongoing debate about the false conviction rate and the measures needed to decrease it to the bare minimum. This debate will raise the awareness of the criminal justice community to the problem of false convictions, which is sometimes ignored due to what Sangero & Halpert called the Hidden Accidents Principle.\(^7\) In doing so, Sangero already achieved one of his main goals. Furthermore, we think that some of Sangero's proposals are much needed and should be adopted by policymakers. Certainly, those ideas which can reduce the false conviction rate with a minimal cost or no cost at all, but even some of the more "expensive" proposals of Sangero should be considered seriously – especially in the field of forensic evidence, as mentioned below.

However, we think there are three basic problems with the Sangero's safety theory. Firstly, although at first glance Sangero's theory seems to introduce a whole new set of terms and ideas to criminal law, taken from a well-established doctrine of safety, a closer inspection reveals a great similarity between a large part of Sangero's theory and other "rules theories" in evidence law, especially Alex Stein's "equal best" principle. Accordingly, a large part of Sangero's theory is exposed to the same kind of criticism that Stein's theory was subjected to.

Secondly, the justification for Sangero's safety theory relays heavily on the assumption that false conviction rate is currently higher than we use to think, and that the actual false conviction rate cannot be accepted from a moral, social or economic standpoint. Unfortunately, this crucial assumption for Sangero's theory is not backed by strong empirical data. To compensate for this disability, Sangero relays heavily on the Hidden Accidents Principle, although this principle cannot help us estimate the correct false conviction rate or the measures needed to reduce it.

Thirdly, Sangero implies that incorporating safety into the criminal justice system could be a win-win situation, as resources could be allocated to assessing and identifying hazards and risks, and instituting safety measures to reduce both wrongful convictions and wrongful acquittals.\(^8\) We will argue that a win-win

\(^6\) Id. at 80-84.
\(^7\) Halper & Sangero, supra note 2, at 398-402.
\(^8\) SANGERO, supra note 1, at 26.
situation can only be attained in a narrow sense, where the "safety procedure" will increase the relevant data presented before the tribunal or increase the accuracy of a forensic technic, without changing the burden of proof, and as long as its cost is negligible. In all other cases, Sangero's theory is indeed limited to "safety from false convictions" and not safety from wrongful acquittals.

After examining those three fundamental problems in Sangero's theory we will inspect more closely three of his specific suggestions to improve the "safety" of the criminal justice system: can a confession be a key piece of evidence for a conviction; should a single piece of evidence be sufficient for a conviction; and implementing the modern safety model STAMP in the criminal justice system. Naturally, in this short article we won't be able to cover some other important matters dealt by Sangero in his book, and they will be left for future deliberation.

Safety in evidence law as a "rules theory"

Sangero's safety theory relates to three areas of the criminal justice system: organizational issues (like the establishment of the SCJSI), forensic sciences and evidence law. The part of Sangero's theory that relates to evidence law includes, for example, his proposals to impose a general principle that a conviction must not be based on a sole piece of evidence,\(^9\) to adjust the Beyond-a-Reasonable-Doubt Standard,\(^10\) to disallow a conviction based on confession unless there is a strong corroboration and unless there are indications that the interrogee knew unrevealed details about the crime scene\(^11\), etc.

In general, evidence law theories can be divided into "free proof" theories and "rules theories". The "free proof" approach to evidence law favors a broad discretion to fact-finders in all matters concerning the fact-finding process, including admissibility issues, the way the evidentiary process should be conducted, the inference process and even the standard of proof. The most prominent advocate of this approach in the last decades is L. J. Cohen, who based his ideal of free proof on the universal cognitive ability to make correct inferences from evidence.\(^12\)

On the other hand, Alex Stein who was willing to embrace Cohen's assumption about our mutual cognitive ability argued, quite rightly, that the inference process in criminal law cannot be detached from moral decisions. Specifically, the fact-finding process, according to Stein, will always involve allocation of the risk of

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\(^9\) Id. at 57-64.
\(^10\) Id. at 65-66.
\(^11\) Id. at 95.
\(^12\) L. Jonathan Cohen, Freedom of Proof, in FACTS IN LAW 1, 4-5 (William Twining ed., 1983).
error in criminal trials (Type I errors, false convictions, versus Type II errors, false acquittals). According to Stein's "equal best" principle, the state must do its best to protect the defendant from the risk of erroneous conviction and must not provide better protection to other individuals, meaning that the state should enact evidentiary rules that will regulate both the admissibility of evidence and its sufficiency.

Implementing Sangero's safety theory in evidence law, demands that the state will continuously enact evidentiary rules that will diminish false conviction rate, as a part of an ongoing process of risk reduction. As can easily be seen, that demand is equivalent to Stein's "equal best" principle, mentioned above. Like Stein's theory, Sangero's safety theory can be viewed as an awkward attempt (an attempt that is not based on empirical data) to reduce the risk of false conviction, while raising the risk of false acquittal, in a way that deviates from the social agreement about the allocation of the risk of error in criminal trials, which is already reflected by the standard of proof. As Larry Laudan pointed out, for every existing evidentiary rule we can always conceive a stricter rule that will grant defendants a better protection from false convictions, but this recursive move will eventually lead us to an absurd rule that deems every incriminating evidence inadmissible.

The best way to demonstrate this flow in Sangero's theory is to return to his analogy between criminal justice system and other safety-critical systems. Let's take a closer look at road transportation, which is clearly a "safety-critical system". In the years 2009-2014 approximately 32,000 people were killed every year in car accidents across the United States and many more were injured. In previous years, the numbers were even higher. Next to that distressing data, that is published on the National Highway Traffic Safety Administration (NHTSA) website, there are recommendations for safety technologies that can save many lives, such as: Dynamic Brake Support, Crash Imminent Braking, Rearview Video System, Forward Collision Warning, Lane Departure Warning and more. None of them are currently mandatory (RVS will become mandatory for new vehicles in May 2018). The economic reason not to compel car manufacturers to include those safety technologies in new vehicles is both cruel and simple: the

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15 SANGERO, supra note 1, at 18 & 55.
16 See LARRY LAUDAN, TRUTH, ERROR AND CRIMINAL LAW – AN ESSAY IN LEGAL EPISTEMOLOGY 117-146 (2006).
17 Id. at 131.
19 Available at https://www.nhtsa.gov/equipment/safety-technologies.
state is willing to sacrifice many lives for the social benefit of affordable cars. In fact, that is the case for every safety-critical system: the best safety measure will always be to forgo the activity altogether, but if we are not willing to resort to such a drastic measure, some (or even many) catastrophic accidents are bound to happen.

Let's return now to the criminal justice system. Why not hold every criminal trial twice before two different tribunals, and only if the defendant is convicted twice he will be found guilty. At first sight, this seem like a great safety precaution, but naturally this suggestion will double the costs of any criminal trial. Moreover, we can reduce this suggestion to absurdity by offering to repeat the trial an infinite number of times. But no matter what safety measures are taken, it's obvious that not all false convictions can be prevented. The question of how many criminal trail "accidents" we want to prevent and at what cost, will be resolved by using moral and economic considerations. Basically, it's the same risk allocation dilemma once again.

Therefore, the true force of Sangero's safety theory lies in the parts of his theory that do not change the risk allocation in criminal trials and does not impose great costs. One example for that line of thinking is the recommendations mentioned by Sangero on how to improve the police lineup identification protocol in accordance with psychological studies. Another example is Sangero’s suggestion that "incidents" in the criminal justice system, like perjury or falsification of evidence by a police investigator, forensic laboratory technician or prosecutor, will be thoroughly investigated so as to identify the system failures.

Similarly, in the field of forensic sciences Sangero suggested some much-needed improvements based on the National Academy of Sciences (NAS) 2009 report and on National Association of Criminal Defense Lawyers (NACDL) 2010 report. In particular, Sangero pointed out that due to the Daubert rule, judges should have become "gatekeepers", preventing the entry into the courtroom of evidence that is not scientifically reliable or valid. In reality, tough, judges lack the expertise in the scientific or pseudoscientific fields ("junk science") they need to approve. To overcome this obstacle Sangero suggests to adopt the NACDL recommendation to establish a central science-based federal agency. One of its central roles will be determining the validity, limitations, and measures of

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20 SANGERO, supra note 1, at 187-194.
21 Id. at 86. It should be noted, tough, that unlike Sangero we don't think a court acquittal should necessarily be considered an "incident". On the contrary, in most cases, acquittals indicate that the justice system operates as it should.
22 SANGERO, supra note 1, at 142-143.
uncertainty of forensic theories and techniques. This recommendation, along with other similar recommendations mentioned by Sangero in the field of forensic sciences, are examples of a win-win situation, where we can improve the accuracy of the criminal justice system without changing the allocation of the risk of error, and at a reasonable cost. We will elaborate this point in another chapter.

Estimating the false conviction rate

Nowadays it is common knowledge that false convictions do happen. Their rate, however, is controversial. Sangero tries to estimate the rate of false conviction by two methods: a theoretical calculation based on the criminal standard of proof and a calculation based on empirical data. As we shall demonstrate below, both methods are not convincing.

Sangero's theoretical estimate of the rate of false conviction assumes that judges use Blackstone's 1:10 ratio as a decision rule for finding defendants' guilt, which means that they are willing to convict a defendant even when there is only a 90 percent certainty of his guilt (that assumption is based on some surveys of judges). According to that assumption, approximately 78,000 defendants are wrongly convicted in the United States every year (5 percent from all convicts).

We argue that even if a judge answered on a survey that the required threshold of proof in criminal law is 90 percent certainty of guilt, it does not necessarily mean that she will be willing to send a defendant to a long-term imprisonment when she is not absolutely certain (100% percent or almost 100% subjective certainty) of his guilt.

Furthermore, we believe that Laurence Tribe was right when he argued that judges do not think in probabilistic terms. Firstly, some of the judges may not even understand the true meaning of a 90 percent threshold, due to lack of adequate statistical knowledge. Secondly, even if a judge thinks there is a 10 percent chance that the defendant is innocent, and he is still willing to convict him, the actual rate of error may be smaller, due to inadmissible data taken into account by the police and the prosecution before the decision to investigate or to

\[^{23}\text{Id. at 154.}\]
\[^{24}\text{Id. at 6-7 and see also Halpert & Sangero, supra note 2, at 402-8.}\]
\[^{25}\text{It should be noted that many judges refused to answer, or answered that the required threshold of proof in criminal law is 100 percent certainty of guilt (see C.M.A. McCauliff, Burdens of Proof: Degrees of Belief, Quanta of Evidence, or Constitutional Guarantees?, 35 VAND. L. REV. 1293, 1325-6 & 1332-2 (1982)).}\]
indict, like a polygraph test, criminal intelligence or the suspect's criminal record. The judges may count on such hidden safeguards, in the back of their minds. Thirdly, the psychological condition of a judge that feels she is absolutely certain of the guilt of a defendant and decides to convict him, even though she is aware that a false conviction is always a possibility, can be explained by the inductive logic of L. J. Cohen. The Beyond-a-Reasonable-Doubt standard is explained by Cohen as follows:

"In constructing a proof beyond reasonable doubt we have to eliminate in turn each legitimate reason for doubting what we want to prove"\(^\text{29}\)

That is, after eliminating all possible scenarios of innocence, inductive logic lets us reach absolute certainty of the defendant guilt (a probability of 1), even though the remote possibility that the defendant is in fact innocent will always exist.

The second attempt of Sangero to estimate the rate of false conviction relies on three empirical studies. The first study of Michael Risinger tried to deduce the rate of false conviction from a group of 11 cases of false conviction for capital rape-murder **between 1982 and 1989** that had been uncovered by the Innocence Project. Risinger tried to calculate the total number of cases with similar characteristics in the same period of time, where DNA samples had been preserved, and concluded (using some additional assumptions) that the false conviction rate was at least 5 percent.\(^\text{31}\)

The second study initiated by the State of Virginia compared samples that had been found in the crime scene with samples taken from the defendants. Data were gathered on 634 cases of rape, sexual assault, murder and manslaughter **between 1973 and 1987**. In 33 of those cases researchers found exculpatory evidence. By omitting the cases where DNA tests where not possible, Sangero argued that this study indicates 15 to 18 percent of false conviction rate.\(^\text{32}\)

\(^{27}\) That situation was described by Ronald J. Allen (see Ronald J. Allen, *On the Significance of Batting Averages and Strikeout Totals: A Clarification of the 'Naked Statistical Evidence' Debate, the Meaning of 'Evidence', and the Requirement of Proof Beyond a Reasonable Doubt*, 65 TUL. L. REV. 1093, 1104 (1991)).


\(^{30}\) Some of those studies are also mentioned by Halpert & Sangero, *supra* note 2, at 405-8.

\(^{31}\) SANGERO, *supra* note 1, at 8-9.

\(^{32}\) *Id.* at 9-11.
The third study by Gross et al. from 2014 tried to estimate the rates of false conviction of criminal defendants who are sentenced to death. The researchers gathered data on 7482 death-sentenced inmates in the United States **between 1973 and 2004**. Of these, **117 defendants** were exonerated. The researchers speculated that because the intensive search for possible errors is largely abandoned once the threat of execution is removed, the actual rate of false conviction is higher than 1.5 percent. Using a "survival analysis" model they reached the estimate of 4.1 percent.33

The three above mentioned studies, combined, examined only 161 cases of false conviction over three decades, while in 2012 alone 1,571,013 prisoners were convicted in the United States.34 Therefore, it seems hard to substantiate a whole safety theory on such meager empirical data, no matter how good the extrapolation methods are. Especially when some of the data is already old, when the forensic methods have improved dramatically over the years (like DNA profiling) and when the data relates only to a small fraction of all criminal offences (the most serious ones, where the social pressure to apprehend and to imprison the offender is highest).

But Sangero has one more card up his sleeve: The Hidden Accidents Principle, which he devised together with Halpert, that is described as follows:

"The general inability to detect false convictions is a prominent characteristic of criminal law, and these 'accidents' typically 'remain undetected'. This inability 'translates into optimism on the part of policymakers that false convictions only occur at negligible rate' " 35

Evidently, this principle – and especially its magnitude – cannot be empirically tested for refutability because the relevant data is "hidden", and so it does not adhere to Karl Popper's principle of falsifiability.36 Moreover, from an economic perspective there is no relevance to a variable (allegedly false convictions) that is "hidden" from the public, and therefore does not affect social behavior or public confidence in the judiciary. Even from a moral point of view it's questionable if we should take safety measures to prevent hypothetical "accidents", while those measures will certainly and very tangibly harm other important moral values, like the right to personal security. Finally, it would be very hard, practically, to take

33 *Id.* at 12-13.
34 *See Id.* at 6.
35 *Id.* at 56 and *see also* Halpert & Sangero, *supra* note 2, at 398-402.
effective safety measures against an "enemy" we can't observe, and we might end up throwing the baby out with the bath water.

As we have shown, Sangero was unable to prove that the false conviction rate in the last decades is substantial or that it exceeds the common knowledge and acceptance of the allocation of the risk of error in criminal trials.

But the high rate of false conviction ("accident" rate) is a central theme and an essential assumption in Sangero's safety theory. In Sangero's own words:

"... the discussion throughout the book will suffice with what is emerging to be conservative assumption of a false-conviction rate of 5-10 percent in general and 5 percent for the most serious offenses".\(^{37}\)

Without that assumption, the justification for establishing a new comprehensive safety system in the criminal justice field is greatly diminished. When we consider installing a new safety system, in any field, the expected value of the cost of accidents is a key datum. If the expected value of the cost of accidents is already very low, there is no economic justification for taking expensive precautions to prevent them and no moral justification for taking precautions that will harm other important social values, like public order.

Our conclusion, then, is that Sangero did not manage to justify the need for a new comprehensive safety system in the criminal justice field, beyond the rules and procedures that are already in place today. Even so, some of Sangero's recommendations for specific "safety" measures that need to be taken in the criminal justice system are worthy, as mentioned above.\(^ {38}\)

Is Sangero's theory a win-win solution

As mentioned above, Sangero implies that incorporating safety into the criminal justice system could be a win-win situation, as resources could be allocated to assessing and identifying hazards and risks, and instituting safety measures to reduce both wrongful convictions and wrongful acquittals.\(^{39}\)

First of all, in the most formalistic sense, a safety measure can never lead to a win-win situation because it has a cost. Law enforcement's resources are always

\(^{37}\) SANGERO, supra note 1, at 14.


\(^{39}\) SANGERO, supra note 1, at 26 and see also Halpert & Sangero, supra note 2, at 374.
limited, and every dollar spent on safety is one less dollar spent on crime control. This fact is particularly noticeable when we consider some of Sangero's most expensive suggestions, like completely abolishing the plea-bargain system or expanding significantly the post-conviction proceedings.

Nevertheless, we are willing to admit that the cost of some "safety measures" can be considered negligible. Even then, we argue that a win-win situation can only be attained in a narrow sense, when the "safety procedure" will increase the relevant data presented before the tribunal or increase the accuracy of a forensic technic, without changing the burden of proof, in practice. In all other cases, Sangero's theory is indeed limited to "safety from false convictions" and not safety from wrongful acquittals. We will use the rules concerning eyewitness identification to clarify this point.

In his new book, Sangero summarizes the professional literature that holds that an erroneous eyewitness identification is far from rare. That literature is undisputed among scholars nowadays. Sangero suggests a wide range of "safety measures" to tackle this problem. The most prominent one is to disallow a conviction based solely on eyewitness testimony. This suggestion will clearly change the risk allocation in criminal trails, by preventing false convictions based on erroneous eyewitness identification, on one hand, while setting free a lot of criminals, on the other hand. The same logic can lead us to even a more radical "safety measure" that will deem eyewitness testimony inadmissible altogether. Those safety measures will surely increase the "safety from false convictions" but they cannot be considered win-win solutions by any measure.

On the other hand, other "safety measures" offered by Sangero, like improving the police lineup identification protocol or recording lineups on video – which will give the court a direct, full documentation of the evidence – will provide fact-finders better information about the nature of the specific eyewitness testimony laid before them, while leaving them full discretion about the weight of that piece of evidence and the ability to convict upon it. Under those restraints Sangero's theory can truly be considered a win-win improvement to evidence law.

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40 Id. at 217-9.
41 Id. at 228-32.
42 Id. at 181-5.
43 Id. at 185-7.
44 Id. at 187-8.
45 Id. at 188.
Confessions

Nowadays it is widely accepted that a confession is no longer the "queen of evidence" and that false convictions may occur due to false confessions. But Sangero goes one step further when he claims that "Given this unequivocal evidence of numerous false convictions based on wrongful confessions given during police interrogations, I have suggested crowning this type of confession the 'empress of wrongful convictions' " 46

Sangero bases his thesis on empirical studies (which supposedly prove the large prevalence of false confessions as a major cause for false convictions and the fact-finders' inability to discern true from false confessions) and on a Bayesian logic analysis. From that he concludes that "… legislators should amend current law to preclude confessions from being the sole, or key, piece of evidence for a conviction, and to assign them only corroborative weight, to support other key evidence in a case". 47 In the following paragraphs we would like to put that conclusion, and its underlying assumptions, to the test.

One of us and Shai Otzari have shown elsewhere that in order to prove that false confessions are more prevalent than fact-finders assume, and therefore cause more false convictions than should be expected by their proportionate share and by the criminal standard of proof, researchers should estimate the proportionate share of false convictions based on confessions from all convictions based on confessions. 48 None of the studies discussed by Sangero provides that datum. 49

Let's take for example the findings of studies conducted by the Innocence Project that about one-quarter (23 percent) of the first 225 cases in which DNA testing proved a conviction to be false had been based on (presumably false) confessions. 50 That datum, in itself, does not indicate whether confessions are more or less reliable than other kinds of evidence or whether false confessions are more prevalent than we should expect. Let's assume, for example, that 70 percent of all convictions are based on a confession as a primary evidence. If so, and if only 23 percent of false convictions are based on confessions, then we can

46 Id. at 158.
47 Id. at 179.
49 SANGERO, supra note 1, at 158.
50 Id.
conclude that confessions are quite reliable, while other kinds of evidence are maybe overestimated.\textsuperscript{51}

To prove the fact-finders' inability to discern true from false confessions, Sangero relies, among other studies, on the findings Richard A. Leo and Richard J. Ofshe who showed "… in a study of sixty false confessions, that 73 percent led to wrongful convictions" (meaning, 44 false convictions), and on similar findings by Stephan A. Drizin and Leo who showed "… that 86 percent of the 120 false confessions that went to trial led to wrongful conviction".\textsuperscript{52}

Once again, the missing datum is the total number of convictions based on a confession. If, for example, there were 4,400 conviction based on a confession in the relevant period, and the standard of proof was 0.99, then the expected value of false convictions should be indeed 44, as Leo and Ofshe had found out. That kind of finding, in the above-mentioned example, does not indicate that fact-finders are unable to discern true from false confessions, to an extent greater than is permitted by the proclaimed standard of proof.\textsuperscript{53}

As mentioned, the other argument of Sangero against the use of a confession as the sole, or key, piece of evidence for a conviction, is based on Bayesian calculation. Sangero uses Bayes' Theorem in an odds form:

\[ \text{Likelihood Ratio} \times \text{Prior Odds} = \text{Posterior Odds} \]

The Likelihood Ratio is the probability (P) of an interrogated suspect confessing if he is guilty (P(E|G)) divided by the probability of his confessing if he is innocent (P(E|I)); The Prior Odds is the probability of guilt divided by the probability of innocence (P(G)/P(I)) without taking the suspect's confession into account, based on other admissible evidence; and the Posterior Odds, which is what we are seeking in a criminal trial, represent the probability of guilt after taking into account both the weight of a confession and other evidence (P(G|E)/ P(I|E)).\textsuperscript{54}

Based on the research and on the false confessions that have been exposed, and taking into account the impact of interrogation and detention conditions on suspects, Sangero assumes that at least one out of every ten innocent suspects will give a false confession during interrogation. He also assumes a 50 percent

\textsuperscript{51} Menashe & Otzari, \textit{supra} note 48, at 510.
\textsuperscript{52} SANGERO, \textit{supra} note 1, at 171.
\textsuperscript{53} Menashe & Otzari, \textit{supra} note 48, at 512.
\textsuperscript{54} SANGERO, \textit{supra} note 1, at 174-6.
probability of the court successfully discerning a false confession. Thus, the probability of a confession that is false and not being identified as such by the court is estimated by Sangero to be 5 percent (P(E|I)=0.05). The probability that a guilty person would confess is estimated by Sangero to be no greater than 50 percent (P(E|I)=0.5). Therefore, Sangero assumes that the Likelihood ratio is 10.\footnote{Id. at 177.}

The Posterior Odds is also estimated by Sangero as 10 (which reflect a threshold of 90 percent that the defendant is guilty). Under those assumptions, the Prior Odds necessary to convict a defendant based on his confession must be at least 1, according the equation mentioned above (Bayes' Theorem in an odds form), meaning P(G)≥P(I). Thus, the probability of guilt based on incriminating evidence, but without a confession, must be at least 51 percent to satisfy the standard of proof of guilt beyond a reasonable doubt given a confession. Sangero derives from this that a confession should be treated like corroboration for other substantial incriminating evidence (if such exist) and should not be the primary evidence of guilt.\footnote{Id. at 177-8.}

As one of us and Shai Otzari have shown elsewhere, the main problem with Sangero's argument is the ambiguity of the term "confession" which is used by Sangero in different contexts. As is known, there is a great variety of confessions: there are long and detailed confessions and there short and sketchy ones; there are confessions that are coherent and logical and there are confessions that are fairy stories; some confessions are given on the spot and some confessions are given after long days of interrogation; and so on.\footnote{Menashe & Otzari, supra note 48, at 516-7.}

It seems that Sangero uses for his Bayesian calculation the most meager form of a confession (a confession that includes only the words: "I confess") that was extracted after intensive questioning. Otherwise, it is hard to accept his assumption that one out of every ten innocent suspects will give a false confession during interrogation. If that is indeed the meaning of the term "confession" used by Sangero, then it's easy to understand why Sangero claims that a conviction should not be based on such a confession.\footnote{Id. at 518.}

But if the confession has additional attributes, that have evidentiary value – like a detailed and logical confession, that includes information known only to the perpetrator, and was given during a peaceful and short interrogation – then those
attributes should be taken into account in the Bayesian calculation, apart from the value of the words "I confess", as though they were separate pieces of evidence.\textsuperscript{59}

At this point it will be helpful to return to an example Sangero uses to illustrate the importance of the Prior Odds: "Assume that a crime was committed and that the person interrogated for committing the crime – not due to any evidence linking her to the specific crime… – has confessed. In her confession, the suspect did not provide any information not already know to the police or the public, and the police have not found any additional evidence tying her to the crime". Sangero uses Bayesian logic to prove that such a confession does not meet the criminal standard of proof.\textsuperscript{60} But even without the use of Bayesian logic, a conviction that is based solely on a non-corroborated confession like that seems, intuitively, very unlikely.

However, as we have shown, that does not mean that all confessions have the same weight as a confession of a person that enters a police station and confesses, out of the blue, to a crime, without any motive and without any special knowledge about the way it was committed. In other words, we cannot deduce from the fact that some confessions should not be used as a sole, or key, piece of evidence for a conviction, that there are no confessions that can be used in that way.

Should a single piece of evidence be sufficient for a conviction

One of the major conclusions that Sangero draws from his Hidden Accidents Principle and his safety doctrine is that no conviction should be based on a single piece of evidence, just as a medical doctor should not base her diagnosis on a lone test without considering the statistical implications.\textsuperscript{61}

Once again Sangero uses Bayes Theorem to illustrate his conclusion. The main point of his argument is that even if the likelihood ratio of a certain evidence, like DNA profiling, is very high, we must not neglect the Prior Odds which are extremely low (if there is no other evidence pointing to the defendant's guilt). After taking into account the Prior Odds according to Bayes Theorem it will be practically impossible to reach a Posterior Odds of 10, which reflect a threshold of 90 percent that the defendant is guilty.\textsuperscript{62}

\textsuperscript{59} Id. at 518-9.
\textsuperscript{60} SANGERO, supra note 1, at 173-4.
\textsuperscript{61} Id. at 57-65 see also Halpert & Sangero, supra note 2, at 415.
\textsuperscript{62} SANGERO, supra note 1, at 60-3.
As an opening remark, it should be noted that Sangero's suggestion that a single piece of evidence should not be sufficient for a conviction is phrased very widely, but in fact is applicable only to cases where the perpetrator of the crime is unknown. Only then the analogy between using a single piece of evidence to determine the identity of the perpetrator of a crime to a home HIV-testing kit (the analogy used by Sangero in his book) can be considered. But in many criminal trials the perpetrator of the supposed crime is well known, and the question is whether the act was committed or whether that act constitutes an offence. Such is the case in most traffic offences, domestic violence, drug possession, tax evasion and many other offences.

In another part of his book Sangero illustrates how he thinks the Prior Odds should be calculated. He considers an example of a person who confesses to committing a crime after interrogation, although she was in police custody for a different crime, and there is no other evidence linking her to the confessed crime. If the crime was committed in a small city of 100,000 adults, Sangero argues that The Prior Odds is 1:100,000.

We think Sangero's assumptions about the prior odds ratio are unrealistic. The Prior Odds that a person interrogated by the police for committing a crime actually did that crime cannot exceed normally 1:10, and in very serious crimes 1:100. This assumption rests on the simple fact that the police do not have the personnel to interrogate so many suspects for every crime committed. To obtain a low Prior Odds which is necessary for the police work, the police screen out suspects by intelligence data, criminal records, polygraph tests and other methods.

But even if we examine Sangero's estimate of the Prior Odds under a moral restriction of using only admissible data, it still seems unrealistically high. We argue that it is not reasonable to assume that all the city's residents will be equally suspected for committing a specific crime in a specific place. For example, if a crime was committed in a certain school on a certain day, the "natural" suspects will be the small population of students, teachers and other professionals that worked in that school on that day. If another person will confess that he had committed that crime, without any evidence that he was in fact present at school while the crime was committed (like mobile phone tracking), the Prior Odds for that person will be indeed very low, and it's hard to imagine him being convicted for that crime when the sole piece of evidence is a sketchy confession.

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63 Id. at 58-60.
64 Id. at 173-4.
But the main flaw in Sangero's argument originates from the conceptual confusion of using the term "evidence" in two different meanings. When the courts use the term "evidence" they use it according to the conventional and formal definition of the term in procedural law: evidence is a piece of information presented by a witness (hereafter: evidence type 1). However, the fact-finders can base their verdict on additional information which is circumstantially related to the main evidence; and for the Bayesian calculation, every piece of relevant information (that has a Likelihood Ratio other than 1) should be considered as a separate piece of evidence (hereafter: evidence type 2). Every evidence type 2 that is placed in Bayes Theorem will change, naturally, the Posterior Odds.

The following example will illustrate the difference between evidence type 1 and evidence type 2. A person is suspected for committing a crime, and the suspect is based solely on a DNA evidence (evidence type 1). In addition, we will assume, like Sangero, that the Prior Odds are extremely low, meaning that the suspect was not part of the community where the crime was committed. No matter what the suspect chooses to do in his interrogation and during his trial (if indicted), there will always be evidence type 2 that should be considered in the Bayesian calculation. Some examples for evidence type 2 in that scenario can be: a) The suspect's inability to explain what he was doing near the crime scene; or b) A decision of the suspect to invoke the right to remain silent; c) The answers given by the laboratory witness during her cross examination; d) A decision of the defendant not to conduct (or not to reveal) a private laboratory test to the DNA sample; etc. All of these will affect the Posterior Odds.

In conclusion, we have shown that there are two meanings for the term "evidence" in Sangero's argument, and that there is no reason to disallow fact-finders to base their conviction on "a single piece of evidence" in the conventional meaning, because that evidence will never be "single" in the Bayesian meaning (there will always be additional circumstantial information that will change the Posterior Odds). Moreover, we have shown that Sangero's estimate of the Prior Odds is unrealistically low and that his argument, to begin with, is only applicable to cases where the perpetrator of the crime is unknown.

The implementation of the STAMP safety model

It's impossible to review all of Sangero's innovative suggestions in this short article, so we decided to mention one last issue which is introduced for the first time in Sangero's book: implementing the STAMP (System Theoretic Accident
Model and Processes) model in the criminal justice system, and particularly upon confessions and plea bargains.\(^65\)

Sangero claims that one of the most prominent safety models today is the STAMP model, which was designed by Nancy Leveson from MIT, who serves, among other things, as a consultant to NASA, and is considered as one of the great experts in her field. In her latest book "Engineering a Safer World" she develops a general safety theory which can be implemented on every system.

Leveson argues that the traditional safety methods are not satisfactory for complex systems that use software and for dealing with human errors. Therefore, she suggests to shift the focus from the reliability of every component in the system to the control of the system's safety as a whole. In her opinion, we should examine thoroughly the system in order to place constraints on the system that will secure its operation without accidents. For example, one of the constraints necessary for the secure operation of a subway or metro system is that the doors will open only after the complete stop of the train, unless an emergency happens. In the second stage, we should set controls that will impose the safety constraints on the system.

According to the STAMP model, accidents happen due to lack of control over the system, which means that there weren't enough constraints over the system in every stage of its development and operation. In her book "Engineering a Safer World" Leveson shows that the STAMP model was tested successfully in a number of different systems and proven effective and efficient, both in investigating accidents and in designing systems' safety in advance. The STAMP model uses a risk assessment method, that simulates an investigation of a hypothetic accident. The STAMP model was originally developed for technical systems, but it should work fine, according to Leveson, on human systems as well, like hospitals.

Sangero's idea is to implement the STAMP model on every stage and on every agent involved in the criminal justice process. Sangero uses confessions and plea bargains as illustrations for the ways in which the STAMP model could be implemented in the criminal justice system. It should be noted though that according to Sangero's theory this implementation should be governed in the future by the SCJSI.

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\(^65\) Id. at 50-2 (general introduction to the STAMP model), at 90-6 (implementation of the model on confession) and at 220-1 (implementation of the model on plea bargains).
As to confessions, Sangero points out to four dangers: 1. An investigation that leads to false confession; 2. A plea bargain that leads to false confession; 3. A false confession that the court finds admissible; 4. An innocent defendant that is convicted due to a false confession ("an accident"). For each danger Sangero offers constraints that should be imposed on the system to reduce the danger. For example, in order to reduce the danger of false confessions, Sangero suggests forbidding any physical or psychological pressure on the suspect during the interrogation, such as lying to the suspect or threatening him in any way or using prolonged interrogations. The controls that can be used to impose those constraints are videotaping the whole interrogation, allowing a defense attorney to be present in the interrogation as an observer, widening the inadmissibility rules, etc.\textsuperscript{66}

To the best of our knowledge, this is the most elaborate attempt yet to introduce a comprehensive theory of safety in the criminal justice system. This attempt is very worthy and one should hope for it to be continued. Nevertheless, in our opinion some of the constraints Sangero wishes to impose on the criminal justice system are overwhelming and exaggerated in a way that can undermine the law and order function of the criminal justice system, as mentioned above.

Summary

The book "Safety from False Convictions" embodies Boaz Sangero's innovative idea, that was originally conceived together with Mordechai Halpert, to implement tools from the field of safety management to the field of criminal law, which he views as a "safety-critical system". In safety-critical systems, like aviation, every accident could result in catastrophic damage, especially the loss of life. Sangero views a false conviction as such a catastrophic "accident" of criminal law.

A wide theory like that is bound to attract a lot of criticism and spark an academic discourse. In our humble contribution to that discourse we argued that there are third basic problems in Sangero's theory. The first problem is that, at the end of the day, most of Sangero's theory is a "rules theory", and like other "rules theories" it has trouble to set criteria for a legitimate level of risk for false convictions. The second basic problem is that Sangero's estimate of the false conviction rate, which is a central assumption needed for his thesis, is not well-founded. The third basic problem is that Sangero's theory cannot be considered a win-win solution in a broad sense, because in most cases it will "safety procedures" will increase the risk of wrongful acquittals.

\textsuperscript{66} Id. at 94-6.
After examining those three fundamental problems in Sangero's theory, we examined more closely three of his specific suggestions, that two of them seemed problematic to us. In contrast to Sangero, we showed why a confession can be considered as a key piece of evidence for a conviction in some cases, and more generally, why "a single piece of evidence" (in the courts' conventional meaning) can be sufficient for a conviction. As to his suggestion to introduce the STAMP safety model to the criminal justice system, we thought that it was a fascinating suggestion that is worth a further discussion and development.

Having said that, we think some of Sangero's ideas, especially in the field of forensic sciences, should be considered seriously by policymakers. Some of these suggestions can reduce false conviction rate with minimal cost or with no cost at all, and without changing the current risk allocation in criminal trails. Additionally, many other ideas mentioned by Sangero in his new book deserve to be the subject of future academic discourse.
The Original Understanding of State Sovereign Immunity

Tristan Dunford*

I. INTRODUCTION

In Nevada v. Hall, California residents brought a suit in California against Nevada when a Nevada employee caused an accident on a California highway. Nevada motioned to have the case dismissed under its sovereign immunity, but California rejected the immunity and allowed the suit to continue. This case was significant because it was the first time a state ignored the sovereign immunity of a sister state. Nevada challenged California’s decision. The Supreme Court held that nothing in the Constitution required states to recognize the sovereign immunity of sister states.

Since Hall, the Court has continued to affirm its decision. In Franchise Tax Bd. of Cal. v. Hyatt (Hyatt I), the Court affirmed its decision and rejected a balancing test under the Full Faith and Credit Clause that would have allowed for states to maintain their immunity in cases of fundamental government responsibility. However the Court recently recognized that there are some limits to states’ ability to refuse to apply their own sovereign immunities to sister states haled into their courts. In Franchise Tax Bd. of Cal. v. Hyatt (Hyatt II), California was sued in Nevada for several intentional torts. Nevada refused to apply its sovereign immunity award limitation to California and the jury found against California in hundreds of millions of dollars. The Supreme Court found that Nevada had employed a policy of hostility against California, and required Nevada to apply its own sovereign immunity limitation to California.

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354 Id. at 412.
355 As will be shown in § IV, there have been a couple of cases where a state was sued in the courts of a sister state, but in those cases, the state overseeing the suit dismissed the case under sovereign immunity.
356 Hall, 440 U.S. at 412.
357 Id. at 426.
359 Id. at 498.
362 Id. at 1280.
363 Id.
364 Id. at 1283.
These decisions are a correct application of law under the current understanding of sovereign immunity. However, these decisions are flawed because they are based on a fundamental misunderstanding of the origin of the doctrine of sovereign immunity and its placement in the Constitution. These decisions follow from the assumption that sovereign immunity is a product of common law that originated with the English feudal system, but sovereign immunity is based in natural law. This is important because sovereign immunity, as a matter of natural law, is a state privilege imbedded in the Constitution. Therefore, court opinions that do not adhere to the traditional and original understanding of the doctrine of sovereign immunity, at the time of the adoption of the Constitution, are incorrect and extraconstitutional.

This Article will lay out the origins of the doctrine of sovereign immunity and the preservation of the doctrine in the Constitution. It will then look at how the courts have interpreted the doctrine as it relates to state sovereignty in the courts of their sister states. It will finally apply the doctrine as enshrined in the Constitution with the primary Supreme Court cases *Hall*, *Hyatt I*, and *Hyatt II*. The Article will conclude that these cases do not correctly represent the sovereign rights of the states as espoused by the Constitution.

II. HISTORY OF SOVEREIGN IMMUNITY

A. Sovereignty: A Development of the Law of Nature

Sovereign immunity is commonly believed to be a common law doctrine that was developed under the English feudal system. According to this view, a feudal lord could not be sued in his own courts without his consent. A lord could only be sued in the court of a higher authority. There was no higher authority than the King, the sovereign, and thus, the King was not subject to any suit, unless he consented to it. The problem with this theory, however, is that if sovereign immunity was an English common law doctrine, then it would only be within English courts and courts of English
Heritage. However, the doctrine is all across Europe and other nations.\footnote{Johann Wolfgang Textor gives the definition of the Law of Nations as “[w]hat its natural reasonableness has established among all men, is observed among all peoples alike and is called Law of Nations, as being the Law used by all nations.” Johann Wolfgang Textor, Synopsis of the Law of Nations 1 (John Pawley Bate, Trans., James Brown Scott, ed. 1916) (1680) (quoting Gaius). Sovereign immunity is well established among all Law of Nations scholars, and no scholar singles out England, or any of its legal inheritors as the sole nations with sovereign immunity. This shows that the doctrine was well established and understood in all of Europe.}

Justice Oliver Wendell Holmes offered another theory of the origins of the doctrine. He believed that the doctrine was based on the notion that one who creates the law is superior to the law.\footnote{The Western Maid, 257 U.S. 419, 432–433 (1922); Kawanakoa v. Polyblank, 205 U.S. 349, 353 (1907).} Holmes’ theory on sovereign immunity derives from legal scholars including Jean Bodin and Sir John Eliot.\footnote{The Western Maid, 257 U.S. at 432–433; Kawanakoa, 205 U.S. at 353; Jean Bodin, Six Books of the Commonwealth 32 (M.J. Tooley, Trans. Barnes & Noble, ed. 1967) (1576); Sir Jean Elliot, De Jure Maistatis (Port Eliot, ed. 1882) (1628–30).} This reasoning makes far more sense than the belief that it is a common law doctrine developed by the old English feudal system, considering that the doctrine carries across other nations. However, this theory merely justifies the doctrine and falls short in describing the doctrine’s origins. Additionally, this theory does not provide any useful guidance as to the extent of the immunity in the courts of other sovereign nations.

Sovereign immunity is a right and privilege of sovereignty, and so to understand it, we must understand the origins of the doctrine of sovereignty. Sovereignty is a development from the law of nature as a means of protection against the dangers of living in a state of nature.\footnote{John Locke, The Second Treatise of Government 10, 57 (Dover Publications, Inc. 2002) (1688) (explaining that men form political societies to preserve property (life, liberty and estate) and punish offenses because a state of nature gives each man the right to protect property and right wrongs but a political society is necessary to judge and preserve property).} Many legal scholars of the seventeenth and eighteenth century understood this concept, which dates back to Aristotle\footnote{Aristot., Politics 5–6 (Benjamin Jowett, Trans., Batoche Books, ed. 1999) (Aristotle wrote that it is the nature of man to create a city, the polis, to advance justice).} and wrote extensively about it.\footnote{These scholars included Jean Bodin, Sir John Elliot, Emer de Vattel, and John Locke.} Therefore, a brief review of the state of nature and its effects on rights and liberties will be helpful in understanding the doctrine of sovereignty and its extent.

All people are equal in a state of nature and are governed by rules of reciprocity and comity.\footnote{Locke, supra note 376, at 2–3.} There is no higher authority to set rules of behavior or meet out justice and punishment when harm is committed.\footnote{Locke, supra note 376, at 39.} Injuries can only be rectified by a self-help state
of war between one who is wronged and the one who has wronged. There is no security in a state where people must rely on the good and comity of others for safety in life, liberty and property. Thus people developed political societies, the state, by “combin[ing] their forces to procure the mutual welfare and security.”

With the formation of the state comes the need to set up a public authority who prescribes duties of each member of the society and enforces those duties upon the populace. This public authority is the sovereign. For this authority to be effective, it must be given certain duties, rights, and privileges to carry out its work. One of those privileges is sovereign immunity, or immunity from suit for actions committed by the sovereign. Sovereign immunity is granted to sovereigns to allow them to work for the best good of the state.

B. Sovereign Immunity Within a State’s Borders

All legal scholars agreed that the sovereign is immune from suit in its own courts, but did not all agree as to the extent of that immunity. Many argued that sovereignty was complete and without limitation. This included Bodin and Elliot. Bodin wrote that the sovereign “cannot in anyway be subject to the commands of another.”

However, E. de Vattel wrote that the sovereign power is as extensive as it is granted by the nation. The nation could grant this sovereign power without limitation, or can limit the power by the fundamental laws of the state. Vattel was joined in this concept by Johann Wolfgang Textor, the German jurist and historian, who wrote that any act committed by a sovereign outside the fundamental laws were null and void “because of the deficiency in the doer’s power.”

Therefore, there are differing opinions among legal scholars of the seventeenth and

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381 Locke, supra note 376, at 10.
382 Bodin, supra note 375, at 28; Locke, supra note 376, at 57.
384 Vattel, supra note 383, at 11.
385 Id.
386 Vattel, supra note 383, at 28.
387 Id.
388 Vattel, supra note 383, at 24.
389 Bodin, supra note 375, at 28; Elliot, supra note 375, at 19 (explaining that a sovereign is not bound by law, but a good sovereign will of its “owne accord live according to lawe, albeit they cannot be compelled thereunto” (sic)).
390 Bodin, supra note 375, at 28.
391 Vattel, supra note 383, at ix.
392 Vattel, supra note 383, at 22.
393 Textor, supra note 373, at 94.
eighteenth century as to the extent of sovereign immunity within the sovereign’s own courts. However, the reasoning of Vattel and Textor is more in line with the nature of creating sovereigns. Sovereigns are established as a means to protect the state. They are created when people voluntarily waive their own independence to form a community for protection. The protectorate of that community would necessarily be bound by the fundamental rules set forth by the people creating it. As this article will further explain in section III, the Constitution is based on this very principle, and therefore, this concept of sovereign immunity fits more in line with the true understanding of the doctrine and its application in American governing principles.

C. Sovereign Immunity Among Sovereign Nations

A sovereign is the supreme authority among those who create it and join the political community it governs. However, sovereigns are in a state of nature with each other. All are equal with none being subordinate to another.

This is true even in situations where one nation is superior in strength, wealth, and prestige, or when one nation is under the protection of another. It is well agreed that nations may be inferior, and even at times subject to other nations, without losing their sovereignty. Sovereignty can only be lost by forcible seizure, surrender, or a transfer of sovereignty. Therefore, under these principles, a nation does not surrender its sovereignty when it interacts with another nation.

A sovereign wronged by another sovereign has the right to seek retribution from its peer. However, there is no supreme authority to appeal to for justice in a state of nature. No one sovereign has authority to judge another, and hence, the courts of one sovereign have no jurisdiction over another. Of course, a sovereign has power to legislate and could give its court’s jurisdiction over other sovereigns. However, these laws would not be binding without force or the other sovereigns’ consent.

Therefore, there are only two ways for a sovereign to hold another sovereign accountable for any alleged harm. The most peaceful would be by treaty or agreement that the one would subject itself to the jurisdiction of the other’s courts for any harms it may cause. However, this is nothing more than the waiver of the immunity, and hence an acknowledgement of the right.

394 Vattel, supra note 383, at 113–14.
396 Elliot, supra note 375, at 21–22; Vattel, supra note 383, at 11–12.
397 Textor, supra note 373, at 315–18.
398 See Locke, supra note 376, at 4–5.
399 See Id.
The other, less peaceful, would be through entering into a state of war, and taking by force the alleged damages.\textsuperscript{400} A state of war could include taking such measures as entering into combat, increasing tariffs on imports and exports, sanctions, and other methods of hostility toward the guilty sovereign. However, a sovereign would not likely take upon itself an act of war unless it is confident that it could win because of the great costs that would be involved.

Further, sovereigns would be less inclined to make laws against other sovereigns, because it would be foolish for a sovereign to make laws that would not be respected. This would weaken the sovereign’s lawmaking power and authority. Thus, sovereign immunity in foreign courts, while in practicality is an act of comity, is in fact the state in which sovereigns find themselves. The immunity is a \textit{de facto} product of the state of nature, if not a \textit{de jure} right granted by a foreign sovereign.

III. SOVEREIGN IMMUNITY ENSHRINED IN THE CONSTITUTION

A. The Debate on Sovereign Immunity During Formation and Ratification of the U.S. Constitution.

In 1787, representatives from 12 of the 13 colonies met in Philadelphia to propose amendments to the Articles of Confederation to solve numerous problems the confederacy was facing. Instead, on September 17, the convention proposed a whole new Constitution that created a union of 13 united sovereign states rather than a confederacy of 13 independent sovereign states.

The Constitution, among other things, created a national, federal, government, with limited powers by requiring the states to give up some of their sovereignty and, to some extent, become subject to the Federal Government.\textsuperscript{401} This surrender of sovereignty made many people nervous about the power the Federal Government would hold over the states and the extent of the sovereignty each state would retain.\textsuperscript{402} Alexander Hamilton addressed these concerns in Federalist No. 32 where he wrote that the states would retain their sovereignty unless the Constitution exclusively delegated sovereignty to the Federal Government.\textsuperscript{403}

\textsuperscript{400} See \textit{Id.}
\textsuperscript{402} The Federalist No. 32 at 240–41 (Alexander Hamilton) (Benjamin F. Wright, ed. 1961); The Federalist No. 81 at 511 (Alexander Hamilton); Daniel A. Farber & Suzanna Sherry, A History of the American Constitution, 297–99 (West, ed. 3d ed. 2013).
\textsuperscript{403} The Federalist No. 32, at 241 (Alexander Hamilton).
Hamilton explained there were three ways that sovereignty could be alienated under the new Constitution.⁴⁰⁴ First, where the Constitution explicitly granted exclusive authority to the Federal Government.⁴⁰⁵ Hamilton gave, as an example, the constitutional grant to Congress authority of “exclusive legislation in all cases whatsoever, over such District . . . as may . . . become the Seat of the Government of the United States.”⁴⁰⁶ Second, where power was granted to the Federal Government in one place of the Constitution and denied to the States in another.⁴⁰⁷ This was exhibited by the constitutional grant of power for the Congress to collect duties, imposts, and excises,⁴⁰⁸ and a denial of such authority to the states without congressional assent.⁴⁰⁹ Third, where authority granted to the Federal Government was not explicitly removed from the states, but such authority exercised by the states “would be absolutely and totally contradictory and repugnant.”⁴¹⁰ Hamilton’s example was the Federal Government’s authority to establish a uniform rule of naturalization.⁴¹¹ There could not be a uniform rule if each state was allowed to set their own rules of naturalization.⁴¹²

Nevertheless, people continued to express concerns regarding a state’s sovereign immunity from suit in the courts of the Federal Government.⁴¹³ Article III gave federal courts jurisdiction to hear cases and controversies between two or more states, suits between a state and citizens of another state, and suits between a state and foreign governments or the citizens of a foreign government.⁴¹⁴ Many were troubled by the last two provisions allowing for suits against the states by citizens of other states and foreign governments and their citizens.⁴¹⁵ People feared that the states would be haled into federal court to account for their debts, which were substantial, from the Revolutionary War.⁴¹⁶

Numerous writers at the time argued that the idea that a sovereign could be haled into any court, including a foreign sovereign’s court, went completely beyond reason. This is a great display on how strong sovereign immunity was considered at the time. Hamilton wrote in Federalist 81 “[i]t is inherent in the nature of sovereignty not to be amenable to

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⁴⁰⁴ Id.
⁴⁰⁵ Id.
⁴⁰⁶ Id.; U.S. Const. art. I, § 8, cl. 17.
⁴⁰⁷ The Federalist No. 32, at 241 (Alexander Hamilton).
⁴⁰⁸ U.S. Const. art. I, § 8, cl. 1.
⁴⁰⁹ The Federalist No. 32, at 242 (Alexander Hamilton).
⁴¹⁰ Id.
⁴¹¹ Id.
⁴¹² Id.
⁴¹³ The Federalist No. 81 at 511 (Alexander Hamilton); Farber & Sherry, supra note 402, at 297–99.
⁴¹⁴ U.S. Const. art. III, § 2.
⁴¹⁵ The Federalist No. 81 at 511 (Alexander Hamilton); Farber & Sherry, supra note 402, at 297–99.
⁴¹⁶ The Federalist No. 81 at 511 (Alexander Hamilton).
the suit of an individual without its consent." Both James Madison and John Marshall shared this belief. James Madison argued at the Virginia Ratifying Convention that the Constitution only granted the federal courts authority to hear cases brought by states against citizens of another state. John Marshall agreed and further added:

> With respect to disputes between a State, and the citizens of another State, its jurisdiction has been decried with unusual vehemence. I hope no Gentleman will think that a State will be called at the bar of the Federal Court. . . . It is not rational to suppose, that the sovereign power shall be dragged before a Court.

The founders fully understood that sovereignty protected states from any court, including the courts of another.

B. *Chisolm v. Georgia* and the Eleventh Amendment.

In *Chisolm v. Georgia* the Supreme Court overturned this long held view of Sovereign Immunity. In *Chisolm*, Alexander Chisolm sued Georgia in federal court on behalf of Robert Farquhar, a citizen of South Carolina, for payments due for goods Farquhar had provided Georgia during the Revolutionary War. Justice Iredell would have ruled as Hamilton, Madison, and Marshall would have expected. He argued that Congress had not granted federal courts the authority to hear suits against states, and would have dismissed the case. He also argued that he did not believe that the Constitution had removed sovereign immunity from the states, because to do so would have required express language, which, he argued, the Constitution did not have.

However, Justice Iredell was alone. The majority held that the Constitution did in fact give federal courts the authority to hear suits against states. Chief Justice Jay looked at the actual language of the Constitution which granted federal courts authority to hear cases “between a State and the citizen of another State.” The plain language was clear that where a state and a citizen were a party to a case, the federal government would have authority to hear the case. The language did not distinguish between plaintiff and

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417 *Id.*
419 Farber & Sherry, *supra* note 402, at 301.
420 *Id.*
421 2 U.S. 419 (1793).
422 Boren, *supra* note 418, at 421 n. 22.
423 Chisolm v. Georgia, 2 U.S. 419, 449 (1793) (Iredell, J., dissenting).
424 *Id.* at 449–50 (Iredell, J., dissenting).
425 Georgia, 2 U.S. 419.
426 U.S. Const. art. III, § 1.
427 Georgia, at 476 (Jay, J. concurring).
defendant, merely parties.\textsuperscript{428} Therefore, the Constitution did remove sovereign immunity from the states.\textsuperscript{429}

The \textit{Chisolm} court was correct in its holding. Those supporting the immunity were under the false assumption that sovereign immunity was irrevocable. However, what they failed to take into account is that the Constitution, as a fundamental law, had the power to repeal and rewrite the laws of nature. As originally written, the Constitution did not distinguish the types of suits federal courts had the authority to hear regarding states. The general assumption, under principles of the law of nature and sovereign immunity, was that the state could only be in a suit as a plaintiff, unless the state elected to waive its sovereign immunity and become a defendant. However, because the Constitution had the power to overcome natural law, and because no distinction was made as to what party a state could be, the \textit{Chisolm} Court correctly announced that Georgia could be sued by a citizen of another state within a federal court.

This was immediately rectified in 1798 with the ratification of the Eleventh Amendment.\textsuperscript{430} The Eleventh Amendment removed from federal jurisdiction all suits involving states and citizens of other states, foreign governments, or citizens of foreign governments.\textsuperscript{431} In effect, the immunity lost by fundamental law was once again restored by fundamental law.

\textbf{C. Abrogation of Sovereign Immunity in the U.S. Constitution.}

At a federal level, the Courts had generally interpreted the Eleventh Amendment as a complete prohibition against suing states in federal courts.\textsuperscript{432} However, in 1976, the Supreme Court recognized another constitutional repeal of state sovereign immunity.\textsuperscript{433} In \textit{Fitzpatrick v. Bitzer},\textsuperscript{434} the Supreme Court recognized that the Fourteenth Amendment granted Congress authority to enforce its provisions “by appropriate legislation.”\textsuperscript{435} The Court held that this meant Congress could pass legislation that removed state sovereignty in federal courts for Fourteenth Amendment violations.\textsuperscript{436} Nonetheless, the authority was limited only to conduct that violates the Fourteenth Amendment’s

\begin{thebibliography}{9}
\bibitem{428} Id.
\bibitem{429} Id. at 479.
\bibitem{430} U.S. Const. amd. 11.
\bibitem{431} Id.
\bibitem{432}See Hans v. Louisiana, 134 U.S. 1, 15 (1890) (holding that the Eleventh Amendment applied to suits brought against states by their own citizens, even though the Eleventh Amendment does not explicitly block such suits from coming forward in Federal Court).
\bibitem{434} 427 U.S. 445 (1976).
\bibitem{435} U.S. Const. amd. 14, § 5.
\bibitem{436} Bitzer, 427, U.S. at 456.
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substantive provisions. The Court has held that only one other provision of the Constitution abrogated state sovereign immunity. It held in Pennsylvania v. Union Gas Co. that the Commerce Clause gave Congress the authority to abrogate state’s sovereign immunity. However, in Seminole Tribe of Florida v. Florida, the Supreme Court overturned Union Gas when asked to extend its reasoning to the Indian Commerce Clause. The Court held that the Court inappropriately relied on Fitzpatrick’s holding that the Fourteenth Amendment could expand the Article III powers limited by the Eleventh Amendment. The Fourteenth Amendment was adopted after the Eleventh Amendment and “alter[ed] the pre-existing balance between state and federal power achieved by Article III and the Eleventh Amendment.” Article I, on the other hand, fell under the balance developed by the Eleventh Amendment, and could not disrupt that balance as the Fourteenth Amendment could.

Nevertheless, under the logic of Fitzpatrick and Seminole Tribe, Congress would have the authority to abrogate state’s sovereign immunity under the Thirteenth, Fifteenth, Nineteenth, Twenty Fourth, and Twenty Sixth Amendments which also grant Congress the authority to enforce these amendments by statute. All of these Amendments provide Congress the authority to enforce them by legislation, and they were all ratified after the Eleventh Amendment and therefore would amend the “pre-existing balance between state and federal power achieved by Article III and the Eleventh Amendment.” However, outside these limited circumstances, a state retains its sovereign immunity within federal courts.

IV. STATE SOVEREIGN IMMUNITY WITHIN THE COURTS OF SISTER STATES

D. Traditional State Recognition of Sister State Sovereign Immunity

State courts have long recognized the immunity of sister states. Among the first cases in

438 491 U.S. 1, 19 (1989).
440 Id. at 66.
441 Id.
442 Id.
443 Id.
444 U.S. Const. amend. XIII, § 2 (prohibiting slavery); U.S. Const. amend. XV, § 2 (granting people of all races the right to vote); U.S. Const. amend. XIX, § 2 (granting women the right to vote); U.S. Const. amend. XXIV, § 2 (prohibiting the use of a poll tax); U.S. Const. amd. XXVI, § 2 (granting all people 18 years and older the right to vote).
445 Seminole Tribe, 517 U.S. at 66.
the legal history of the United States dates back to 1781, *Nathan v. Virginia*,\textsuperscript{446} where a Pennsylvania citizen sought to attach property belonging to Virginia in a Pennsylvania court.\textsuperscript{447} The Pennsylvania court dismissed the suit on the basis of Virginia’s sovereign immunity.\textsuperscript{448}

The Constitution did not specifically mention state sovereign immunity in the courts of other states. The Tenth Amendment guaranteed that powers not denied to the states or granted to the Federal Government were reserved for the states.\textsuperscript{449} However, there was no express grant or denial of the immunity anywhere written in the Constitution, except of course Article III, as already addressed in the previous section.

Very few cases exist after the ratification of the Constitution, which only emphasizes a long held recognition of the doctrine that made it futile to bring such suits. The only cases known include two cases evolving from the same incident, in North Dakota.\textsuperscript{450} A miner working for a South Dakota mine located in North Dakota brought a suit for injuries against South Dakota in a North Dakota court.\textsuperscript{451} The North Dakota Supreme Court dismissed the cases holding that it was bound by comity and the Constitution to recognize the sovereign immunity of South Dakota.\textsuperscript{452} The North Dakota Supreme Court reasoned that if the Eleventh Amendment prevented even the Federal Government from ignoring the sovereign immunity of a state, then there is a stronger argument that states are not allowed to ignore the immunity either.\textsuperscript{453}

**E. The End of the Doctrine: Nevada v. Hall and Franchise Tax Bd. of California v. Hyatt I**

States appeared to recognize the doctrine of sovereign immunity until the issue came before the Supreme Court for the first time in 1979.\textsuperscript{454} In *Nevada v. Hall*,\textsuperscript{455} California residents were injured when a University of Nevada employee caused a collision on a California highway.\textsuperscript{456} The California residents brought suit against Nevada in California.\textsuperscript{457} Nevada sought to have the case dismissed under its sovereign immunity,
but was denied by the California Supreme Court.\textsuperscript{458} Nevada then tried to limit recover to $25,000 under its statutory waiver limitation, arguing that the Full Faith and Credit Clause required California to recognize its statutory waiver limitation.\textsuperscript{459} Again, California rejected the argument, and a jury found in favor of the California residents and awarded damages of $1,150,000.\textsuperscript{460} Nevada challenged the denial of its sovereign immunity and the rejection of its statutory waiver limitation in the U.S. Supreme Court.\textsuperscript{461} The Supreme Court affirmed the California courts’ decisions.\textsuperscript{462}

The Court recognized the two aspects to sovereign immunity—immunity within a sovereign’s own courts and immunity within the courts of another sovereign.\textsuperscript{463} The Court declared that the immunity within a sovereign’s own courts was a product of the common law that was based on the old feudal system and the fiction that the King could do no wrong.\textsuperscript{464} The court rejected the fiction, but realizing that the immunity was still recognized under case law, held that it also came from the “right to govern,”\textsuperscript{465} and was “based ‘on the logical and practical ground that there can be no legal right as against the authority that makes the law on which the right depends.’”\textsuperscript{466} However, the Court did not find either of these justifications for the immunity helpful in determining whether the immunity extended to another state’s courts.\textsuperscript{467}

Therefore, the Court turned to \textit{The Schooner Exchange v. McFadden},\textsuperscript{468} wherein Chief Justice Marshall maintained that any immunity enjoyed by a French vessel must be granted by American law.\textsuperscript{469} The Court held that this case recognized that it was a principle of comity for a sovereign to recognize the sovereign immunity of another.\textsuperscript{470} This same principle would apply to states, if they were separate sovereign nations, and should therefore apply to them as united sovereign states, unless there was a constitutional provision that prevented states from recognizing the immunity of sister states.\textsuperscript{471}

The Court rejected a constitutional protection of sovereign immunity under the Eleventh

\textsuperscript{458} Hall v. Nevada, 8 Cal.3d 522, 524, 526 (Cal. 1972).
\textsuperscript{459} \textit{Hall}, 440 U.S. at 412–13.
\textsuperscript{460} \textit{Id}.
\textsuperscript{461} \textit{Id}.
\textsuperscript{462} \textit{Id}.
\textsuperscript{463} \textit{Id} at 414.
\textsuperscript{464} \textit{Id} at 414–415.
\textsuperscript{465} \textit{Id} at 416 (quoting Justice Jay in Chisholm v. Georgia, 2 U.S. 419, 472 (1793)).
\textsuperscript{466} \textit{Id} at 416 (quoting Justice Holmes in Kawananakoa v. Polybank, 205 U.S. 349, 353 (1907)).
\textsuperscript{467} \textit{Id} at 416.
\textsuperscript{468} 7 U.S. 116 (1812).
\textsuperscript{469} \textit{Hall}, 440 U.S. at 416–417.
\textsuperscript{470} \textit{Id} at 417–418.
\textsuperscript{471} \textit{Id} at 418.
Amendment, because the Eleventh Amendment extended only to federal courts.\textsuperscript{472} It did not apply to states and did not work as a protection of a state’s sovereign immunity in another state’s courts.\textsuperscript{473} The Supreme Court further rejected Nevada’s argument that the Full Faith and Credit Clause of the Constitution “implicitly establishes a Union in which the States are not free to treat each other as unfriendly sovereigns, but must respect the sovereignty of one another.”\textsuperscript{474} The Supreme Court recognized that while the nation was not a complete union of 50 completely independent states, the recognition of sovereignty among them was still nothing more than “a matter of comity.”\textsuperscript{475} California had chosen a policy that required full compensation in its courts for the injuries committed on its highways. The Court held that the Constitution did not give the Court authority to “frustrate that policy out of enforced respect for the sovereignty of Nevada.”\textsuperscript{476}

Additionally, the Supreme Court agreed that the Full Faith and Credit Clause did not bind California to recognize Nevada’s statute waiving sovereign immunity to the amount of $25,000.\textsuperscript{477} Court precedent made clear that a state was not required to recognize “another State’s law in violation of its own legitimate public policy.”\textsuperscript{478} The Court recognized California’s legitimate interest in “providing ‘full protection to those who are injured on its highways through the negligence of both residents and nonresidents’” was so important to California that it had removed its own immunity in these suits.\textsuperscript{479} It found that requiring California to limit recovery against Nevada to $25,000 “would be obnoxious to its statutorily based polices of jurisdiction over nonresident motorists for full recovery.”\textsuperscript{480} The Court held that the Full Faith and Credit Clause did not require this outcome.\textsuperscript{481}

\textit{Hall}, seemingly settled the question for 24 years. Then, in 2003, the Supreme Court once again faced the question whether a State could be haled into the court of a sister state in \textit{Franchise Tax Bd. of California v. Hyatt (Hyatt I)}.\textsuperscript{482} Again, the same characters in this story, California and Nevada, but the roles were reversed. This time, Nevada was haling California into its courts. The Supreme Court upheld \textit{Hall}, and held that the Full Faith and Credit Clause does not require a state to recognize another state’s sovereign

\textsuperscript{472}Id. at 420.
\textsuperscript{473} Id.
\textsuperscript{474} Id. at 424–425.
\textsuperscript{475} Id. at 425.
\textsuperscript{476} Id. at 426.
\textsuperscript{477} Id. at 421.
\textsuperscript{478} Id. at 421–422.
\textsuperscript{479} Id. at 424.
\textsuperscript{480} Id.
\textsuperscript{481} Id.
\textsuperscript{482} Franchise Tax Bd. of California v. Hyatt, 538 U.S. 488 (2003)(\textit{Hyatt I}).
immunity statutes.

In *Hyatt I*, a former California citizen, Gilbert P. Hyatt, moved to Nevada in 1991, and filed a part-year resident income tax return with California.\(^{483}\) In the tax return, Hyatt informed California that he had become a resident of Nevada.\(^{484}\) In 1993, California Franchise Tax Board (CFTB) conducted an audit to determine whether Hyatt had underpaid state taxes.\(^{485}\) CFTB concluded that Hyatt did not become a resident of Nevada until April, 1992.\(^{486}\) California assessed taxes for 1991 and 1992 and imposed civil fraud penalties.\(^{487}\) Hyatt initiated a suit against CFTB in Nevada.\(^{488}\)

CFTB challenged the court’s jurisdiction on the basis of sovereign immunity.\(^{489}\) The Nevada Supreme Court ordered the District Court to dismiss the negligence claims under principles of comity, but held that the intentional torts claims could proceed.\(^{490}\) In making this ruling, the Nevada Supreme Court noted that both Nevada and California had generally extended waivers to suits against their agencies, unless a statute expressly provides for immunity.\(^{491}\) In this case, California had extended immunity to its tax collecting agency, CFTB, where Nevada had not.\(^{492}\) Therefore, it was incumbent on the Court to decide whose law would be applied under principles of comity.\(^{493}\) The Court found that recognizing the immunity in negligence cases did “not contravene any Nevada interest,” but recognizing the immunity in the intentional cases would be because Nevada’s interest in protecting its citizens from bad faith and intentional torts outweighed California’s interest in giving complete immunity to its taxation agency.\(^{494}\)

The U.S. Supreme Court upheld Nevada’s decision by affirming “that the Constitution did not confer sovereign immunity on States in the courts of sister States.”\(^{495}\) CFTB asked the court to recognize a rule within the Full Faith and Credit Clause that would grant states sovereign immunity in suits where “a refusal to do so would ‘interfer[e] with a State’s capacity to fulfill its own sovereign responsibilities,’” in this case, its sovereign responsibility to collect taxes.\(^{496}\) The court noted that in the past it tried a balancing test

\(^{483}\) Id. at 490.
\(^{484}\) Id.
\(^{485}\) Id.
\(^{486}\) Id. at 491.
\(^{487}\) Id.
\(^{488}\) Id.
\(^{489}\) Id.
\(^{490}\) Id. at 492.
\(^{491}\) Id.
\(^{492}\) Id.
\(^{493}\) Id. at 493.
\(^{494}\) Id.
\(^{495}\) Id. at 497.
\(^{496}\) Id. at 495, 497.
in the context of the Full Faith and Credit Clause, but found the test to be unworkable, and abandoned such a test.\textsuperscript{497} The court thereafter held that “a State need not ‘substitute the statutes of other states for its own statutes dealing with a subject matter concerning which it is competent to legislate.’”\textsuperscript{498} The court also held that a similar rule to the one offered by CFTB was rejected on a federal level under the Tenth Amendment as “unsound in principle and unworkable in practice.”\textsuperscript{499} Further, if the court adopted such a rule, it would need to find a distinction between Nevada’s sovereign interest in education, the sovereign authority under question in \textit{Hall}, and California’s sovereign interest in collecting taxes.\textsuperscript{500} The Court could not find a “constitutionally significant distinction between these relationships.”

\textit{Hall} again withstood challenge in the 2016 case \textit{Franchise Tax Bd. of California v. Hyatt (Hyatt II)},\textsuperscript{501} a follow-up case to \textit{Hyatt I} that will be further discussed in the next subsection. A divided Court again affirmed that the Constitution does not protect state sovereign immunity.\textsuperscript{502}

\textbf{F. A Limitation on the Force Waiver: \textit{Franchise Tax Bd. of California v. Hyatt II}}

Thirteen years after the Supreme Court heard \textit{Hyatt I}, the Court heard a follow-up case on whether, the Constitution permitted a state to award damages against a sister state greater than it would award to similar suits against itself.\textsuperscript{503} After \textit{Hyatt I}, a jury found in favor of Hyatt and awarded him nearly $500 million in damages and fees.\textsuperscript{504} California challenged the award on the basis that Nevada limited awards in similar cases against itself to $50,000.\textsuperscript{505}

In \textit{Franchise Tax Bd. of California v. Hyatt (Hyatt II)},\textsuperscript{506} the Supreme Court held that the Constitution did not permit Nevada to award damages against California that were greater than it would award against itself in similar cases because it evidenced a “‘policy of hostility’ toward California.”\textsuperscript{507} It reasoned that its holdings on the Full Faith and Credit Clause maintained that a state may choose to apply its own law over another

\textsuperscript{497} Id. at 495–96.
\textsuperscript{498} Id. at 496 (quoting Pacific Employers Ins. Co. v. Industrial Accident Comm’n, 306 U.S. 493, 501 (1939)).
\textsuperscript{499} Id. at 498 (quoting Garcia v. San Antonio Metropolitan Transit Authority, 469 U.S. 528 (1985)).
\textsuperscript{500} Id.
\textsuperscript{501} Franchise Tax Bd. of California v. Hyatt, 136 S.Ct. 1277, 1280 (2016) (\textit{Hyatt II}).
\textsuperscript{502} Id. at 1280.
\textsuperscript{503} Id.
\textsuperscript{504} Id.
\textsuperscript{505} Id.
\textsuperscript{506} 136 S.Ct. 1277 (2016).
\textsuperscript{507} Id. at 1281.
state’s law, but consistently the court had found “that the State had ‘not adopt[ed] any policy of hostility to the public Acts’ of that other State.”\textsuperscript{508} Nevada had “disregarded its own legal principles” of Nevada immunity law by allowing damages greater than $50,000, which is hostile toward California without offering “sufficient policy considerations’ to justify the application of a special rule of Nevada law that discriminates against its sister States.”\textsuperscript{509} Nevada had justified its ruling because California agencies operate outside of Nevada’s legislative control and oversight. The court held this justification was not enough to overcome a discriminatory rule against a sister state.\textsuperscript{510}

V. \textbf{The Supreme Court’s Failures}

The Supreme Court made several mistakes in these state sovereign immunity cases. As will be further explained below, the Court incorrectly applied \textit{McFaddon}, by not recognizing that California had not in fact rejected state sovereign immunity. Additionally, the Court ignored the inability of states and the Federal Government to enforce judgments against sovereign states. The Court also ignored a fundamental flaw with its Full Faith and Credit holdings, by forgetting to recognize the authority of states to ignore judgments that are repugnant to their own public policy. Finally, the Court’s reasoning in \textit{Hyatt II} is contradictory by allowing states to ignore a sister state’s sovereign immunity, but still recognize its sister state’s sovereignty. These flaws highlight the court’s inaccurate application of state sovereign immunity due to a misunderstanding of its history and place in the Constitution.

G. \textbf{Sovereignty Must be Granted by the Sovereign of the Territory}

The Supreme Court held that \textit{McFaddon}\textsuperscript{511} stood for the proposition that sovereign immunity must be given by the sovereign of the territory.\textsuperscript{512} If the sovereign of the territory does not recognize the immunity, then there is no immunity. Therefore, a state may choose to recognize or reject the immunity of a sister state.

However, the Supreme Court disregards the holding in \textit{McFaddon} that a sovereign may ignore another sovereign’s immunity, “[b]ut until such power be exerted in a manner not to be misunderstood, the sovereign cannot be considered as having imparted to the ordinary tribunals a jurisdiction, which it would be a breach of faith to exercise.”\textsuperscript{513} In other words, there is a strong presumption that a sovereign enjoys its immunity in the courts of another sovereign, until that other sovereign explicitly and clearly establishes

\begin{footnotesize}
\textsuperscript{508} \textit{Id.} at 1281 (quoting Carroll v. Lanza, 349 U.S. 408, 413 (1955)).
\textsuperscript{509} \textit{Id.} at 1282.
\textsuperscript{510} \textit{Id.}
\textsuperscript{511} 7 U.S. 116 (1812).
\textsuperscript{512} Nevada v. Hall, 440 U.S. 410, 417 (1979).
\textsuperscript{513} \textit{The Schooner Exchange v. McFaddon}, 11 U.S. 116, 146 (1812).
\end{footnotesize}
that it no longer recognizes the immunity. Such policy change cannot come from the courts. Chief Justice Marshall further noted in *McFadden* that the court could not recognize the rebuttal of this presumption because of “the general inability of the judicial power to enforce its decisions.” Therefore, “the sovereign power of the nation is alone competent to avenge wrongs committed by a sovereign, that the questions to which such wrongs give birth are rather questions of policy than of law, that they are for diplomatic, rather than legal discussion.”

The Supreme Court’s misrepresentation of the immunity as a doctrine of common law allows for its fundamental error in permitting a judicial repeal of it. If the immunity is a doctrine of common law, it could be repealed by common law. However, it is a fundamental right each sovereign holds. Only the sovereign can waive its own sovereignty by legislation, or the people can remove it by fundamental law. Because the doctrine is so fundamental to a sovereign’s being, a repeal of the right through a court case without notice would be a fundamental violation on the law of nations. As Chief Justice Marshall acknowledged, it is a “question of policy,” meaning policy makers, legislators, are the only ones who can repeal the right within the territory.

Further, because the right is a fundamental right, a state would be required to give notice that it would no longer recognize the sovereignty of a sister state. Chief Justice Marshall stated in *McFadden*, “[a] nation would justly be considered as violating its faith, although that faith might not be expressly plighted, which should suddenly without previous notice, exercise its territorial powers in a manner not consonant to the usages and received obligations of the civilized world.” This would be important because:

> One sovereign being in no respect amenable to another; and being bound by obligations of the highest character not to degrade the dignity of his nation, by placing himself or its sovereign rights within the jurisdiction of another, can be supposed to enter a foreign territory only under an express license, or in the confidence that the immunities belonging to his independent sovereign station, though not expressly stipulated, are reserved by implication, and will be extended to him.

California had never passed legislation stating that sister states would be susceptible to suit for any harms caused by them on California’s highways. The fact that California waived its own immunity in such cases does not send a signal that another sovereigns’ sovereignty would be waived in those same circumstances. It was merely a statement that California would allow itself to be haled into its own courts for such harms.

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514 *Id.*  
515 *Id.*  
516 *Id.* at 137.  
517 *Id.*
California was required to give notice by statute that sister states would also be haled into California’s courts for highway injuries. No such statute was passed, and California’s courts could not remedy this in an *ex post facto* fashion through new case law.

**H. Enforcement of Judgments Against Sovereign States**

A sovereign can act as it pleases, but it must be able to enforce its actions to make them effective. The states have been stripped of all powers to enforce their judgments against a sister state. The power to declare war, or to initiate sanctions, to raise tariffs, or prohibit imports and exports with its sister states, were all stripped by the Constitution. Further, an appeal to a higher authority, the Federal Government, would be a violation of the Eleventh Amendment. The Eleventh Amendment prohibits extending the judicial power to suits against states. It is a judicial power to recognize judgments, and the judgment would need to be recognized before it could be enforced. So even an appeal to the President or the Congress to enforce a judgment would first require a judicial recognition of the judgment as valid, and hence, a violation of the Eleventh Amendment.

It is within a state’s best interest, to maintain its respect and authority, to only hale a sister state into court, in such cases where the sister state has waived its sovereignty. For if a state were to bring forth too many judgments against its sister states, other states may be unwilling to recognize judgments in cases where they have waived their immunity. Thus, the accusing state loses opportunities of relief for its citizens.

Additionally, a state that does not recognize the sovereignty of a sister state risks losing all respect of their own sovereignty at some future point. *Hall* and *Hyatt I*, are perfect examples of this reciprocity. In *Hall*, California ignored Nevada’s sovereign immunity and held it liable for the accident that took place in California. Several years later, in *Hyatt I*, Nevada is given the same choice, whether to recognize California’s immunity, and, of course, it does not.

Therefore, a state may pass judgment against a sister state, but there is no power to enforce that judgment except by the good will of the sister state under the judgment.

**I. Full Faith and Credit**

The Supreme Court has affirmed and reaffirmed that the Full Faith and Credit clause does not require states to recognize the sovereign immunity of sister states. However,

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519 U.S. Const. amd. XI.
the court is looking at only one side of the issue. While saying the Constitution does not prevent a state from issuing judgments against another state, the Court presumes that the Constitution does remove the other state’s authority to ignore such judgments. Yet, there is no explanation to justify why a state’s power to ignore another’s sovereign immunity takes precedence over the other’s power to ignore the judgments against itself.

The Full Faith and Credit Clause does not require a state to recognize judgments that are “in contravention of its own statutes or policy.” It would be repugnant to a state’s policy to enforce a judgment against itself, where it has not waived its sovereignty. This interest would far outweigh any interest of the state issuing the judgment because to do so would be to recognize a sovereign over itself, which would in turn degrade the integrity of the state. Therefore, a state is under no obligation to recognize such judgments against it.

J. Whether a State Must Give its own Sovereign Immunity to Another State

In *Hyatt II*, the Court espouses a double standard. A state is not required to recognize the sovereign immunity of a sister state, but must provide all sovereign rights it gives unto itself. In other words, a state is not required to recognize the sovereignty of a sister state, but is at the same time required to recognize a sister state as a sovereign. A state makes the determination that a sister state is to be treated as a private person within its own courts when it makes the determination that it will not recognize the sovereignty of a sister state. If a state provides a limitation on damages to a private person, then of course, any award against a sister state that is greater than any such limitation upon private parties would be discriminatory. This could be accurately described as a policy of hostility toward a sister state.

However, it is perfectly within the rights of a state to not provide a sister state with the same sovereign privileges it grants itself in its own courts. If a state was recognizing a sister state as a sovereign, it would also recognize the sister state’s sovereign rules and privileges. On the other hand, by ignoring the immunity to begin with, the state has made the determination that its sister state has no sovereign rights within its own courts, unless its legislature has made an exception for foreign sovereigns. The record does not show that Nevada provides any exceptions for other sovereigns in its courts. Thus, presumably, Nevada law does not provide the limit to damages that California was seeking.

The Court cannot pick and choose under the Constitution. Either states retain their

521 Hall, 440. U.S. at 424 (quoting Pac. Employers Ins. Co. v. Indus. Accident Comm’n of State of California, 306 U.S. 493, 502 (1939) (“It has often been recognized by this Court that there are some limitations upon the extent to which a state may be required by the full faith and credit clause to enforce eve the judgment of another state in contravention of its own statues or policy”)).
sovereignty under the Constitution, in which case a state cannot be haled into the courts of a sister state, or the Constitution does not recognize state sovereign immunity, in which case a state may choose to recognize the immunity, limit that immunity, or not recognize any immunity at all within its own courts.

VI. CONCLUSION

The Constitution guarantees that states retain all their sovereignty that was not forfeited to the Federal Government. Sovereign immunity, while initially forfeited in federal courts by Article III, has since been returned to the states by the Eleventh Amendment. Nowhere does the Constitution remove or limit the sovereign immunities of a state within the courts of a sister state. Under natural law, where sovereign immunity was formed, sovereigns have no authority over each other, and are only liable to each other by comity or force. The Constitution prevents states from engaging in using force against each other, leaving comity. It may be in the best interest of a state to waive its immunity in cases where citizens of a sister state has been harmed, but there is no constitutional provision that requires this waiver.

Hall answers the question whether a state may be haled into the courts a sister state and face suit. However, the Supreme Court has not yet ruled whether States are bound by these judgments. States have the right, under their constitutionally guaranteed sovereignty, to ignore these judgments. As a matter of comity and reciprocity, it may be in the states’ best interest to pay the judgments against them. This will allow them to pursue remedies for harms done to their own citizens by sister states. However, this is a policy question that states are better positioned to answer. States cannot be constitutionally compelled to pay any damages they choose not to pay.