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The Logic and Limits of Municipal Bankruptcy Law
Vincent S.J. Buccola†

Municipal bankruptcy’s recent prominence has stimulated academic interest in the workings of Chapter 9, much of it critical, but no general framework has been developed against which scholars and policymakers can evaluate the law’s performance. This Article offers a normative, economic account of municipal bankruptcy and uses that account to assess current law and suggest changes. It contends that bankruptcy’s singular aim should be to preserve spatial economies—the advantages to locating within a municipality’s unique geographic boundaries—when large public debts, by discouraging investment, threaten to dissipate them. Judged with this end in view, it is argued, Chapter 9 is a marked failure. The law’s compass is so narrow that intervention comes, if at all, only when spatial economies are likely to have been squandered and economic dysfunction has taken hold. Municipal bankruptcy, as it now exists, serves mainly as an ad hoc and ill-conceived subsidy program. This Article outlines changes to the law that could hasten debt relief while acknowledging potential objections.

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INTRODUCTION

Cities and towns across the country face debt burdens of a magnitude not seen since the Great Depression. Four of the five largest municipal bankruptcies in history have been filed in the last decade, and more are bound to come. The perilous financial...
condition of so many local governments has, among other things, stimulated academic interest in municipal bankruptcy. Scholars with a critical attitude have expressed dissatisfaction with the narrow compass of Chapter 9, the part of the Bankruptcy Code that deals with government debtors, and have suggested useful, incremental remedies to the law’s perceived defects. Missing from the academic literature, however, is a general theoretical framework against which the law, as well as suggested reforms, can be assessed. Put in other words, the literature has not sufficiently grappled with the question: What is municipal bankruptcy for?

This Article develops and applies a normative account that seeks to do for municipal bankruptcy what the “creditors’ bargain” rubric has done for the law of corporate reorganization. The creditors’ bargain, which Professor Thomas Jackson pioneered in the 1980s and developed most prominently with Professor Douglas Baird, addressed a simple question: Given that state commercial law defines a complete set of creditor rights and remedies, what good is a corporate bankruptcy law? What economic function might it play? The answer Baird and Jackson gave was that bankruptcy might forestall a wasteful “race of diligence,” a scenario in which each of multiple creditors finds private advantage in foreclosing on her claim before others do, resulting in the piecemeal destruction of an operationally sound business. Bankruptcy law


3 Pub L No 95-598, 92 Stat 2549, codified at 11 USC § 101 et seq.
4 See 11 USC §§ 901–46.
5 See Part I.B.
mandates a collective proceeding so that valuable firms will not be torn apart.\textsuperscript{8}

A rationale for municipal bankruptcy must necessarily look very different. As Professors Michael McConnell and Randal Picker pointed out in their foundational “introduction” to the subject more than twenty-five years ago, the race of diligence has no analog in the municipal context.\textsuperscript{9} Creditors have exceedingly weak remedies under state law. They cannot foreclose on municipal property in any meaningful sense, so bankruptcy’s utility, if it has any, must lie in its capacity to do something other than coordinate collection efforts. Moreover, the economic logic of the municipality is quite unlike that of most commercial firms. A municipality’s value is tied to the fruits of its unique geographic territory. Its business model, so to speak, turns on the preservation and cultivation of that territory’s spatial economies, by which I mean the properties of a physical location that make people and firms want to locate there.\textsuperscript{10} Municipal governments provide infrastructure and ensure social conditions that encourage people to exploit these properties. Thus the residual beneficiaries of successful municipal government are not investors in that government (as shareholders are investors in a commercial firm) but rather the owners of land under its authority. The significance of debt—and, indeed, the whole notion of the balance sheet—is different. The title of Jackson’s seminal book on Chapter 11 bankruptcy\textsuperscript{11} is this Article’s point of reference, then, not because its diagnosis and prescriptions can be translated mechanically to the municipal context—they cannot—but in homage to its method.

\textsuperscript{8} In the three decades since Jackson first wrote, scholars working in the creditors’ bargain tradition have identified additional problems of investor coordination that bankruptcy might ameliorate. See generally, for example, Kenneth Ayotte and David A. Skeel Jr, Bankruptcy Law as a Liquidity Provider, 80 U Chi L Rev 1557 (2013) (arguing that bankruptcy can remedy illiquidity caused by debt overhang and information asymmetries).


\textsuperscript{10} Economic geographers and urban economists typically distinguish two generic kinds of spatial economy. What in this Article I call a “natural economy” refers to the savings occasioned by locating economic activity near a valuable natural resource, broadly defined. The port city’s proximity to a harbor is thus a natural economy. But so, too, in my usage, is a factory’s proximity to a railroad, even though railroads are a product of human, and not strictly natural, design. What in this Article I call a “density economy” refers to the savings occasioned by locating complementary people and activities near one another. The technology firm’s proximity to a stable of programming talent is an example. This distinction between natural and density economy is offered as a heuristic, but notice that it is only that. As the railroad example shows, the distinction turns ultimately on an arbitrary classification. For elaboration, see Part II.A.

\textsuperscript{11} Thomas H. Jackson, The Logic and Limits of Bankruptcy Law (Harvard 1986).
The task is to identify, in a peculiar institutional setting, how the existence of debt is apt to pervert allocative decisions and then to articulate a role for a (federal) debt relief law that is proportionate to the disease.

My core normative claim is that municipal bankruptcy law ought to aim at preserving spatial economies when public debt otherwise threatens to dissipate them. Large municipal debts can discourage local investment, public and private alike—investment that is needed both to efficiently exploit and to sustain spatial economies. Chronic underinvestment erodes the value of the land under a municipality’s jurisdiction. And because locations implicitly compete for resources, underinvestment can provoke irreversible capital flight. What bankruptcy can do, at least in principle, is to rationalize investment decisions by removing the distorting effects of debt.

This account can be brought to bear on current law as well as prospective reforms. And it explains why so many observers have the critical intuition that Chapter 9 is of little moment. Under current law, bankruptcy intervenes too late. Debt relief comes, if at all, only when a municipality can no longer service its debts in the near term. Its spatial economies are by then likely to have been squandered, and there may be no reason for investment to return. If municipal bankruptcy is to achieve its end, I argue, it must allow write-downs, and indeed encourage them, before public debt can undermine investment and precipitate economic decline. This Article outlines some ways the law could be amended.

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12 That government debt can discourage investment is not a novel observation. McConnell and Picker themselves saw that municipal bankruptcy may be grounded on a “fresh start” policy. They put the point this way: “The theory of Chapter 9 is that the burden of debt service, if sufficiently high, will affect the taxpayers of a city as it would a debt-ridden individual; it will sap initiative and depress money-generating activity.” McConnell and Picker, 60 U Chi L Rev at 468–70 (cited in note 9). Their observation, that what the finance literature calls debt overhang is connected to municipal bankruptcy, is right as far as it goes. But because their aim was not to state a comprehensive agenda for municipal bankruptcy, they had no occasion to consider in detail the relationship between investment and public debt. The truth is that debt does not act on a municipality as it does on an individual. Municipal fiscal policy is reflected, or “capitalized,” in the value of local real estate. Because that property is valuable quite apart from municipal activity, landowners have reason to pay down inefficiently large public debts or to substitute private investment for public investment. These dynamics are discussed at length in Part II.D.

13 What bankruptcy cannot do is remedy economic dysfunction—cases in which for whatever reason, including chronic underinvestment, a municipality can no longer sustainably generate revenues sufficient to cover the costs of maintaining basic infrastructure and providing basic services. See notes 96–102 and accompanying text.

14 See notes 27–31 and accompanying text.
to better accomplish its aim. It acknowledges that practical objections might, in the final analysis, make such amendments unwise. In particular, a policy of liberal debt relief can in some specifications tighten lending ex ante, provoking a choice between scenarios the costs and benefits of which are imperfectly known. A definitive resolution is impossible here, but this Article makes a start by developing plausible alternatives and setting out their competing considerations.

The balance of this Article is arranged in three parts. Part I introduces the features of municipal bankruptcy law pertinent to the main analysis and reviews the extant critical literature. Parts II and III form the Article's analytical core. Part II develops a normative framework for evaluating municipal bankruptcy law. Incorporating findings from economic geography and urban economics, it draws a conceptual distinction between two kinds of debt-burdened municipalities, one suffering economic dysfunction and the other facing merely financial distress; and it argues that bankruptcy, in its ideal form, is suited to remedy the latter but not the former. Part III applies this theoretical framework to critique existing law and to develop practical means by which bankruptcy law's promise might be realized. It outlines rule changes that would stimulate earlier debt relief—thereby better preserving spatial economies—and discusses potential drawbacks inherent in such changes.

I. CHAPTER 9 STRUCTURE AND CRITIQUE

Municipal bankruptcy differs in key respects from bankruptcy's individual and business varieties, and understanding the thrust of these differences is important to grasping criticisms of existing law and concrete possibilities for reform. To that end, this Part furnishes background on the structure of municipal bankruptcy law needed to grasp the significance of the argument to come. It then describes the scholarly, critical literature. As a descriptive matter, the remarkable feature of municipal bankruptcy is its limited domain. Its strict eligibility conditions ensure that Chapter 9 is rarely invoked. When it is invoked, the court's authority to alter debtor policy, to say nothing of the governance parameters under which policy is formulated, is sharply curtailed. Most critical work has bracketed eligibility. Instead, the literature has been mainly concerned with the appropriate balance of power, in bankruptcy, between the federal judge overseeing the case and the local officials whom state law charges with managing municipal affairs in the ordinary course. What is almost entirely
missing from academic discourse, oddly enough, is debate about what a municipal bankruptcy law is for in the first place.

A. Key Features of Municipal Bankruptcy

1. Strict eligibility conditions.

The most striking fact about Chapter 9 is how little used it is. Recent years have seen a marked increase in municipal bankruptcy’s salience and economic importance. Still, filings under Chapter 9 are historically rare and remain uncommon today. To give a rough indication of its infrequency, consider that, in the 35 years between 1980 and 2015, only 293 Chapter 9 cases were filed in total. The most recent census counts roughly ninety thousand local government entities, meaning that only 0.3 percent of municipalities sought bankruptcy protection during an interval that included four national recessions. Moreover, those municipalities that do file are disproportionately “special purpose” entities—utilities; hospitals; water, sewer, and school districts; and the like. Only fifty-three of approximately thirty-nine thousand “general purpose” cities, towns, and counties entered bankruptcy over the same thirty-five year period.

Multiple factors plausibly contribute to the infrequency of municipal bankruptcy. But surely part of the story, and probably a big part, is the strictness of eligibility criteria. Chapter 9 limits who will be a debtor in three important ways. First, no municipality can be a debtor unless its state “specifically authorize[s]” it to become one. States vary in their approach to authorization.

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15 See Spiotto and Garceau, Chapter 9 Municipal Bankruptcy Statistics (cited in note 1).
17 See Spiotto and Garceau, Chapter 9 Municipal Bankruptcy Statistics (cited in note 1) (showing that 58 percent of all Chapter 9 filings since 1980 have been filed by utilities and special districts).
18 Id; 2012 Census of Governments (cited in note 16).
19 These do not exhaust the statutory requirements but reflect the most important structural barriers to bankruptcy court jurisdiction. For discussion of the full suite of eligibility criteria, see Laura N. Coordes, Gatekeepers Gone Wrong: Reforming the Chapter 9 Eligibility Rules, 94 Wash U L Rev 1191, 1216–28 (2017).
20 11 USC § 109(c)(2) (conditioning eligibility for bankruptcy relief on authorization under state law). This is an opt-in provision. The law originally allowed states to opt out, but the default rule was toggled in 1994. See Bankruptcy Reform Act of 1994, Pub L No 103-394, 108 Stat 4106, codified in various sections of Title 11.
The most permissive states authorize the governing body of any municipality to file a petition on its own initiative. The most restrictive deny eligibility outright to all municipalities. Between these polar approaches, many states limit eligibility to specified classes of municipality or condition eligibility on the approval of the governor, a tax commissioner, or some other representative of the state’s general interests. Depending on how one counts, only around half of the states currently provide a route to bankruptcy. The significance of state law contrasts sharply with consumer and business modes of bankruptcy. In these other, more familiar modes, state law frequently determines substantive recovery rules, but it has no bearing on whether a mandatory collective proceeding is to be initiated.

Second, municipalities enter bankruptcy on a voluntary basis only. This does not mean Chapter 9 necessarily depends on the consent of a municipality’s residents or even its elected officials. State law might vest municipal power—entirely or with respect to fiscal matters only—in an emergency manager or control board, and these could invoke bankruptcy irrespective of local will. What the requirement of a voluntary petition means, rather, is that long-term creditors cannot force a municipality to confront what may be unsustainable debts. They must wait. To be sure, municipal creditors today would have little use for an involuntary mechanism because, as I discuss below, current law vests municipal debtors with broad discretion in bankruptcy over the use and disposition of property. But the lack of an involuntary mechanism, coupled as it is with weak creditor-collection rights, has important implications for the utility of proposed law reforms that seek only to alter the conduct of cases actually filed.

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21 See, for example, Ala Code § 11-81-3.
22 See, for example, Ga Code Ann § 36-80-5.
25 See 11 USC § 301(a) (providing that Chapter 9 is commenced by the debtor’s voluntary filing of a petition).
26 This is especially true for possibilities I suggest in this Article—in particular, bankruptcy-specific priority schemes and creditor-sponsored plans of adjustment. See notes 174–83 and accompanying text.
Third, a municipality may not invoke Chapter 9 unless it is insolvent. And insolvency is narrowly defined in this context. A municipal debtor is ineligible for Chapter 9 unless it is “generally not paying its debts as they become due” or is “unable to pay its debts as they become due.” Courts have read this formulation narrowly. Most famously, after Bridgeport, Connecticut, filed a petition in 1991, the court found that the city was not insolvent and hence could not use bankruptcy because, despite its dire financial condition, it was sufficiently liquid to service debts during the coming fiscal year. Just how much of a municipality’s borrowing or taxing capacity it must exhaust before it is “unable” to meet current obligations is uncertain, but the thrust of the law in this area is clear: a city cannot use bankruptcy in a farsighted manner to adjust long-term debts with structural implications but must instead wait until its coffers are near empty.

2. Circumscribed judicial authority.

Aside from its eligibility criteria, two features of Chapter 9 are particularly remarkable: the debtor’s broad discretion to use property as it wishes and to control the course of proceedings. Put differently, what distinguishes municipal from individual or business bankruptcy is the court’s, and by extension the creditors’, relative weakness.

The function of the automatic stay, which goes into effect when a bankruptcy petition is filed, is to block creditors’ ordinary

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27 11 USC § 109(c)(3). Consumer and business debtors face no comparable limitation. Under the Bankruptcy Act of 1898, debtors were required to allege either insolvency or inability to pay debts. See Act of July 1, 1898, §§ 3a(5), 3(b), 30 Stat 544, 546, superseded by Bankruptcy Reform Act of 1978, Pub L No 95-598, 92 Stat 2549, codified as amended at 11 USC § 101 et seq. The Bankruptcy Code, enacted in 1978, omitted any such requirement. See, for example, In re Marshall, 403 Bankr Rptr 668, 689 (CD Cal 2009) (“[T]here has never been a requirement for a debtor to prove his or her insolvency before taking advantage of the protections of the Bankruptcy Code.”).


29 11 USC § 101(32)(C) (defining municipal insolvency as a “financial condition such that the municipality is—(i) generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute; or (ii) unable to pay its debts as they become due”).


31 In re City of Bridgeport, 129 Bankr Rptr 332, 338 (Bankr D Conn 1991). See also In re Pierce County Housing Authority, 414 Bankr Rptr 702, 710–11 (Bankr WD Wash 2009) (approving Bridgeport’s construction of the insolvency standard); In re Hamilton Creek Metropolitan District, 143 F3d 1381, 1386 (10th Cir 1998) (same).
remedies under state law.\textsuperscript{32} In individual and business cases, bankruptcy, having undermined creditor interests with one hand, promises with the other to protect them from debtor malfeasance or neglect by asserting judicial control over contested property. The law does this via the statutorily defined “estate,”\textsuperscript{33} authority over which is vested in a court-appointed trustee, subject to direct judicial approval of important decisions.\textsuperscript{34} To be sure, the managers of a business in Chapter 11 typically retain control of day-to-day matters as debtor-in-possession (just as an individual debtor retains possession of her property in Chapter 13).	extsuperscript{35} But transactions outside the ordinary course, which have the greatest capacity to upset creditor expectations, require judicial blessing.\textsuperscript{36} Moreover, the law prevents malingering in bankruptcy by allowing creditors to propose a viable plan if the debtor cannot or will not do so,\textsuperscript{37} or to have the case converted to a liquidation.\textsuperscript{38} The net effect is a regime in which the bankruptcy judge has final say-so over important dispositions and the debtor is, relative to other interested parties, at best something like the first among equals.

Not so in Chapter 9. A city’s filing of its petition stays creditor collection activities but does not create an estate.\textsuperscript{39} And there is no trustee.\textsuperscript{40} Rather, the debtor retains during bankruptcy all of its authority to conduct its affairs as it wishes. The Code secures debtor discretion with broad language:

Notwithstanding any power of the court, unless the debtor consents or the plan so provides, the court may not, by any stay, order, or decree, in the case or otherwise, interfere with—

(1) any of the political or governmental powers of the debtor;
(2) any of the property or revenues of the debtor; or

\textsuperscript{32} See 11 USC § 362(a).
\textsuperscript{33} See 11 USC § 541.
\textsuperscript{34} See 11 USC §§ 323(a), 1104(a).
\textsuperscript{35} See 11 USC § 1107(a) (giving a debtor-in-possession under Chapter 11 most of the rights and obligations of a trustee); 11 USC § 1303 (granting an individual debtor under Chapter 13 some of the rights of a trustee); 11 USC § 1306(b) (directing that property of the estate remain in debtor’s possession).
\textsuperscript{36} See, for example, 11 USC § 363 (sale of assets); 11 USC § 364 (new borrowing); 11 USC § 365 (assumption or rejection of leases and executory contracts).
\textsuperscript{37} This is true in Chapter 11 but not Chapter 13. See 11 USC § 1121(c)–(d) (specifying conditions in which parties other than the debtor may propose a plan of reorganization).
\textsuperscript{38} This is true of both Chapters 11 and 13. See 11 USC §§ 1112(b)(1), 1307(c).
\textsuperscript{39} 11 USC § 922(a) (describing the automatic stay). See also 11 USC § 901(a) (excluding by reference § 541, and therefore the concept of the estate, from Chapter 9).
\textsuperscript{40} See 11 USC § 902(5) (defining “trustee” as the debtor).
(3) the debtor’s use or enjoyment of any income-producing property.\textsuperscript{41}

Not only ordinary-course operations are insulated from judicial interference. Municipal debtors are permitted to use or dispose of property outside the ordinary course and to borrow additional funds (unless the new lender would have a priming lien)—all without seeking judicial approval.\textsuperscript{42} Only the debtor can propose a plan of adjustment,\textsuperscript{43} and the case can’t be converted to another chapter because there is no “liquidation” of a municipality.

This is not to say the court is powerless. A municipality enters bankruptcy because it wants a debt adjustment (or in any case, the people acting on its behalf want one), and it is the bankruptcy judge’s province to decide whether to approve such an adjustment.\textsuperscript{44} Some of the criteria the judge is to consider are vague—for example, the requirement that a plan be “in the best interests of creditors and [] feasible”\textsuperscript{45}—so she inevitably has latitude to deny relief. If the judge thinks it appropriate, she can dismiss the case outright. As commentators have long pointed out, a judge could leverage her discretion with respect to plan confirmation, turning it into de facto influence over debtor conduct: power exercised with “a wink and a nod.”\textsuperscript{46} So, for example, a bankruptcy judge might be able to cajole municipal authorities into imposing a new tax, even though she is prohibited from imposing one in her own name. But there are obvious limits to such roundabout authority. First, it might be thought inappropriate for a judge to do indirectly what the Code expressly declares she shall not do directly. And unseemliness impairs communication channels, if nothing else.\textsuperscript{47} Second, municipal officials will bend

\textsuperscript{41} 11 USC § 904.
\textsuperscript{42} See 11 USC § 901(a) (excluding by reference §§ 363 and 364(a)–(b)).
\textsuperscript{43} 11 USC § 941 (“The debtor shall file a plan for the adjustment of the debtor’s debts. If such a plan is not filed with the petition, the debtor shall file such a plan at such later time as the court fixes.”).
\textsuperscript{44} See 11 USC § 943(b) (enumerating criteria judges must apply).
\textsuperscript{45} 11 USC § 943(b)(7).
\textsuperscript{46} See, for example, McConnell and Picker, 60 U Chi L Rev at 474 (cited in note 9).
\textsuperscript{47} There is a question not only about the advisability, but also about the actuality, of indirect judicial influence. Professor Melissa Jacoby’s study of the Detroit case finds judicial influence ubiquitous. See generally Melissa B. Jacoby, Federalism Form and Function in the Detroit Bankruptcy, 33 Yale J Reg 55 (2016). See also Laura N. Coordes, Formalizing Chapter 9’s Experts, 116 Mich L Rev 1249, 1263–74 (2018) (suggesting that bankruptcy judges use mediators and other third-party expertise in part to overcome Chapter 9’s formal limitations on judicial power).
only so far. Debt adjustment is worth something but not everything. In a high-profile matter, moreover, dismissal of the case is apt to be viewed as a judicial failure as much as a municipal disappointment. The court might balk, and city officials know this. The situation resembles a bilateral monopoly. Negotiations, so to speak, are unlikely to get the judge just what she wants. The plain fact is that courts in Chapter 9, compared to other forms of bankruptcy, are essentially weak and can do relatively little to influence debtor operations or policy more generally.

B. The Critical Literature

The modern scholarly literature on municipal bankruptcy began in the early 1990s, motivated, it seems, by Bridgeport’s abortive filing. Professors McConnell and Picker, in particular, set what are still the bounds of academic debate. Their contribution was twofold. First, they showed that the economic problem that corporate bankruptcy was thought to solve, the creditors’ “race of diligence,” has no analog in the municipal context. Compared with the frustrated business or, indeed, consumer creditor, McConnell and Picker observed, the municipal creditor has exceedingly weak remedies under state law. A municipality cannot be dismembered, so there is no need for bankruptcy to coordinate creditor collections efforts. Second, McConnell and Picker identified two familiar properties of bankruptcy with more promising municipal analogs: its capacity to grant the debtor a “fresh start” and to improve management. To the extent a person’s debt burden has blunted her incentive to invest in the future, cleaning up her balance sheet can be expected to yield salutary effects. And


49 McConnell and Picker, 60 U Chi L Rev at 429–50 (cited in note 9).

50 Id.

51 Id at 469–70 (“The theory of Chapter 9 is that the burden of debt service, if sufficiently high, will affect the taxpayers of a city as it would a debt-ridden individual: it will sap initiative and depress money-generating activity.”). See also id at 472 (“In most cases, chronic financial difficulty is a sign that ordinary political processes are not functioning properly.”) (citation omitted).

52 Thoughtful observers have understood this economic rationale for the fresh start from as early as the mid-nineteenth century. See, for example, Joseph Story, 3 Commentaries on the Constitution of the United States 4–5 (Hilliard 1833) (“The latter course [allowing garnishment without end] obviously destroys all encouragement to industry and enterprise on the part of the unfortunate debtor, by taking from him all the just rewards of his labour, and leaving him a miserable pittance, dependent upon the bounty or forbearance of his creditors.”).
to the extent a firm’s managers or managerial policies are to blame for its woes, cleaning up the executive suite can do the same. The translation of these functions to the municipal sphere is imperfect, McConnell and Picker saw, but they might yet ground the law.

Academic interest in municipal bankruptcy has grown considerably since the Great Recession and the wave of filings that began with Vallejo, California, in 2008. Much of the scholarship has had a descriptive ambition, meant to explicate or clarify existing law rather than to criticize it. Because the application of Chapter 9 to sizeable, general purpose municipalities is still a novelty, many interesting and difficult questions of law are yet to be resolved.

Critical scholarship has focused on the second of the two functions McConnell and Picker identified—the law’s capacity to improve municipal policy. The most prominent critique of Chapter 9 is that, unlike Chapter 11, lacks direct mechanisms by which the judge and creditors can correct dysfunctional governance.

53 Bankruptcy is not a necessary precondition to either kind of change, but its reckoning may spur action.


norms.\textsuperscript{56} Much of the literature in this vein starts with the premise that incompetent management and dysfunctional electoral politics (which tend to produce incompetent managers) are to blame for excessive municipal debt.\textsuperscript{57} It follows that debt relief without a corresponding change in policy or governance is futile and that healthy policy and governance changes can have a big, long-term impact. The question, then, is what, if any, role bankruptcy should play in effecting change.\textsuperscript{58} At one pole are those who think federal judicial intervention in local governance either inconsistent with law or more generally ill-founded. On this view, state law is the proper source of municipal reform.\textsuperscript{59} Bankruptcy

\textsuperscript{56} See Juliet M. Moringiello, \textit{Goals and Governance in Municipal Bankruptcy}, 71 Wash & Lee L Rev 403, 421–29 (2014) (discussing scholarship critiquing the limited powers that Chapter 9 grants to bankruptcy courts). See also Andrew B. Dawson, \textit{Beyond the Great Divide: Federalism Concerns in Municipal Insolvency}, 11 Harv L & Pol Rev 31, 32–33 (2017) (noting that relegation of governance to state control is “one of the fundamental bases for much of the criticism of the municipal bankruptcy laws”).

\textsuperscript{57} See, for example, Dawson, 11 Harv L & Pol Rev at 33 (cited in note 56) (“While financial distress may result from exogenous shocks, it frequently results from poor governance.”); Clayton P. Gillette and David A. Skeel Jr, \textit{Governance Reform and the Judicial Role in Municipal Bankruptcy}, 125 Yale L J 1150, 1154 (2016) (“The financial distress of a substantial municipality nearly always signals that its politics are dysfunctional.”); McConnell and Picker, 60 U Chi L Rev at 472 (cited in note 9) (“In most cases, chronic financial difficulty is a sign that ordinary political processes are not functioning properly.”) (citation omitted).

\textsuperscript{58} A narrow question that dates to McConnell and Picker is whether a bankruptcy judge should (and can) impose special taxes or spending cuts as a condition for granting debt relief. McConnell and Picker thought so. McConnell and Picker, 60 U Chi L Rev at 472–81 (cited in note 9). Others have supplemented or doubled down on their analysis. See, for example, John P. Hunt, \textit{Constitutionalized Consent: Preemption of State Tax Limits in Municipal Bankruptcy}, 34 Yale J Reg 391, 424–28 (2017) (arguing that Congress could, if it wished, authorize municipalities in bankruptcy to impose taxes that would exceed the limits of state law); Clayton P. Gillette, \textit{Fiscal Federalism, Political Will, and Strategic Use of Municipal Bankruptcy}, 79 U Chi L Rev 281, 283–84, 326–28 (2012) (arguing that judges should be allowed to impose “resource adjustments” when political pathologies have prevented elected officials from doing so). But this is by no means the unanimous view. See generally, for example, Kevin A. Kordana, \textit{Tax Increases in Municipal Bankruptcies}, 83 Va L Rev 1035 (1997) (arguing that bankruptcy judges should not seek to levy additional taxes even if they can as a practical matter).

\textsuperscript{59} See, for example, Samir D. Parikh, \textit{A New Fulcrum Point for City Survival}, 57 Wm & Mary L Rev 221, 277–96 (2015) (advocating for further state intervention); Moringiello, 71 Wash & Lee L Rev at 457–71 (cited in note 56) (arguing that Chapter 9 was designed to allow minimal federal intervention); Omer Kimhi, \textit{Chapter 9 of the Bankruptcy Code: A Solution in Search of a Problem}, 27 Yale J Reg 351, 369–85 (2010) (arguing that rationales for bankruptcy do not apply to Chapter 9); Omer Kimhi, \textit{Reviving Cities: Legal Remedies to Municipal Financial Crises}, 88 BU L Rev 633, 660–72 (2008) (comparing the efficacy of state and federal interventions and finding state law superior). See also generally Clayton P. Gillette, \textit{Dictatorships for Democracy: Takeovers of Financially Failed Cities}, 114 Colum L Rev 1373 (2014) (advocating state use of control boards to rationalize municipal policy, but not on the ground that federal intervention would be inherently illegal or inappropriate). See also Austin Murphy, \textit{Bond Pricing in the Biggest City Bankruptcy in History: The
ought to serve as, at most, an implement states can use to write down municipal debt notwithstanding the Constitution’s Contracts Clause. At the other pole, Professors Clayton Gillette and David Skeel argue that judicial intervention in bankruptcy not only is consistent with existing law but frequently is advisable, precisely because the fact of bankruptcy suggests that the levers of reform at the state level are not working.

Whatever their view on the propriety of federal intervention in municipal governance, those writing critically on Chapter 9 implicitly concede a narrow sphere for municipal bankruptcy. Even Gillette and Skeel, for example, acknowledge that judicial intervention is possible only to the degree an eligible municipality’s managers want debt relief. If a municipality does not qualify for Chapter 9 or does not ask for a plan of adjustment, there is nothing for a court to do. Normative debate is thus very real, but because eligibility criteria are so strict, the functional significance of that disagreement has been unavoidably slim. Whether for that

Effects of State Emergency Management Laws on Default Risk, 54 Intl Rev L & Econ 106, 107, 109–15 (2018) (finding evidence that emergency management in Detroit reduced city default risk but may have increased default risk of geographically proximate governments). Although not principally concerned with the scope of bankruptcy law, Professor David Schleicher also has much of interest to say about the connection between state-level policy and the shape of municipal distress. See generally David Schleicher, Stuck! The Law and Economics of Residential Stagnation, 127 Yale L J 78 (2017).

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60 See Dawson, 11 Harv L & Pol Rev at 39–42 (cited in note 56) (describing this view and its foundations). The Constitution bars states from “impairing the Obligation of Contracts.” US Const Art I, § 10. That power belongs to the federal government alone, by virtue of the Bankruptcy Clause. See US Const Art I, § 8, cl 4 (granting Congress the power to make “uniform Laws on the subject of Bankruptcies throughout the United States”). Thus, on one understanding, Chapter 9 serves only, or primarily, to enable the states effectively to write down their municipalities’ debts notwithstanding the Constitution’s formal prohibition. Moringiello, 71 Wash & Lee L Rev at 410–15 (cited in note 56) See also generally Juliet M. Moringiello, Chapter 9 Plan Confirmation Standards and the Role of State Choices, 37 Campbell L Rev 71 (2015) (arguing for greater deference to state-created priority norms). This end-around works formally because the federal court’s confirmation of a plan of adjustment is understood to be the agent of impairment and not the actions of the state that generates a confirmable plan. See Buccola, 33 Rev Bank & Fin L at 591, 600–08 (cited in note 54) (“Impairment is a federal, and not a state, activity.”). Whether federal law is a necessary aid, as a constitutional matter, is in some doubt. See, for example, Vincent S.J. Buccola, An Ex Ante Approach to Excessive State Debt, 64 Duke L J 235, 246–48 (2014). But federal law is surely needed in light of the existing statute. See 11 USC § 903(1) (preempting whatever authority states would otherwise have to compromise municipal debts without creditor consent).

61 Gillette and Skeel, 125 Yale L J at 1153 (cited in note 57). But see Jacoby, 41 Fordham Urban L J at 865 (cited in note 54) (suggesting that bankruptcy judges assert more control already than most have suspected).

62 Gillette and Skeel, 125 Yale L J at 1211 (cited in note 57) (“Once a state does authorize its municipalities to file, only a municipality itself can invoke Chapter 9.”).
reason or another, little scope has been given to the question: What, in principle, might a sensible municipal bankruptcy law achieve?\footnote{Commentators might alternatively have felt constrained by what are often assumed to be narrow constitutional bounds in this domain. See, for example, Gillette, 114 Colum L Rev at 1379–80 (cited in note 59) (advocating for state “takeover boards” because, among other things, “the scope of federal bankruptcy for municipalities may be constrained by federalism and Tenth Amendment considerations”); Gillette, 79 U Chi L Rev at 293 (cited in note 58) (“Some suggest that the noninterference principle preserves the constitutionality of a federal bankruptcy law directed at municipalities by minimizing the role of federal actors in matters best left to state consideration.”); McConnell and Picker, 60 U Chi L Rev at 472–81 (cited in note 9) (suggesting that bankruptcy judges might force governance and tax changes by conditioning debt relief but also that, given constitutional doubts, it might be sensible to scrap federal intervention altogether). Even those who are bullish on federal power tend to condition their claims on state consent. See Gillette and Skeel, 125 Yale L J at 1202–06 (cited in note 57) (arguing that bankruptcy judges can, under existing law, condition relief on governance modifications and that such conditioning is consistent with the Constitution because of the prerequisite of state consent and the maintenance of state authority over municipal governance); Michelle W. Anderson, The New Minimal Cities, 123 Yale L J 1118, 1152 (2014) (suggesting that bankruptcy is not as helpful as it might be because “[f]or Tenth Amendment reasons, this option is available only where the [municipality’s] state has ‘specifically authorized’ the municipality . . . to [ ] file”). See also generally Hunt, 34 Yale J Reg 391 (cited in note 58) (arguing that bankruptcy law could permit judges to impose new taxes and that such power would be consistent with the Constitution because of the prerequisite of state consent). My current research, still in progress, finds that Congress has a much freer hand than observers have assumed.  \footnote{The seminal paper is Jackson, 91 Yale L J 857 (cited in note 6). Important early elaborations include Douglas G. Baird and Thomas H. Jackson, Bargaining after the Fall}}

II. FRAMING AN OBJECTIVE FOR MUNICIPAL BANKRUPTCY

The economic function of bankruptcy, in general, is to cure allocative distortions that follow from high levels of debt. Debt alters behavior, and when it becomes overwhelming, it can induce people to forgo valuable opportunities. In a frictionless world, investors would bargain around debt so as not to leave surplus on the table—the Coasean nirvana—but in the real world they cannot always do so. Bankruptcy cuts the knot. By cleaning up a debtor’s balance sheet, it encourages people to make investment decisions in accord with the underlying value of available resources.

The creditors’ bargain model, the leading normative framework for understanding corporate bankruptcy, is an application of this insight. The question that model addresses is: How does debt generate allocative inefficiencies \textit{in the corporate setting}? The answer, which Professor Jackson gave and elaborated with Professor Baird in the 1980s, is that a firm’s default can lead to a creditor run, dismembering specific investments and thereby destroying joint value.\footnote{The seminal paper is Jackson, 91 Yale L J 857 (cited in note 6). Important early elaborations include Douglas G. Baird and Thomas H. Jackson, Bargaining after the Fall} What bankruptcy can do is forestall grab
When investors would, if they could coordinate cheaply, opt to keep a firm intact. That is, bankruptcy can help investors not waste the value associated with an indebted firm’s peculiar configuration of resources. Here is the law’s logic and also its limit.\textsuperscript{65} This Part identifies a corresponding objective toward which municipal bankruptcy law might be directed. Its motivating question, then, is: How does debt generate allocative inefficiencies \textit{in the municipal setting}? The answer will take some pages to unpack, but in principle it can be simply put: High levels of government debt can lead to underinvestment, both public and private, in infrastructure within a municipality’s territorial limits. This in turn threatens to dissipate spatial economies associated with the location.\textsuperscript{66} What bankruptcy can do, even if existing law does it poorly, is preserve these economies by writing down debts likely to discourage local investment. What bankruptcy cannot do, on the other hand, is equally clear. Just as surely as debt can cause spatial economies to be dissipated, it can also be a consequence, or symptom, of their natural decay. One city has too much debt; another city has too much debt because the once-prosperous mine near which it sits has become defunct. It is familiar to talk of “disruptive” technologies undermining once-vibrant businesses. But the same process, although celebrated with less fanfare, has the capacity to undermine once highly productive places, too. When a location cannot generate revenues sufficient to pay for basic social services, it is tragic but not a matter bankruptcy is calibrated to resolve. Law reform should be undertaken with this logic in mind.\textsuperscript{67}

\textsuperscript{65} Consider Ayotte and Skeel, 80 U Chi L Rev 1557 (cited in note 8) (identifying creditor-coordination problems other than the grab race and arguing that bankruptcy appropriately addresses them, too).

\textsuperscript{66} See Part II.D.

\textsuperscript{67} Just what kind of policy response locational decline calls for is an open and much debated question, with recent volleys having been launched in the \textit{Yale Law Journal Forum}. Compare generally Schleicher, 127 Yale L J F 78 (cited in note 59), with Naomi Schoenbaum, \textit{Stuck or Rooted? The Costs of Mobility and the Value of Place}, 127 Yale L J F 458 (2017); Michelle W. Anderson, \textit{Losing the War of Attrition: Mobility, Chronic Decline, and Infrastructure}, 127 Yale L J F 522 (2017). For a recent review of the economic rationales for,
A. The Economic Function of Cities and Towns

Why do people and firms locate where they do? What is the use of cities and towns? These are the central questions of economic geography and urban economics. Here is not the place to explore the state of the art in those fields, but it will be helpful, in trying to understand the significance of government debt, to bear a few ideas in mind. Modern theory on the question of location is usually traced to Alfred Marshall. People and industry tend to concentrate in a particular location, Marshall saw, for two generic reasons—either to exploit natural advantages associated with the place or to benefit from proximity to complementary people and activities. I call these reasons “natural” and “density” economies, respectively, and I use the term “spatial” economies to refer generically to either.

Natural economies refer to the cost savings to be had by locating activity close to valuable natural resources. These resources vary widely in character. They include endowments such as rich soil, proximity to mines or quarries, or access to transportation networks. No exhaustive catalog is possible because what counts as a natural advantage depends ultimately on contingent facts about technology and culture. What is advantageous in one time and place is a function of given modes of production and consumption. Thus, Marshall’s illustrations of natural advantage are distinctive of and specific to the England of his time:

Straw plaiting has its chief home in Bedfordshire, where straw has just the right proportion of silex to give strength without brittleness; and Buckinghamshire beeches have afforded the material for the Wycombe chairmaking. The Sheffield cutlery

...
trade is due chiefly to the excellent grit of which its grindstones are made.\footnote{Marshall, Principles of Economics at 223 (cited in note 69).}

Natural economies are not only about production strictly understood. Place-based amenities such as fair weather and access to mountains or beaches also help to explain location decisions.\footnote{Consumption amenities cannot be isolated from production processes, as they may affect wage demands.}

Again these are defined contingently. For example, temperatures along the Sun Belt in the southern United States became an amenity only with the advent of cheap and reliable air conditioning.

Density economies refer to the savings to be had by locating complementary activities near one another and so reducing transport costs. Marshall posited three advantages to industrial clustering, corresponding to the need of transporting goods, labor, and ideas, respectively.\footnote{Marshall, Principles of Economics at 269–75 (cited in note 69). I use “density” economies in favor of terms like “agglomeration,” “localization,” or “urbanization” economies because I wish to avoid adjudicating the subtleties of their technical and nontechnical usages. “Density economy” also emphasizes the source of the surplus—namely, the nearness of economic actors to each other.}

These advantages are usually described today as input sharing, labor pooling, and knowledge spillover,\footnote{See Arthur O’Sullivan, Urban Economics 45–64 (McGraw-Hill 8th ed 2012).} and empirical investigation confirms the influence of each on observed patterns of industrial concentration.\footnote{See generally Glenn Ellison, Edward L. Glaeser, and William R. Kerr, What Causes Industry Agglomeration? Evidence from Coagglomeration Patterns, 100 Am Econ Rev 1195 (2010) (estimating the contribution of each factor to observed agglomeration patterns).}

Input sharing refers to the capacity of proximately situated firms to split the fixed costs of factors of production on which each relies. Broadly understood, it also describes the process by which a place’s residents split the fixed costs of consumption or cultural goods—for example, the costs of maintaining an opera or a football club or an array of dining options. Labor pooling refers to the advantage to firms of having many workers to choose from, and to workers of having many employers to choose from. There are benefits to matching as well as implicit insurance.\footnote{Labor matching is sometimes described as a distinctive advantage to urbanization that cuts across industries. See O’Sullivan, Urban Economics at 55–58 (cited in note 74).}

Knowledge spillover refers to the tendency of know-how and the fruits of innovation to spread through informal channels among persons or firms in a place.
Knowledge spillovers are thought to be especially important in explaining technology clusters.\footnote{For an overview, see Enrico Moretti, The New Geography of Jobs 138–44 (Houghton Mifflin 2012).}

It is not easy, and might be impossible, to pronounce definitively on the relative importance of each source of economy.\footnote{One study finds that measured natural advantages explain approximately 20 percent of observed industrial agglomerations and conjectures that, in combination with all that is unmeasured, natural advantages could explain 50 percent; Glenn Ellison and Edward L. Glaeser, The Geographic Concentration of Industry: Does Natural Advantage Explain Agglomeration?, 89 Am Econ Rev 311, 315–16 (1999). But estimates of this sort depend as a matter of course on definitions that may prove arbitrary in the final analysis. The determinants of agglomeration economies are likewise elusive. See Patricia C. Melo, Daniel J. Graham, and Robert B. Noland, A Meta-analysis of Estimates of Urban Agglomeration Economies, 39 Regional Sci & Urban Econ 332, 332, 337–41 (2009) (finding, among other things, “that agglomeration estimates for any particular empirical context may have little relevance elsewhere”).}

What does seem clear, however, is that path dependence mediates natural and density economies and, in so doing, explains much about the location of thriving cities and towns. Purely natural economies are less of a factor in the modern American economy than they once were. (Movement off the farm and advances in transportation and communication technology ensure that.) And density economies, by definition, do not depend on a specific location; they require only that some place be a focal point of concentration.\footnote{See Edward L. Glaeser, Agglomeration Economics 7 (Chicago 2010): A century or more ago, when shipping goods was expensive, cities like Chicago and New York formed around ports and rail yards. Over the twentieth century, the cost of moving goods declined enormously, and few modern agglomerations seem built on the easy movement of physical output. Today, the bulk of urban growth, at least in the United States, appears to be in far-flung places that seem to have little advantage in the shipment of goods.}

History connects these ideas. In a simple model, people initially cluster in a place endowed with natural advantages—a favorable location on a navigable river, say—and agglomeration persists or accelerates, long after the endowment has become obsolete, on account of the fact of the initial clustering.\footnote{See Hoyt Bleakley and Jeffrey Lin, History and the Sizes of Cities, 105 Am Econ Rev 558 (2015) (“Intuitively, if endogenous amenities are important for location decisions, then agglomerations might be possible at many sites, especially if they share similar exogenous natural characteristics.”).}

Put simply, returns to scale may become self-reinforcing up to a point.\footnote{See id at 558–60. See also generally Hoyt Bleakley and Jeffrey Lin, Portage and Path Dependence, 127 Q J Econ 587 (2012).}

This means, however, that, if the density economies in a place are dissipated, there might be no continuing natural economies on which to fall back.
The growth of Chicago during the nineteenth century, from a fur-trading outpost to one of the world’s leading cities, illustrates the way natural and density economies can depend on one another.\textsuperscript{83} When the city was founded in 1837, its site at the mouth of the Chicago River was no accident. The harbor there, although poor in absolute terms, was the best to be found in the south part of Lake Michigan, and the River’s upstream limit was only about a dozen miles from a ridge separating the watersheds of the Great Lakes from those of the Mississippi. As a portage, Chicago stood to be an obvious trading place for goods moving across the country, from New York to New Orleans. A canal built during the 1840s connected the Atlantic and Gulf by inland waters, in the process expanding Chicago’s effective hinterlands and increasing its value as a marketplace. Beginning in the 1850s, the railroads superseded the canal for the shipment of most goods; but the railroads were built to Chicago precisely because it was already a regional center. By the time of the World’s Fair in 1893, the economies initially provided by the harbor and river were essentially irrelevant. The city’s place at the hub of a hub-and-spokes rail system now defined its endowment, a kind of “second nature,” but that system was itself a product of the density economies that could be traced back to the fur trade.

An individual deciding where to locate might reasonably take the existence of spatial economies as given. But as the example of Chicago suggests, only the rawest natural economies are spontaneously generated. For the most part, the development and exploitation of spatial economies requires capital. Investment is needed.

Which brings us, at last, to the municipality. The economic function of municipal government is to develop local spatial economies—by direct investment and by acting as a spur to private investment (supplying social regulation and conditions conducive to investment). In principle, municipal government is unnecessary. In principle, private investment can fund infrastructure. And in principle, state and federal governments can ensure the public safety necessary to make that investment viable.\textsuperscript{84} But in

\textsuperscript{83} This account is drawn from the excellent book by William Cronon, \textit{Nature’s Metropolis: Chicago and the Great West} (Norton 1991).

\textsuperscript{84} This insight was the basis of Professor Robert Ellickson’s discussion of private associations as alternatives to city governments. See generally Robert C. Ellickson, \textit{Cities and Homeowners Associations}, 130 U Pa L Rev 1519 (1982). More recent experiments with the “private city” model are in this vein. For an introduction, see Alex Tabarrok and Shruti
fact, at least in the United States, local government has always been intimately tied up in local development. And this generally seems a sensible arrangement. Government, with its coercive tax power, has an advantage in solving freeriding problems; and local governments, in particular, are responsive to those who stand to gain (and lose) most from investments in infrastructure. As a result, municipal governments are generally well positioned to provide efficient levels of public and quasi-public goods—street repair, sanitation, police and fire protection, and so forth. All does not always go well, however, and a municipality may find itself under a mountain of debt.

B. Economic and Financial Distress

A central notion in corporate bankruptcy theory, perhaps the central notion, is the distinction between economic and financial distress. Economically and financially distressed firms alike face
unsustainable debts, but the significance of their debts differs. A company in economic distress lacks a viable business model. The demand for its products or services is insufficient to cover costs at anything like current scale. A restaurant that prepares lousy food at high cost is the prototype. Its few loyal (and idiosyncratic) patrons do not eat enough to pay for the labor, rent, ingredients, and so forth that go into the meals, and the disparity between receipts and costs must be covered by borrowing. Even well-managed and once-profitable companies can find themselves in economic distress. The advent of the word processor, for example, spelled the end for typewriter manufacturers of long standing. In a market economy, these firms are doomed. Relief from creditors will not save them. It will at most delay a reckoning, and all bankruptcy can do is to structure the inevitable liquidation and disbursal of proceeds.

A company in financial distress, by contrast, has a viable business model—its revenues are sufficient to cover operating costs—but its cash flows are inadequate to cover costs and service outstanding debt. Its balance sheet needs recapitalization, but its peculiar combination of real resources is operationally sound. The nineteenth-century railroads furnish the classic example. A struggling railroad’s bondholders might value keeping its tracks together even if the railroad’s revenues will not satisfy their claims in full. (Railroad ties sold for their second-best use, as firewood, would be unlikely to fetch a superior return.) Because any one impaired lender might nevertheless find it privately advantageous to levy on the wood and steel comprising the railroad, as she was entitled to do under ordinary legal principles, a debt restructuring mechanism could produce value. Fundamentally, bankruptcy can prevent the fact of debt from destroying the surplus associated with a particular configuration of assets.

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89 See, for example, Laurence Zuckerman, Smith Corona, a Computer Victim, Files for Bankruptcy (NY Times, July 6, 1995), archived at http://perma.cc/TH4R-W6W8.

90 Indeed, the logic was so apparent that courts of equity were willing to validate a series of new legal fictions, jointly known as the equity receivership, in order to effect reorganization rather than piecemeal liquidation. For description and analysis of the receivership mechanism, see Stephen J. Lubben, Railroad Receiverships and Modern Bankruptcy Theory, 89 Cornell L Rev 1420, 1440–52 (2004); Douglas G. Baird and Robert K. Rasmussen, Boyd’s Legacy and Blackstone’s Ghost, 1999 S Ct Rev 393, 397–408; David A. Skeel Jr, Debt’s Dominion: A History of Bankruptcy Law in America 56–60 (Princeton 2001).

91 Note that economic and financial distress are polar concepts, ideal types rather than directly observable conditions. Even the sagest observer confronts a probabilistic landscape. Future cash flows could be greater or lesser than one expects. As a matter of logic, then, the definitive categorization of a distressed firm is impossible—one observer’s
The concepts of economic and financial distress map imperfectly onto the municipal context. A city occupies a fixed geographic territory as a matter of law, and creditors cannot in any meaningful sense foreclose on or liquidate its property. And while the owners of locally situated real estate are, after a fashion, the residual beneficiaries of municipal policy and action, and in that sense resemble corporate stockholders, their property cannot be seized to satisfy entity-level creditors. So the particular risk-return profile the residual beneficiaries face is quite different. Nevertheless, it will be useful to effect a conceptual translation, to emphasize a parallel ambiguity in the significance of municipal and corporate debt. A local government, like a company, has a kind of business model. It offers a suite of services, charges for them, and can sustain unbalanced budgets only as long as its credit will last. That credit depends, in turn, on the perceived viability of the business model.

C. Municipal Economic Distress: Productivity Shock → Debt

A municipality is economically distressed when it is in debt and its sources of revenue—taxes, fees, and reliable grants-in-aid— are insufficient to pay for the scale of services it has been known to provide or that most Americans demand unconditionally. Such a municipality cannot increase its long-run revenues because the

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92 For discussion of creditors' remedies under state law, see McConnell and Picker, 60 U Chi L Rev at 427–50 (cited in note 9).
93 See Joseph Gyourko and Joseph Tracy, Local Public Sector Rent-Seeking and Its Impact on Local Land Values, 19 Regional Sci & Urban Econ 493, 495 (1989) (“Landowners are the equity holders in a locality.”).
94 Once upon a time, the New England states allowed municipal creditors to levy on privately held property. See McConnell and Picker, 60 U Chi L Rev at 437–42 (cited in note 9).
95 Not for nothing, observers have long remarked on the similarity between municipal governments and consumer cooperatives. See, for example, Kordana, 83 Va L Rev at 1055–56 (cited in note 58) (“[A] municipality is, in important ways, similar to a corporation. Or more precisely, a corporation and a municipality represent different ways of achieving a similar task: creating and delivering goods and services more efficiently through the creation of an enterprise.”); Ellickson, 130 U Pa L Rev at 1520–26 (cited in note 84) (“Although cities are considered ‘public’ and homeowners associations ‘private,’ I discern only one important difference between the two forms of organization—the sometimes involuntary nature of membership in a city versus the perfectly voluntary nature of membership in a homeowners association.”).
The act of raising tax rates or imposing new fees will generate offsetting delinquency and flight.\textsuperscript{96} Nor can it balance its long-run operating budget by reducing services or skimping on capital maintenance because this too will cause flight—and moreover, many municipal services are mandated by state law if not by good conscience. In short, this is a municipality whose business is cooked. Despite what is sure to be cheap real estate, the location no longer attracts economic activity on a scale sufficient to pay the bills.

How does a city or town come to find itself in economic distress? Chronic mismanagement and political dysfunction can do the job. The dominant story is not, however, about malfeasance or even negligence, but about technological and cultural change.\textsuperscript{97} The world changes in ways that undermine a place’s spatial economies, the reasons for people’s being there, and debt is a frequent byproduct.

A process culminating in municipal economic distress often begins with a negative productivity shock—a change, whether local or macroeconomic, that makes locating within the municipality less valuable than before. Even a major shock—for example, the exhaustion of an important natural resource—does not cause municipal operations to shutter immediately, however. Local life continues because infrastructure is durable. Professors Edward

\textsuperscript{96} The theory is discussed, and four budgets are analyzed in depth, in Haughwout, et al, 86 Rev Econ & Stat 570 (cited in note 88). Land itself cannot flee, of course, and a municipality can foreclose on abandoned property to protect its tax liens. But foreclosures diminish the value of nearby real estate and so can further erode the tax base.

\textsuperscript{97} Economic geographers understand the connection between innovation and locational decline. See, for example, Sukkoo Kim and Robert A. Margo, \textit{Historical Perspectives on U.S. Economic Geography}, in J.V. Henderson and J.F. Thisse, eds, 4 \textit{Handbook of Regional and Urban Economics} 2981, 2983 (Elsevier 2004) ("New industries develop and, for technological or other reasons, find it profitable to situate in different locations than old industries. Transportation networks emerge, linking far-flung markets, within and across countries, again potentially altering the spatial distribution of resources."); Paul Krugman, \textit{The Gambler’s Ruin of Small Cities (Wonkish)} (NY Times, Dec 30, 2017), archived at http://perma.cc/6RML-3LA5 ("In the modern economy, which has cut loose from the land, any particular small city exists only because of historical contingency that sooner or later loses its relevance."). The relationship has largely escaped notice in the legal literature, a notable exception being Schleicher, 127 Yale L J F at 578–79 (cited in note 67):

Just as we have different firms in the S&P 500 than we did a hundred years ago, the variety and sizes of regions and cities required by a dynamic economy and society change over time. We cannot stop some cities from declining and other cities from growing without stopping the economy or society from changing and improving.
Glaeser and Joseph Gyourko capture the dynamic in an important model of urban decline. The model’s logic starts with the familiar observation that a place’s spatial economies are reflected, or “capitalized,” in the price of local real estate. A negative shock to the magnitude of these economies induces the mobile residents who are most sensitive to the effects of productivity changes to leave for more lucrative opportunities. But the population does not immediately decrease. Instead, housing prices are bid down, and new residents, less vulnerable to the effects of productivity loss and more sensitive to housing cost, move in to replace the departed. Population declines only as the housing stock and complementary infrastructure are exhausted.

Versions of this story have played out across the United States for a long time. Sometimes the agent of change is industry-specific and therefore concentrated in particular regions or localities. Reversals in the coal industry hit parts of Appalachia hardest, for example, and the decline of the timber industry disproportionately affected the Pacific Northwest. But other changes alter patterns of clustering more generally. Consider for example the many market towns that once thrived as trading hubs in agricultural regions. When a large fraction of the population was “on the farm” and travel was slow, a relatively large number of relatively small market towns flourished. Developments in agriculture and transportation shocked the spatial equilibrium. As the number of agricultural workers and the cost of travel fell, it became inevitable that many once-vibrant cultural hubs would decline.

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100 I focus on productivity shocks, but essentially the same story can be told of shocks to level of amenities. Arguably the move of population from the American Northeast to the South and Southwest is due in large part to an amenity shock. Warm weather became more valuable after air conditioning was perfected. Put differently, the disamenity of cold weather was magnified.
101 See Glaeser and Gyourko, 113 J Polit Econ at 348–53 (cited in note 98) (furnishing evidence for the claim that negative shocks, such as wage decreases, are followed by large decreases in housing prices but little change in population).
102 See id at 370 (“The supply side of the housing market helps explain why cities decline so slowly even though they can grow at very fast rates. Durable housing can also explain the striking persistence of urban decline.”).
103 Paul Krugman put the idea well in a recent column in the New York Times. See Krugman, The Gambler’s Ruin (cited in note 97) (“[O]nce upon a time dispersed agriculture ensured that small cities serving rural hinterlands would survive. But for generations
The conditions following a major negative productivity shock put pressure on a municipality’s budget. Although population remains constant for a time, revenues shrink because the tax base is impaired. Incomes are lower, property worth less, and the dollar volume of taxable transactions diminishes. At the same time, demand for government services may increase because those least sensitive to productivity may require more public aid. It stands to reason, for example, that the elderly and the infirm are on average less sensitive to productivity because they are not seeking employment. Thus, “[a]s tax revenues are falling, spending needs are rising.”\textsuperscript{104} Moreover, when population eventually declines, the cost of providing a fixed level of services may increase as former scale economies are lost.\textsuperscript{105} In principle, economic decline need not lead to large public debts. If managers can adjust quickly and nimbly enough by scaling back spending on margins formerly, but no longer, in high demand and cultivating subsidies and charitable aid, they might be able to “wind down” operations.\textsuperscript{106} But this is no easy task, and for obvious reasons the adjustments needed to avoid chronic deficits will often be unpalatable to the voting electorate. Debts grow.

Under these conditions, there is little for bankruptcy to do. An initial shock or series of shocks has set in motion adjustments that, in equilibrium, leave a degraded tax base and increased demand for public services. If the magnitude of the shock or shocks is large enough, the municipality finds itself unable to raise revenues sufficient to cover basic services such as police, fire, and sanitation. Unsustainable debt may be one consequence, but it is a product rather than cause of distress. There is no reason to think debt relief or a bankruptcy judge’s intervention in local governance will stimulate new investment.


\textsuperscript{105} Hence, arguments for shrinking governance in cities that have lost population. See, for example, Anderson, 123 Yale L J at 1126–27 (cited in note 63) (discussing the concept of “shrinking governance” for cities facing rapid population decline and increasingly concentrated poverty).

\textsuperscript{106} The parallel is to the failed restaurant financed entirely with the entrepreneur’s equity.
D. Municipal Financial Distress: Debt → Underinvestment

The degree to which spatial economies are exploited depends on complementary capital investment, physical as well as human. For example, the area near deep and still water becomes valuable as a port location only when docks are built; the area near a mineral deposit becomes valuable as a mining location only when extraction facilities are built; the area near a ski mountain becomes valuable as a resort location only when a lodge is built, trails are cleared, and lifts installed. Likewise, a functioning road system makes a city a more valuable place to congregate, a more useful focal point for interaction. Spatial economies are likely to depend as well on investments in goods such as schools, sanitation, law enforcement, and real estate improvements of all kinds, as well as investments not mediated by market exchange, such as the founding of clubs and religious and cultural associations. All else equal, most people prefer to be clean, safe, and comfortably housed. These goods are costly, of course, and the law of diminishing marginal returns defines an upward limit on the wisdom of their procurement, but the fact is that investment is needed to enhance and exploit spatial economies.

A corollary to this proposition is that underinvestment threatens to erode or dissipate spatial economies. The port whose harbor is inadequately dredged becomes a less valuable conduit of trade; the city whose roads have too many potholes becomes, on the margin, a less useful place to congregate. Locations compete with one another for economic activity, whether explicitly or not. As a location’s spatial economies are dissipated by underinvestment, the people and firms most sensitive to its productivity loss will be tempted to leave. In other words, underinvestment is one path to economic dysfunction.

Large public debts can cause underinvestment. Municipal financial distress describes the condition when they threaten to do so. What bankruptcy can do, in principle, is truncate those debts and so prevent financial distress from turning into, or creating, economic distress. But one needs to be careful about the mechanism. As Part III explains, the wisdom of a more aggressive municipal bankruptcy regime depends on the ability to identify cases of financial distress accurately, and to do that, one needs to grasp how exactly municipal debt is apt to discourage investment. The propensity for underinvestment has a public and a private side, and I take these in order.
1. Public underinvestment.

The place to start is with the proposition that large municipal debts discourage public investment in valuable infrastructure. It is because a city faces so much debt, the thought goes, that it skimps on cost-justified expenditures on transit and police and the like—penny-wise savings that are pound-foolish because underinvestment erodes spatial economies. This, at any rate, is an effect municipal bankruptcy could in principle ameliorate.

Why should debt have such an effect? The general mechanism is given by what the corporate finance literatures calls “debt overhang.” Debt overhang describes a condition in which an entity’s existing obligations blunt investors’ willingness to contribute new capital to finance new investment.\textsuperscript{107} This can cause it to fail to exploit even opportunities that all investors expect to be socially valuable. Speaking generally, is a consequence of the fact that existing creditors have first dibs on cash flows. Junior investors, because they do not fully internalize the creditors’ interests, are disinclined to fund the gamble.

To illustrate, start with a simple example in the corporate setting. Suppose that Acme Corporation is deciding whether to raise capital for a new investment. The project costs 80 today and will pay out either 200 or nothing tomorrow, after which Acme’s investors will settle their affairs. Success and failure of the project are equally likely.

If Acme has no debt, then its stockholders will expect the investment to make them better off by 20:

\[
[0.5(200) + 0.5(0)] - 80 = 20.
\]

\textsuperscript{107} The identification of debt overhang is usually traced to Stewart C. Myers, \textit{Determinants of Corporate Borrowing}, 5 J Fin Econ 147 (1977). Somewhat confusingly, the term has sometimes been used in the development economics literature to signify a related but different phenomenon. See, for example, Paul Krugman, \textit{Financing vs. Forgiving a Debt Overhang}, 29 J Dev Econ 253, 254–55 (1988) (defining a country as having a debt overhang problem “when the expected present value of potential future resource transfers [to creditors] is less than its debt”). The conception in the corporate finance literature is broader than Krugman’s conception, which applies only to scenarios in which a debtor is “balance-sheet” insolvent—that is, when in expectation the borrower will be unable to pay its debts in full. As I use the term, consistent with its use in corporate finance, debt overhang describes any case in which the fact of outstanding debt blunts investment incentives. A debtor need not be insolvent for its debt to have this effect. Consider Vincent S.J. Buccola, \textit{Beyond Insolvency}, 62 U Kan L Rev 1 (2013) (discussing implications for law of recognizing solvency as a continuous rather than discrete variable).
Stockholders who are indifferent to risk will want to contribute the necessary capital because the project will, in expectation, generate revenues in excess of costs.

But if, on the other hand, Acme has debt, then its stockholders might wish to forgo the new investment. Suppose that Acme owes its creditors 50 at the time the new project is considered. If the project is undertaken and proves successful, the creditors will lay claim to 50 of the proceeds, leaving 150 for the stockholders. If the project is undertaken and proves unsuccessful, then, of course, the creditors and stockholders both take 0.\textsuperscript{108} On this specification, Acme’s stockholders will not wish to contribute the necessary capital because they expect the investment to make them worse off by 5:

\[0.5(200 - 50) + 0.5(0)] - 80 = -5.\]

The project is socially valuable, but the stockholders, to the extent they are in control, will prevent the investment from being made.\textsuperscript{109} More generally, debt overhang implies that risk-neutral stockholders will seek to invest in a new project only to the extent its expected value is positive net of the face value of the company’s debts.\textsuperscript{110} The bigger those debts are relative to the company’s equity cushion, the more valuable investment opportunities the company is likely to pass up.

The translation of a corporate model of debt overhang to the municipal context is imperfect but important to effect because, in many relevant respects, firms and towns can be expected to behave similarly. After all, in both cases, the primary residual beneficiaries of successful investment elect officials to mediate relationships

\textsuperscript{108} The stockholders in this example are assumed to have limited liability. If they were liable for Acme’s debts, the debt overhang problem would disappear. This is because debt overhang arises from the fragmentation of investors’ interests in the company’s success. See Myers, 5 J Fin Econ at 156–57 (cited in note 107) (specifying limited liability as a property of the debt contracts underlying the basic model).

\textsuperscript{109} Note that this is so only if Coasean bargaining is impossible. In an ideal world, the creditors would “bribe” the stockholders to undertake the project, perhaps in the form of partial debt relief, or would loan Acme funds to pursue the project. The project is worth 25 to the creditors in expectation. (If the project is undertaken, they have a 50 percent chance of receiving 50; if it is not undertaken, they have no chance of receiving anything.) A bargain between them and the stockholders would yield a surplus of 20—that is, the social value of the project.

\textsuperscript{110} For the same reason, new debt financing is hard to come by unless it takes priority over existing debt. One function of bankruptcy is to relax the liquidity constraint associated with existing debt by authorizing new, priming loans subject to judicial approval. See 11 USC § 364. For discussion of the tradeoff associated with priming loans, see generally George G. Triantis, A Theory of the Regulation of Debtor-in-Possession Financing, 46 Vand L Rev 901 (1993).
between and among themselves and the entity’s lenders, employees, and other constituents. In the corporate case, stockholders bear the primary residual interest in activities overseen by the board of directors they choose because the value of equity depends on the profitability of corporate investment. In the municipal case, residents and (especially) landowners bear the primary residual interest in activities overseen by the mayor or council they elect because the value of local real estate depends on, among other things, the relationship between taxes and the municipal infrastructure they procure. The value of operations is capitalized in equity securities in one case and in real estate in the other. In both cases, those with a residual interest in operations will tend to support investments they believe are likely to enhance the value of what they have, even if they must “pay for” these investments, and will tend to disapprove investments whose costs they expect to exceed the benefits to them. This is just what is needed to produce debt overhang in the face of large entity-level debts. Because, under these conditions, creditors stand to capture a disproportionate share of the value of new investments, those who are junior to them in the pecking order may find it in their private interest not to fund even valuable new projects. In the corporate context, stockholders decline to contribute new capital to fund profitable projects. In the municipal context, residents and (especially) landowners decline to support taxes to develop or renew cost-justified infrastructure and

111 There are important differences between contexts, of course. Municipalities have no stockholders, and they don’t typically return the profits from public investments to their taxpayers or residents. Indeed, one of the principal reasons for public investment is that the benefits of infrastructure are difficult to capture fully in market transactions. The costs and benefits of municipal investments are unevenly distributed both across geographic territory and among those who are able to influence municipal policy. The franchise is ascribed according to residency, even though landowners bear a disproportionate financial interest in the residual value of municipal investment. These differences mean that highly stylized models of the corporate setting appear to fit the municipality poorly. But the differences may be less important than one suspects. Stylized models are, after all, inaccurate in the corporate setting, too. In fact, stockholders do not necessarily benefit ratably from corporate action, and they certainly do not exert equal influence over policy. And while a wedge between residents and landowners can and probably does sometimes complicate the picture, available evidence suggests that landowners participate disproportionately in local politics. See generally, for example, Fischel, The Homevoter Hypothesis (cited in note 87).

112 This is an approximate statement. All constituents can be expected to benefit to some extent from a growing surplus.

113 This logic is most fully elaborated, in accessible terms, in Fischel, The Homevoter Hypothesis (cited in note 87).
other quasi-public goods. Debt overhang can thus lead to under-investment in both contexts, at least in principle.

Scholars have long recognized a version of this insight, and some have sought to justify municipal bankruptcy partially in reference to it. An important qualification to the analogy between stockholders and landowners needs to be made, however. Compared to stockholders, landowners have relatively strong private reasons to pay down entity-level debts, through special assessments if necessary, if they believe that those debts are likely to thwart efficient public investments.

To see why, recall that the basic model of corporate debt overhang is driven by stockholders’ limited liability. The stockholders have reason to forgo profitable new corporate investment opportunities only because they are not personally responsible for the company’s debts. If they were so responsible, they would fully internalize the harmful effect underinvestment has on the company’s creditors. Put differently, it is just because stockholders’ exposure to the consequences of poor corporate performance is truncated that they do not bear the full consequences of under-investment.

Landowners have limited liability, too, of course, in the sense that they are not held to personal account for a municipality’s debts. But landowners are financially exposed to poor municipal performance well apart from their responsibility for municipal debts. This is because their investment, real estate, is apt to have value independent of municipal behavior—it would have value even if the municipality were to vanish. Unlike a stock, whose

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114 McConnell and Picker were the first to identify something like debt overhang in the municipal context. They located a basis for bankruptcy in the “fresh start” policy, which could be useful because, as they put it, “the taxpayers of a city will cease to pay taxes if rates are too high and the citizens get none of the benefit.” McConnell and Picker, 60 U Chi L Rev at 470 (cited in note 9).

115 See note 108.

116 See note 107 and accompanying text.

117 For the most thorough, recent discussion of stockholder limited liability, see generally Stephen M. Bainbridge and M. Todd Henderson, Limited Liability: A Legal and Economic Analysis (Edward Elgar 2016).

118 But see McConnell and Picker, 60 U Chi L Rev at 437 (cited in note 9) (discussing the New England rule, now outmoded, under which residents’ property could be seized to make good on municipal debts).

119 For example, suppose that the efficient provider of drinking water to a particular parcel of real estate is the municipality. If the municipality provides the water, the parcel is worth 100. This does not mean the value goes to zero if the municipality ceases to provide water. Instead the property owner is likely to switch to a second-best method of getting water—drilling a well, say, or arranging for periodic delivery from a tanker. The parcel’s value drops to 90, say, not to 0. To be sure, real estate values may approach zero in cases of extreme economic distress. Tales of nearly free real estate are common in such cases.
worth is wholly derivative of the issuer’s financial condition, a parcel of land may be desirable for its natural beauty, for the use-value of improvements built on it, or for other reasons. Landowners’ downside in case of municipal economic distress is apt to be extensive, and consequently they have an incentive to see public debts paid down if doing so can be expected to spur cost-justified public investment. At first approximation, then, even large municipal debts should not be expected to produce public underinvestment.

This qualification suggests that, when municipal debt overhang becomes a practical problem that bankruptcy could usefully address, it is likely to be accompanied by some other economic or political pathology, or a combination of multiple. There are a number of possible explanations. One kind of explanation looks to facts about a municipality’s residents and especially its landowners; another looks to sources of political dysfunction. The following are four important species of political friction:

   a) Liquidity constraints. A municipality’s taxpayers and landowners may be liquidity constrained. They may see that paying down municipal debts would be wise, because new public investments would be valuable, yet lack the funds to do so. This kind of explanation is most plausible in times of macroeconomic stress, especially when, as in the Great Depression, liquidity constraints are coupled with deflation. Between 1930 and 1932, the dollar deflated by approximately 30 percent.

See, for example, Drew Philp, Why I Bought a House in Detroit for $500 (BuzzFeed, Jan 9, 2014), archived at http://perma.cc/JH5E-B7F3. This just means that landowners’ downside exposure to municipal performance is extensive but not unlimited.

This is just a way of saying that landowners ought to be, and generally are, willing to pay taxes, the proceeds of which will be used to invest in infrastructure that, in turn, will increase the land values. See generally Fischel, The Homevoter Hypothesis (cited in note 87). Theory coincides with a sizeable empirical literature that suggests more is capitalized than casual observers would probably suspect. For example, there is evidence that expected rent-seeking by public-sector unions is capitalized in real estate. See generally Gyourko and Tracy, 19 Regional Sci & Urban Econ 493 (cited in note 93). On the other hand, there is some evidence that unfunded pension obligations are not fully capitalized. See Dennis Epple and Katherine Schipper, Municipal Pension Funding: A Theory and Some Evidence, 37 Pub Choice 141, 147–51 (1981). See also generally Robert P. Inman, Public Employee Pensions and the Local Labor Budget, 19 J Pub Econ 49 (1982).

Moreover, municipal residents and landowners might be able to finance efficient investment with revenue bonds or by having a “special purpose entity” chartered even if the municipality’s general obligations are swollen. See also Adam J. Levitin, Bankrupt Politics and the Politics of Bankruptcy, 97 Cornell L Rev 1399, 1433–38 (2012) (making a similar point with respect to state rather than municipal governments).

were written in nominal terms, municipal debts jumped proportionally in real terms. This effect, combined with the general reduction in output, meant that many debts simply could not be paid.\textsuperscript{123} And this notwithstanding whatever residents might have thought about the merits of infrastructure investment.\textsuperscript{124}

\textit{b) Leveraged ownership.} Landowners in a municipality might have leveraged positions in their real estate. Concretely, much of the value of their property might be mortgaged to a lender so that the owner herself has little equity in the land. This is not the same as saying the land has little value, as in the case of an economically distressed location. The land could be valuable, but if much of the claim to that value is mortgaged, then titleholders, who hold the immediate political influence, face relatively little downside to municipal dysfunction and so can be expected to behave like stockholders under conditions of debt overhang.

\textit{c) Legal barriers to taxation.} State law might make raising taxes difficult or impossible and so prevent a municipality’s residents and landowners from paying down public debts efficiently. California’s Proposition 13 is only the most well-known friction of this kind.\textsuperscript{125} That constitutional amendment limited the rate at which property in the state could be taxed,\textsuperscript{126} with certain exceptions, as well as the rate at which the assessed value of such property could increase.\textsuperscript{127} California law permits municipalities to levy other kinds of taxes and special assessments with voter (often supermajority) approval,\textsuperscript{128} and these could be used as imperfect substitutes for a tax on real estate. But because landowners are the primary residual beneficiaries of municipal investment, it is they who have the greatest interest in resolving excessive public debts. More generally, legal barriers to a municipality’s raising revenue magnify the significance of its debt.

\textsuperscript{123} See id. And these two phenomena appear to go together. See Irving Fisher, \textit{The Debt-Deflation Theory of Great Depressions}, 1 Econometrica 337, 342 (1933).

\textsuperscript{124} The first municipal bankruptcy law was enacted in 1934. Act of May 24, 1934, 48 Stat 798. When it was introduced in Congress, the case made for it was precisely this prototypical scenario. See generally \textit{Amend the Bankruptcy Act—Municipal Indebtedness}, HR Rep No 207, 73d Cong, 1st Sess 1 (1933).

\textsuperscript{125} See Cal Const Art XIII A (codifying Proposition 13).

\textsuperscript{126} Cal Const Art XIII A, § 1(a) (“The maximum amount of any ad valorem tax on real property shall not exceed One percent (1%) of the full cash value of such property. The one percent (1%) tax to be collected by the counties and apportioned according to law to the districts within the counties.”).

\textsuperscript{127} Cal Const Art XIII A, § 2(b) (allowing assessed values to increase at a capped annual inflationary rate).

\textsuperscript{128} See, for example, Cal Const Art XIII A, § 4 (“Cities, Counties and special districts, by a two-thirds vote of the qualified electors of such district, may impose special taxes on such district.”).
d) Political barriers to taxation. The vicissitudes of electoral politics might prevent excessive debts from being paid down even when no legal barrier outright prohibits efficient taxation. Municipal voters are not a homogeneous bloc. They do not share equally from the gains associated with efficient investment; they do not share equally in the costs associated with paying for investment; some may lose coming and going. The central lesson of coalition formation is that multiple equilibria are possible. Moreover, some systems of municipal government are more apt than others to produce inefficient budget practices.129

2. Private underinvestment.

Spatial economies are sustained not only by the public or quasi-public goods traditionally provided by the public sector, such as roads and police, but also by goods traditionally provided by the private sector. Improvements to real estate—residential, commercial, industrial—are the most important examples.130 If large public debts discourage private investment, whether by incumbent residents or prospective new entrants, as well as public investment, this effect would be an important feature of municipal financial distress. And there is reason to think public debts can have just such an effect, especially on relatively fixed investments. Two channels are apparent:

a) Fear of debt overhang. The first is a derivative of the problem just discussed—namely public underinvestment. Suppose our friend Acme Corporation is deciding where to locate a new headquarters. It must choose between two municipalities, Springfield and Shady Grove, identical in every respect but one: Springfield has large debts; Shady Grove has none. Where will Acme choose to invest?

At first approximation, Acme should be indifferent. The expectation of future tax burdens in Springfield ought to be higher because the town’s expected future revenue needs will be higher; and this fact ought to make the purchase price of land in Springfield


130 Private investment is also an (imperfect) substitute for public investment. This is true both because the private sector can provide public and quasi-public goods, even if less efficiently than government, and also because private goods are partial substitutes for public and quasi-public goods. For example, my well-tended garden is an imperfect substitute for a well-tended but much larger public park.
cheaper than an identical parcel in Shady Grove by an amount equal to the present value of the difference in expected future taxes. But as we have seen, first approximations might be misleading. Frictions might exist such that Springfield’s debt overhang in fact leads to public underinvestment in valuable infrastructure. Springfield’s roads or schools or water quality might deteriorate relative to Shady Grove’s. Shady Grove’s spatial economies might in turn come to dominate Springfield’s.

This future is uncertain, of course. But uncertainty augurs in favor of Shady Grove. One might expect the price of real estate in Springfield to reflect the greater risk associated with its fortunes and so be correspondingly cheaper than it otherwise would be, restoring parity. And indeed uncertainty might be capitalized in land prices to some extent. But uncertainty discourages relatively fixed investments, like physical plant, more than it does relatively mobile investments for the (definitional) reason that mobile investments can be repurposed if, in the future, an unfavorable state of the world is realized. To illustrate, suppose the property Acme is considering is a large warehouse complex. Acme’s plan is to refit the complex into state of the art office space at a cost of millions of dollars. An alternative potential buyer, Logistics Incorporated, would use the existing structures as a shipping depot. It would house millions of dollars of merchandise there at any given time, all of which could be loaded into trucks on short notice. Even if office space is the more valuable use of the land, on average, Logistics may be the high bidder under uncertainty because it can simply reroute its shipments if municipal conditions become dire. If things turn south, Logistics will lose only the warehouses’ purchase price; Acme will lose that plus the millions of dollars in renovation costs it must also spend. Uncertainty costs Acme more because its proposed investment is relatively fixed. In this way, large public debts can be expected to discourage valuable fixed private investments in particular.131

131 The underinvestment in this example, and indeed the underinvestment that follows debt overhang more generally, can be understood as a consequence of Tieboutian sorting. See generally Charles M. Tiebout, A Pure Theory of Local Expenditures, 64 J Polit Econ 416 (1956). Residents’ exposure to municipal debt is a legal phenomenon, a policy dimension according to which mobile capital providers can be expected to sort themselves. In the hypothetical, Logistics is less sensitive than Acme to municipal debt and so locates where the debt is bigger—even though this location choice might fail to fully exploit spatial economies. Professor Schleicher has shown that policy-based sorting in general can undermine agglomeration economies. See generally David Schleicher, The City as a Law and Economic Subject, 2010 U Ill L Rev 1507. See also generally David Schleicher, City Unplanning, 122 Yale L J 1670 (2013) (showing how zoning rules in particular can undermine agglomeration economies). Debt can thus be understood as a special case of a more
b) Fear of discrimination. Large public debts might alternatively discourage the most valuable private investments by inducing fear of discriminatory treatment. If Springfield must pay down a large debt, it might need to increase revenues. This it can do most effectively by taxing the owners of immobile capital disproportionately. Fixed investments are easier to tax because, by definition, they are less prone to flight from the jurisdiction in case of a rate increase.\footnote{An immense literature considers the relationship between capital mobility and fiscal policy. For an introduction to the problem in the municipal context, see generally Richard C. Schragger, \textit{Mobile Capital, Local Economic Regulation, and the Democratic City}, 123 Harv L Rev 482 (2009).} Projecting that endgame, potential investors of relatively fixed capital, like Acme, might prefer less indebted locations. The result is that local real estate systematically stays in the hands of less productive enterprises.

If these channels of private underinvestment seem abstract, consider the location choice Amazon faced for its so-called “HQ2.” The $5 billion the company plans to spend building a new campus—\footnote{See \textit{Amazon Announces Candidates for HQ2} (Business Wire, Jan 18, 2018), archived at http://perma.cc/PD7J-H84X.} or two—is a highly immobile investment. It follows that Amazon needed to evaluate not only the geographic attributes of potential locations, their spatial economies, but also what it calls “[a] stable and business-friendly environment and tax structure.”\footnote{\textit{Amazon HQ2 RFP} *5 (Amazon), archived at http://perma.cc/5W6X-635V.} Places that are too heavily indebted risk being unable to promise stability and so become unattractive sites for investment. Amazon’s prospective investment is unusually big, but the basic mechanism affects the location choices of individuals and smaller businesses as well.

* * *

Where, then, do we stand? When a municipality such as Springfield faces large debts, these debts can discourage investment and so lead over time to the dissipation of the qualities that make the place productive. In such cases, stagnation and decline represent a wasted opportunity for municipal constituents as a group—including sometimes for creditors.\footnote{Consider in this regard the numerical example of debt overhang provided above in Part II.D.1. See also Part III.A.} It follows that mu-
nicipal constituents could, in principle, bargain around debt’s per-
nicious effects. But for familiar reasons, coordination is difficult
and frequently impossible. This is when bankruptcy in its ideal
form would intervene to write down claims against the munici-
pality—when debt threatens investment, long before spatial econ-
omy is so eroded that servicing debt in the near term is impos-
sible. The real world is not ideal, however, and it remains to be
considered how the law might nevertheless be useful.

III. CHAPTER 9 RECONSIDERED

If municipal bankruptcy is to be more than an unpredictable,
ad hoc, and expensive to deliver subsidy mechanism, it needs to
target the debt of local governments in financial, not economic,
distress. To date, however, the general purpose cities and towns
that have entered Chapter 9 have been economically distressed.136
In her study of the twenty-eight local governments that entered
bankruptcy or receivership between 2008 and 2013, Professor
Michelle Wilde Anderson finds that widespread poverty was a
consistent theme.137 The bankruptcies also tended to follow signif-
ificant depopulation.138 Thus, Anderson reports that half of the cit-
ies and towns she studied had more than a quarter fewer resi-
dents than they had fifty years earlier.139 Because depopulation
typically lags behind large negative productivity shocks,140 these
data paint a bleak picture of the economic viability of the general
purpose municipalities that enter Chapter 9 (at least on a famil-
lar scale of operations). As things stand, then, we can conclude
that intervention comes only after debt has metastasized and,
along with other factors, caused economic dysfunction. The rub is

136 Most Chapter 9 cases, by number although not by social importance, involve “spe-
cial purpose” instrumentalities and taxing districts. See note 17 and accompanying text.
These present different considerations. They frequently resemble the commercial firms
that file under Chapter 11 more than they do general purpose municipalities. Indeed, it is
sometimes hard to tell whether such a debtor is better classified as a business or a munici-
pal entity. Compare In re Las Vegas Monorail Co., 429 Bankr Rptr 770, 795–800 (Bankr
D Nev 2010) (holding that, although debtor’s bonds were tax exempt, debtor did not pos-
sess characteristics of municipality for Chapter 9 eligibility), with In re New York City Off-
Track Betting Corp, 427 Bankr Rptr 256, 265–66 (Bankr SDNY 2010) (holding that debtor,
a public benefit corporation, was a municipality for Chapter 9 eligibility). Chapter 9 may
work reasonably well for most special purpose debtors.

137 See Anderson, 123 Yale L J at 1124–26 (cited in note 63) (reporting the results of
a study of municipalities with populations above fifteen thousand that entered bankruptcy
or receivership between 2008 and 2013).

138 See id.

139 Id at 1137–38.

140 See Glaeser and Gyorko, 113 J Polit Econ at 346–47 (cited in note 98). See also
notes 98–101 and accompanying text.
that, by the time a city has become unable to deliver basic services, such as law enforcement and sanitation, its density economies are likely to have dissipated. Mobile people and capital will have left for greener pastures, and they may have no reason to return. Debt relief must come sooner to be effective.

At the same time, the case for liberal municipal debt relief is not straightforward. One needs to reckon with the costs and benefits a more liberal regime would likely entail and trade them off against one another. This is not a simple task. A change in the availability of debt relief is of course likely to affect borrowing costs for municipalities going forward. But one cannot even say a priori what directional effect it is likely to have. If, for example, the law were to permit a debtor to cancel debts at will for good reason, bad reason, or no reason at all, lenders would understandably become slower to lend. Compared to a world in which debt relief is unavailable, a rule of unilateral jubilee could be expected to depress the likelihood of full repayment and, consequently, lenders would need to charge higher interest rates, or deny credit to more borrowers, or both to compensate. But debt relief rules can also increase creditors’ expected recoveries compared to a world in which debt relief is unavailable and so make municipal borrowing a cheaper prospect.

The wisdom of a particular bankruptcy regime depends on its real-world capacity to distinguish cases. The remainder of this Part addresses this difficulty. It begins by setting out in general terms the costs and benefits debt relief can entail under real-world conditions—that is, when facts about the debtor’s prospects cannot be established with certainty. I then argue that modern patterns of municipal finance and operations, which in terms of complexity dwarf those of the era when Congress first established municipal bankruptcy, have heightened both the risks and potential benefits associated with more liberal debt relief. Finally, I outline some concrete changes to the law that could be expected to hasten debt relief and so help municipal bankruptcy better achieve its aim. These I offer not as uniquely optimal rule changes but in the spirit of suggestion, as a spur to further thought and analysis.

A. The Prospect of Debt Relief: General Considerations

A debt relief rule can manifest in three basic ways:

First, debt relief can act as a simple wealth transfer from creditor to debtor, reducing creditors’ expected recoveries without
much improving investment incentives (Scenario 1). This is easy to imagine. It is what debtors try to accomplish when they make fraudulent transfers, and, from the economic perspective, it is lose-lose relative to a world in which debt relief is unavailable. It increases the cost of capital ex ante and does nothing to improve investment incentives ex post.

Second, debt relief can improve investment incentives and increase creditors’ expected recoveries (Scenario 2). This scenario is less intuitively obvious but follows from the possibility of debt overhang. To illustrate, let us return to Acme Corporation and the project it considered and rejected above. To refresh: Acme faced an investment opportunity that would cost its stockholders 80 today and would pay out either 200 or 0, with equal likelihood, tomorrow. Because Acme owed its creditors 50, the project had a negative expected value for the stockholders, and they declined to contribute the needed capital:

\[0.5(200 - 50) + 0.5(0)] - 80 = -5.\]

The creditors in this scenario recovered nothing (and there was no investment).

But now suppose bankruptcy were to intervene and write down three-fifths of Acme’s debts. Acme now owes its creditors only 20, and the stockholders will find the investment profitable:

\[0.5(200 - 20) + 0.5(0)] - 80 = 10.\]

The creditors are better off for having had their debts written down. Because the stockholders have been induced to invest, the creditors now have a 50 percent chance of recovering 20 instead of a 100 percent chance of recovering nothing.

This kind of debt relief is win-win relative to a world in which debt relief is unavailable. It reduces borrowing costs ex ante and encourages efficient investment decisions ex post. An example of this kind of adjustment can be found in the facts of an important case from the Great Depression, *Faitoute Iron & Steel Co v City of Asbury Park*. In the 1920s, Asbury Park borrowed extensively to fund improvements to its boardwalk. The Depression led the city to default. Under New Jersey law at the time, the

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141 See Part II.D.1.

142 Notice that in this hypothetical a range of levels of debt relief will induce the efficient investment. The investment will be made as long as Acme’s debt is less than 40. From the economic point of view, the distribution of the surplus achieved by making the efficient investment is immaterial. But the allocation of more or less of the surplus to the creditors will affect borrowing costs.

143 316 US 502 (1942).
state’s supreme court was permitted to effect a composition of municipal debts if 85 percent of the bondholders (by value) consented. The court did just that after Asbury Park procured the requisite consents, and the Supreme Court of the United States affirmed the decree over dissenting bondholders’ Contract Clause objections. The justices leaned heavily on the fact that a super-majority of bondholders had accepted the restructuring, their acquiescence being evidence that investors could not realistically have hoped for more absent the adjustment. Reducing the bonds’ nominal value had, the Court observed, increased their market value.

Third, debt relief can improve investment incentives but reduce (at least some) creditors’ expected recoveries (Scenario 3). This can occur if creditors are unable to reach the fruits of the investments that debt relief encourages due to contracting or other frictions. Suppose, for example, a debtor has cash flows sufficient to pay near-term obligations in full but only at the expense of investments that will yield benefits in the long term. Even a modest haircut to the short-term creditor will reduce her recovery. Yet that might be just what is needed to induce valuable investments that could forestall municipal decline. It may be theoretically possible but practically unworkable to compensate the frustrated creditor with a long-dated, zero-coupon claim. Debt relief in this scenario can be lose-win. It can increase borrowing costs ex ante—but efficiently so, in the sense that the higher cost of capital may preserve a valuable option to default ex post.

In an ideal world, bankruptcy would provide relief in cases resembling Scenario 2, and perhaps Scenario 3, but not Scenario 1. In the real world, however, sorting cases may not be so easy. It is one thing to draw up hypotheticals that stipulate the range of possible investments, the probability distributions of payouts of those investments, and unanimous opinion about the same. It is quite another to discover these facts in the real world, where much is unknown and the parties may have private reasons to hide or mislead about the rest. The basic difficulty of a more liberal municipal debt relief regime is the prospect of strategic filings, by which I mean the invocation of bankruptcy machinery to effect a wealth transfer (Scenario 1) rather than to resolve financial distress (Scenarios 2 or 3). Strategic filings are at heart a

144 See id. at 515–16.
145 Congress quickly abrogated the decision, leaving federal law as the sole means to effect a composition of municipal debt. See 11 USC § 903.
problem of limited information. The practical utility of more liberal municipal bankruptcy law will depend on bankruptcy’s capacity to weed out cases of strategic default or, put differently, to accurately identify cases of bona fide financial distress.

B. Municipal Capital Structures and the Design of Chapter 9

When Congress introduced municipal bankruptcy for the first time, at the height of the Great Depression, the law was well calibrated to distinguish cases of bona fide financial distress from those of opportunistic default.\(^\text{146}\) The law’s primary target was the debt of a vast number of improvement districts—special purpose municipalities incorporated to build agricultural and other infrastructure—hobbled by the macroeconomic downturn and especially the collapse of commodity prices.\(^\text{147}\) These districts usually had simple capital structures. They were financed primarily by unsecured bonds, the principal and interest on which were to be paid out of the surplus property tax revenues the infrastructural improvements were expected to generate as a matter of course. This meant that creditors would face a straightforward calculation in the event of a proposed debt composition. Was the debtor

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\(^{146}\) The first municipal bankruptcy law was enacted in 1934. Act of May 24, 1934, 48 Stat 798. The Supreme Court held the law unconstitutional two years later. *Ashton v Cameron County Water Improvement District No 1*, 298 US 513, 530–32 (1936). Congress quickly responded with a new law nearly identical to the first. Act of Aug 16, 1937, 50 Stat 653 (1937 Act). This time the Court upheld the law’s constitutionality. See *United States v Bekins*, 304 US 27, 51 (1938).

\(^{147}\) Municipalities of every description were included in the law’s ambit, but the agricultural sector, hard hit by declining commodity prices, was the impetus. The 1937 Act’s enumeration of the subjects of its protection is telling. The law extended to the composition of debt of:

(1) Drainage, drainage and levee, levee, levee and drainage, reclamation, water, irrigation, or other similar districts commonly designated as agricultural improvement districts or local improvement districts, organized or created for the purpose of constructing, improving, maintaining, and operating certain improvements or projects devoted chiefly to the improvement of lands therein for agricultural purposes; or (2) local improvement districts such as sewer, paving, sanitary, or other similar districts, organized or created for the purposes designated by their respective names; or (3) local improvement districts such as road, highway, or other similar districts, organized or created for the purpose of grading, paving, or otherwise improving public streets, roads, or highways; or (4) public-school districts or public-school authorities organized or created for the purpose of constructing, maintaining, and operating public schools or public-school facilities; or (5) local improvement districts such as port, navigation, or other similar districts, organized or created for the purpose of constructing, improving, maintaining, or operating ports and port facilities; or (6) any city, town, village, borough, township, or other municipality.

1937 Act § 81, 50 Stat at 654.
trying to default opportunistically, or was there a genuine debt overhang problem? Scenario 1 or Scenario 2? Individual creditors might reach different conclusions, but the question posed was itself uncomplicated. And because creditors typically shared a financial interest, the law could sensibly overcome holdout problems by binding all to a supermajority vote.

Cameron County Water Improvement District Number One, the subject of the first constitutional challenge to municipal bankruptcy legislation,\(^{148}\) was for most of the last eighty years also the paradigmatic municipal debtor. In the late nineteenth century, the economy around Brownsville, Texas, depended principally on ranching and trade (especially as a point of departure for smuggling operations into Mexico). In 1904, however, the St. Louis, Brownsville, and Mexico Railway connected Cameron County with parts north and encouraged farmers from the Midwest to settle the region. (Cameron County’s population quintupled between 1900 and 1930.\(^{149}\) The Texas legislature incorporated the district to accommodate the migration, as a vehicle to finance the irrigation of more than forty thousand acres previously suitable only for cattle.\(^{150}\) To raise funds for a canal system, the district sold two issues of 6 percent bonds with face value of approximately $800,000 in total.\(^{151}\) Irrigation would allow ranchlands to be turned to more profitable uses, especially to the production of citrus fruits and cotton. Landowners would then use (some of) their newfound productivity to pay down the bonds. But the Depression frustrated plans. Commodity prices plummeted, and local farmers found it difficult or impossible to pay their taxes. Many preferred to surrender their land outright rather than work it for the benefit of bondholders, and the district defaulted and sought a reprieve.\(^{152}\)

The question for the district’s bondholders, as for the creditors of so many special districts, was what to do. Were they better off writing down some of the debt in the hope that doing so would encourage local farmers to stay and work the land? Or should they continue to demand full payment and hope that the economy would turn around or that the farmers were bluffing? The law

\(^{148}\) See generally Ashton, 298 US 513.

\(^{149}\) See Alicia A. Garza and Christopher Long, Cameron County (Texas State Historical Association, June 12, 2010) archived at http://perma.cc/F2QG-9SMP.

\(^{150}\) Ashton, 298 US at 523, 527; id at 533 (Cardozo dissenting).

\(^{151}\) Id at 523, 527.

\(^{152}\) See id at 533 (Cardozo dissenting).
encouraged resolutions to questions like this in two ways. It mandated, first, that all of a municipality’s general unsecured creditors receive equal treatment under a plan of composition and, second, that the creditors vote together as a single class on the plan’s advisability. Because all general unsecured creditors would be treated alike, there was no use in anyone trying to jockey for special treatment by threatening to scuttle a sensible plan. Moreover, facts on the ground were relatively easy to observe. Tax delinquencies and foreclosures, to say nothing of prevailing agricultural prices, were matters of public record, and creditors could plausibly be charged with reaching a judgment about the significance of these facts for the outlook on their bonds. In short, in the setting for which municipal bankruptcy was initially designed, the law likely did a good job identifying cases of debt overhang and distinguishing them from cases of opportunistic default.

Much in the landscape has changed, and the changes suggest both (i) that distinguishing strategic filings from filings designed to relieve debt overhang may be more difficult than it once was and also (ii) that Scenario 3 cases have become much more plausible. Circumstances today furnish a stronger case for the efficiency of municipal debt relief even when some, and perhaps even a large fraction of, creditors correctly anticipate that debt relief will harm them. The risk associated with a more forgiving municipal bankruptcy law is thus likely greater than it once was, but the social reward from such a law is also likely much greater.

Part of the change is traceable to the simple fact that general purpose towns, cities, and counties, some quite large, now access bankruptcy as well as special purpose districts. This first became conceivable in 1976. Before then, a municipality could not even file a petition until it had lined up support from the holders of 51 percent of all securities to be affected by a composition. This

153 1937 Act § 83(b), 50 Stat at 656:

> [T]he judge shall classify [a debtor’s] creditors according to the nature of their respective claims and interests: Provided, however, That the holders of all claims, regardless of the manner in which they are evidenced, which are payable without preference out of funds derived from the same source or sources shall be of one class.

In cases with a capital structure like the district’s, a simple two-thirds vote of all creditors was sufficient to accept a composition (subject to judicial discretion). 1937 Act § 83(d), 50 Stat at 657.

154 See 1937 Act § 83(a), 50 Stat at 655–56. The 1976 amendments permitted a municipality to file if it had made a good faith attempt to negotiate with creditors holding 51 percent of affected claims or if “such negotiation [was] impracticable.” Act of Apr 8, 1976 § 84, Pub L No 94-260, 90 Stat 315, 317, codified as amended at 11 USC § 109(c).
requirement alone foreclosed the possibility of bankruptcy for all but the most rudimentary general purpose municipalities. But whatever the theoretical possibility, bankruptcy remained the province of special districts until Bridgeport tried and Orange County succeeded in making a case in the 1990s.

The operational and financial complexity of the modern, general purpose municipality effectively guarantee genuine (as opposed to merely strategic) disagreement among investors about the municipality’s affairs. A city’s capital structure was always more complex than an irrigation district’s. But the financing arrangements of even modestly sized municipalities have become increasingly fractured. A large share of most municipalities’ obligations are owed not to financial creditors but to current and former employees (or their representatives), in the form of pension and healthcare obligations. Even limiting the picture to financial creditors, municipal capital structures have become far more complex than they once were. The full story is beyond the scope of this Article, but it is worth noting just some of the important developments: reliance on short-term credit markets; sale-leaseback transactions; derivative investments; certificates of participation; and revenue bonds (which support project finance without the need for incorporating a special purpose district).

The interests of these various claimants are apt to diverge in the event of a city’s financial distress. Some constituents wear multiple hats. Municipal employees, for example, frequently are also residents and homeowners, and this complicates their aims as creditors. Even creditors who wear a single hat face differential prospects. Their contracts may promise payment at different times, from different pools of funds, with different interest rates, with different kinds of recourse, and subject to different conditions. A plan of adjustment need not treat these various creditors uniformly even if they enjoy equal formal priority. And a plan that does grant uniform treatment may be good for some creditors and bad for others.) Because this is true and known to be true, holdup reemerges as a real barrier to consensual debt restructuring. The key thing to see is that, in the modern setting, there are lots of ways for a negotiated debt relief plan to fail even when relief would increase total wealth. The Coasean bargain is simply difficult to broker. And this means there are potentially many

155 For discussion of the significance of priority equality in Chapter 9, see David A.
Hynes and Walt, 33 Rev Bank & Fin L at 635 (cited in note 54).
cases in which municipal decline could be nipped in the bud if the legal infrastructure were in place to facilitate debt adjustment.

The same factors make it difficult to know, however, whether a plea for debt relief is strategic. A third-party observer such as a judge can no longer, as in the past, infer much from the creditors’ professed attitudes. And the municipal setting is potentially rich soil for strategic gambits. This is because municipal bankruptcy lacks the notion of the “estate,” an identifiable pool of resources to which creditors are entitled to look for satisfaction. Instead, all is up for grabs, with the bankruptcy judge assigned the task of deciding whether a proposed debt adjustment is in creditors’ “best interests.” Too easy a policy of debt relief risks licensing mere wealth transfers to the ultimate detriment of lenders and borrowers alike. Yet the risk of strategic municipal bankruptcy can easily be overstated. Strategic filing is not unique to the municipal context. Bankruptcy judges have been dealing with it in the consumer and corporate settings for a long time. Experience with the basic dynamic probably means bankruptcy judges

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156 But see Vincent S.J. Buccola, The Janus Faces of Reorganization Law, 44 J Corp L 1, 23–27 (2018) (setting out conditions under which bankruptcy judges can rationally infer facts about the efficiency of debtor conduct from creditors’ professions).

157 See 11 USC § 541.


159 See Buccola, 38 Cardozo L Rev at 1318–22 (cited in note 30) (discussing “best interests” standard as it applies to Chapter 9). For the view that “best interests” has an ambiguous sense as applied to Chapter 9, see generally Baird, Statutory Interpretation (cited in note 2).

160 In the consumer setting, for example, one thinks of the scandalous use of generous homestead exemptions in some cases before 2005. The debtor in these cases was able to pay her debts without compromising future earning potential, but she preferred not to pay and sought a discharge instead. The Bankruptcy Code allows individual debtors to exempt certain property from the bankruptcy estate, from which creditors are paid. 11 USC § 522(b). Depending on the contours of state law, debtors may choose between a slate of federal exemptions and a slate of state exemptions. 11 USC § 522(b)(3). Before 2005, some states offered a homestead exemption that allowed debtors to exempt an unlimited amount of equity in a home. A heavily indebted but solvent debtor could strategically invoke bankruptcy to write down debts while sheltering millions of dollars in a newly purchased Florida or Texas mansion. In 2005, Congress capped the homestead exemption for debtors whose homesteads were purchased shortly before bankruptcy. See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 § 308, Pub L No 109-8, 119 Stat 23, codified as amended at 11 USC § 522. Fewer opportunities for strategic bankruptcy are available in the corporate setting because creditors are entitled to payment in full before equity investors retain value, 11 USC § 1129(b), but some opportunism persists. Consider, for example, lien stripping and similar practices that appropriate option value belonging to others outside bankruptcy.
are better at identifying it than many would suppose. Moreover, people generally prefer to pay their debts. Even for strictly game theoretical reasons, repeat players in the capital markets are often best served paying their debts whether they feel obliged to or not. A rough parallel to the sovereign debt markets is worth drawing. Sovereign borrowers can default without even needing to persuade a bankruptcy judge of the soundness of their reasons. Yet they default remarkably rarely. Whether this empirical regularity is best explained by national honor or rational calculation is uncertain. But it is a regularity.

C. Encouraging Earlier Debt Relief

Financial distress precedes economic distress. For some municipalities, the dissipation of spatial economies may occur swiftly and irreversibly. Consider a mill town after the local timber industry moves abroad. As soon as the mill shutters, proximity to it loses appeal. But for other municipalities, there may be a longer period of financial distress during which density economies are slowly eroded by chronic underinvestment. Take, for example, Chicago? Bankruptcy must intervene before economic distress takes root if it is to help resolve financial distress, and that means it may need to intervene before conditions on the ground look dire.

161 The court’s handling of the bankruptcy of Boise County, Idaho, is exemplary. At the close of 2010, rural Boise County, population seven thousand, was tagged with a $4 million judgment on a suit brought under the Fair Housing Act. In re Boise County, 465 Bankr Rptr 156, 161 (Bankr D Idaho 2011). It soon filed a Chapter 9 petition seeking to write down all but $500,000 of the amount owed. Id at 166. (The Fair Housing Act judgment together with contested attorneys’ fees represented fully three-quarters of the county’s total debts. See id at 163–64.) The county’s liquid assets were more than $2 million in excess of its debts, but it argued that it could not pay the judgment while continuing operations. Id at 169–70, 172–73. The court dug into the financials and came to a different conclusion, dismissing the case on the ground that the county could use warrants to cover the difference between its projected revenues and costs during the present fiscal year. Id at 174–75. The decision concerned solvency as the Bankruptcy Code currently defines it, of course, not the county’s financial distress. But Chief Judge Terry L. Myers’s conclusion seems to have rested on something like the view that the county’s filing was strategic. See id at 179 (“In short, the County has not convinced the Court of legal impediments to the issuance of registered warrants, the creation of a warrant redemption fund, and the transfer, at the appropriate time under the statute, of the surplus moneys.”). To pay the judgment, the county would have to assess its residents more than they would like and more than they were used to giving; but there was no reason to think the one-time charge would dissipate investment in the county.

162 See Kordana, 83 Va L Rev at 1077 & n 204 (cited in note 58).

The following suggestions are consequently directed at encouraging bankruptcy’s use, so that unsustainable debts can be written down before they manifest in underinvestment, and at encouraging responsible parties to take advantage of those relaxed standards.

The principal obstacle to earlier municipal debt relief is the Bankruptcy Code’s requirement that a Chapter 9 debtor be “insolvent” to seek relief. Insolvency in this context is defined to mean the financial condition in which a municipality either is “generally not paying” or is “unable to pay its debts as they become due.” As I have explained, bankruptcy courts have plausibly read a temporal specification into the definition. If a municipality will run out of money within a fiscal year, it is insolvent. If, on the other hand, a municipality can scrape together enough liquidity to service its debts for another year, it is ineligible for Chapter 9. This hard standard was perhaps relaxed modestly in the Stockton and Detroit cases, which introduced the notion of “service delivery insolvency.” If, the judges in these cases held, a municipality can service its debts in the near term only at the expense of basic municipal functions, such as providing sanitation and police and fire protection, then the municipality is “unable to pay its debts” within the Code’s meaning. But this innovation, such as it is, just acknowledges that, at some point before operations have ceased entirely, a municipality will have eaten enough seed corn to merit relief.

In any case, the Code’s definition of insolvency is too restrictive. It could be loosened or better yet discarded altogether. Individuals and businesses are eligible for bankruptcy relief without being insolvent, to say nothing of measuring their insolvency under the restrictive standard municipalities face, and bankruptcy works tolerably well for them. The basic problem is that financial distress is likely to cause underinvestment long before a municipality runs out of property it can tax, services it can cut, or

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164 11 USC § 109(c)(3).
165 11 USC § 101(32)(C).
166 See notes 27–31 and accompanying text.
167 See In re City of Stockton, 493 Bankr Rptr 772, 789 (Bankr ED Cal 2013); In re City of Detroit, 504 Bankr Rptr 97, 169–70 (Bankr ED Mich 2013).
168 Rather than condition eligibility on insolvency in these cases, the Code permits bankruptcy judges to dismiss petitions prosecuted in bad faith—that is, for a purpose other than resolving financial distress. See, for example, In re Integrated Telecom Express, Inc, 384 F3d 108, 118–20 (3d Cir 2004) (construing 11 USC § 1112(b)); In re Myers, 491 F3d 120, 125 (3d Cir 2007) (construing 11 USC § 1307(c)). A good faith requirement applies explicitly in Chapter 9. 11 USC § 921(c). Bankruptcy judges could use it rather than a solvency test to weed out cases prosecuted for reasons other than dealing with debt overhang.
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franchises it can sell.\footnote{Privatization is a source of liquidity that can be tapped irrespective of its efficiency consequences. For an excellent discussion, see generally Julie A. Roin, Privatization and the Sale of Tax Revenues, 95 Minn L Rev 1965 (2011).} Debt relief must come sooner to be useful.\footnote{Sometimes, as I have noted, financial distress derives from a municipality’s political failure to raise taxes rather than from the strict \textit{inability} of its residents and landowners to pay down public debts. For this reason, debt relief can in principle involve the imposition of a tax as well as the reduction or restructuring of amounts owed. Some commentators think it might be wise policy to allow bankruptcy judges to impose taxes. See, for example, Gillette, Fiscal Federalism, 79 U Chi L Rev at 291–92, 326–29 (cited in note 58). And some think such a power would be constitutionally permissible. See generally, for example, Hunt, 34 Yale J Reg 391 (cited in note 58). On the latter issue I am not persuaded. The imposition of a tax has been traditionally understood as a legislative function. This is why creditors’ remedy against a recalcitrant municipality has always been a writ of mandamus directing a competent official to impose a tax sufficient to pay the debt, \textit{not} a decree imposing the tax directly. See McConnell and Picker, 60 U Chi L Rev at 445–50 (cited in note 9). And it is why the Supreme Court has repeatedly held that federal courts cannot appoint a receiver to take control of municipal affairs. See, for example, Meriwether v Garrett, 102 US 472, 520–21 (1880); East St. Louis v Zebley, 110 US 321, 324 (1884). But see Supervisors v Rogers, 74 US (7 Wall) 175, 180 (1868) (finding an exception when state law affirmatively permitted jilted creditor to seek appointment of a receiver in any court of competent jurisdiction).} The insolvency requirement was meant to prevent strategic filings. It has achieved that end, but mainly by preventing meritorious filings, too, and so ensuring that municipal bankruptcy has a limited office. The insolvency requirement must be relaxed if Chapter 9 is to become a serious tool for addressing municipal financial distress.

Even if the insolvency requirement were repealed, municipal bankruptcy would be underused. Additional changes to the law are probably needed. This is because current law vests multiple people and institutions with effective veto power, the unilateral ability to block a filing or plan of adjustment if they believe the terms would be unfavorable to them or their constituents.\footnote{See Buccola, 39 Cardozo L Rev at 1322–37 (cited in note 30) (identifying Chapter 9 veto players and discussing implications of their veto rights).} The most prominent “veto players” are municipal and state officials. A mayor or city council can decline to file a petition; a state legislature can cancel their ability to file; under the law of many states, the governor or another appointed official can also unilaterally block access to bankruptcy.\footnote{See id.} And the bankruptcy judge herself has ample discretion to prevent a debt adjustment she disfavors. The result is a regime in which bankruptcy can restructure municipal obligations only if each of multiple institutions agrees, after the fashion of legislation in a multicameral body.
Would-be holdouts need persuade only one veto player of the righteousness of their cause to scuttle a deal that would be advantageous for municipal constituents as a group. On top of the prospect of capture, elected officials appear to be systematically unwilling even to acknowledge major fiscal problems, let alone to hasten a restructuring process that might end their political tenure.\textsuperscript{173} Reducing the number of veto players is a worthy goal.\textsuperscript{174}

To that end, two related innovations ought to be considered: introducing involuntary bankruptcy for municipalities and establishing bankruptcy-specific creditor priorities.\textsuperscript{175} In combination, they could lead to timelier and in that sense more useful reckonings.

An involuntary mechanism would permit creditors to initiate bankruptcy, irrespective of what state or local officials might want, and to propose a plan of adjustment if the debtor is unable or unwilling to propose a viable plan itself. There are a number of ways such a mechanism might look, but the involuntary procedures already in place for reorganizing business debtors provide a useful model. The Bankruptcy Code allows creditors holding at least $10,000 of claims to put a debtor into Chapter 11.\textsuperscript{176} Under current law, the bankruptcy judge is to issue an order for relief over the debtor’s objection only if the debtor “is generally not paying [its] debts as such debts become due.”\textsuperscript{177} This limitation would need to be relaxed for municipal debtors. It is the same formulation that defines municipal insolvency, and we have just seen why it is too restrictive. A metric aimed at determining future ability to pay, such as a ratio between annual revenues and total outstanding debt, or a suite of such metrics, is more suitable for municipalities.


\textsuperscript{174} In this sense, the legislation introduced in 2017 by then-Congressman John Conyers would move the law in exactly the wrong direction. See Protecting Employees and Retirees in Municipal Bankruptcies Act of 2017, HR 139, 115th Cong, 1st Sess, in 163 Cong Rec E4 (Jan 3, 2017) (giving union representatives veto power over plans of adjustment that modify collective bargaining agreements, and heightening evidentiary requirement for proof of municipal eligibility).

\textsuperscript{175} Some will think any proposal for involuntary municipal bankruptcy flatly illegal, and not for nothing. The Supreme Court held the first municipal bankruptcy statute unconstitutional, in a 1936 opinion never formally overruled, precisely because it asserted too much federal control over a state creation—and that was a voluntary bankruptcy law. See Ashton, 298 US at 530–32; note 146. My research, still in progress, suggests otherwise, and I plan to publish an argument that the Constitution permits an involuntary municipal bankruptcy law.

\textsuperscript{176} See 11 USC § 303(b)(1)–(2) (setting out criteria for involuntary cases under Chapters 7 and 11).

\textsuperscript{177} 11 USC § 303(h)(1).
Once a case begins in earnest, whether voluntary or not, the recalcitrant debtor cannot win by sandbagging. A Chapter 11 debtor has the exclusive right to propose a plan of reorganization for 120 days.\footnote{11 USC § 1121(b).} After that, or earlier if the judge so orders,\footnote{11 USC § 1121(d)(1).} any party in interest may propose a plan.\footnote{11 USC § 1121(c). See also 11 USC § 941 (permitting only the debtor to file a plan).} Creditor-sponsored plans are uncommon, but only because their prospect spurs managers to assert agenda control by proposing a viable plan first. The rules for plan confirmation are the same whether a case is voluntary or not. The aim of an involuntary proceeding is not to change substantive entitlements, only to force a reckoning. In particular, Chapter 9's criteria for plan confirmation needn't change to capture the benefits of an involuntary mechanism.

Involuntary business bankruptcies are exceedingly rare,\footnote{See Richard M. Hynes and Steven D. Walt, Bankruptcy Bounties *22 (University of Virginia School of Law, Law and Economics Paper Series 2018-15, Oct 30, 2018), archived at http://perma.cc/ESKB-HF5T.} and one might be tempted to infer that involuntary processes are by nature useless. That would be wrong. The infrequency of involuntary business cases is a function of the background norms of creditor-debtor law. Business creditors, enjoying as they do relatively robust collection rights under state law, are usually happy to pursue their interests unilaterally rather than in a bankruptcy forum. Anticipating the practical effectiveness of individual creditors' remedial powers, the managers of distressed businesses are apt to file for relief themselves—if not to delay the inevitable, then at least to choose the time and place of reckoning. It stands to reason that an involuntary mechanism would be more prominent in the municipal context, precisely because creditors' collection rights under ordinary state law are so weak. In business cases, a generic creditor can usually maximize her personal recovery by unilaterally foreclosing, or suing, or threatening to do one or the other. But in municipal cases, a creditor's best hope might be to have other debts written down, thereby reducing the debtor's leverage and the competition for its scarce resources.

Which brings us to bankruptcy-specific priorities. An involuntary procedure can reduce municipal debt in a timely fashion only to the extent creditors—or at least a subset of them—are keen on the idea. Someone must invoke the process and drive the case. That may be unlikely given the uncertain priority scheme...
now in place. In particular, an involuntary mechanism is unlikely to induce earlier filings in what above I call Scenario 3 cases—in which debt relief is expected to stimulate investment but to decrease creditor recoveries. Especially if creditors believe a bailout is possible if conditions deteriorate far enough, they may rationally prefer a wait-and-see strategy. Things could always turn around; and anyway someone else might be left holding the bag.

If Scenario 3 cases seem likely, a bankruptcy-specific priority scheme is worth considering. This would stratify categories of municipal debt in bankruptcy that are treated outside bankruptcy as having identical priority (for example, as general unsecured obligations). The idea is to privilege certain creditors and so give them special reason to prefer the bankruptcy forum, to cause an involuntary petition to be filed or to lobby for a voluntary one. The standard economic wisdom objects to bankruptcy-specific priorities for just this reason: they give an incentive to those most advantaged by the special rules to jockey for bankruptcy administration. But that would be precisely the aim of this intervention. It would induce those who do best under a bankruptcy reckoning to seek one before time dissipates too many local resources.

A plausible priority rule might, for example, give pension claims priority over general obligation bonds. The rule would provide that a plan of adjustment, to be confirmable over the objection of an impaired class, must wipe out general obligation

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182 Bankruptcy-specific priorities are staples of the Bankruptcy Code. For example, the Code declares that the unsecured claims of people “engaged in the production or raising of grain” have priority over the unsecured claims of “governmental units” even though the two kinds of claims have identical status outside bankruptcy. Compare 11 USC § 507(a)(6)(A), with 11 USC § 507(a)(8).


185 For normative arguments that bondholders ought to bear the risk of municipal default, see Gillette, 39 Fordham Urban L J at 654–70 (cited in note 183); Schragger, Citizens versus Bondholders, 39 Fordham Urban L J at 789–93 (cited in note 183).
bond debt before impairing pensions claims at all.\textsuperscript{186} The rule’s primary effect would be to ensure pensioners that their own claims will not be affected by an adjustment of the municipality’s overall debt burden. Its secondary effect, but from the economic point of view the crucial one, would be to encourage pensioners to lobby for earlier bankruptcy. If in a given case reducing outstanding bond debt could be expected to stimulate local infrastructure investment (Scenarios 2 or 3), then pensioners would view themselves as better off for having caused a reckoning early, if only because the reckoning increases the chance they will encounter a solvent municipality in the future.\textsuperscript{187} This result would, of course, affect the terms on which municipalities can sell bonds; but the prospect of Scenario 3—municipal financial distress, really—implies that higher borrowing costs might be preferable.

**CONCLUSION**

The process of technological and cultural change implies that once-prosperous municipalities, like business firms, will sometimes go bust. Serious social dislocations can follow, as many people are unable or unwilling to adjust. Law may have a role to play in dampening the effect of such dislocations. Whether place-based subsidies or person-based supports make wiser policy is an open question. But in any case, one needs to reckon with reality. In a market economy, local decay is as inevitable as innovation. Some places will become unable to generate the wealth needed to pay for infrastructure and public goods that most Americans deem

\textsuperscript{186} In principle, of course, the use of secured debt and the pledge of special revenues could undermine the effectiveness of a bankruptcy-specific priority scheme. But in practice, most municipalities have limited property that can be effectively encumbered.

\textsuperscript{187} An alternative, bankruptcy-specific priority scheme would do the opposite and subordinate unfunded pension liabilities to general obligation debt. As Professor David Skeel has argued, such a rule might induce public employees to lobby for the full funding of their postemployment benefits, unwinding some of the agency problems associated with public-sector bargaining and, perhaps, encouraging more balanced government budgets. See, for example, David A. Skeel Jr, *States of Bankruptcy*, 79 U Chi L Rev 677, 692–93 (2012) (suggesting that the restructuring of pension obligations at the state level might have this salutary effect); David A. Skeel Jr, *Is Bankruptcy the Answer for Troubled Cities and States?*, 50 Houston L Rev 1063, 1073–74 (2013) (same). This alternative scheme suggests a possible downside to subordinating general obligation debt: an incremental disincentive for public employees to attend to the adequacy of pension funding. But in my view, the subordination of public-employee benefits, however theoretically satisfactory a strategy, is politically unthinkable ex post when push comes to shove—at least on a wide scale. And if that is true and known to be true (in other words, a matter of common knowledge), then the supposed incentive benefits of declaring ex ante that unfunded pension liabilities will be subordinated are likely to be illusory.
mandatory, and bankruptcy, which cannot change that fact, is an ill-fitting bandage.

What municipal bankruptcy can do, this Article has argued, is preserve natural and density economies that public debt, by discouraging investment, threatens to dissipate. Chapter 9, as it now stands, does little to accomplish this aim, however, because it fosters debt adjustment only after financial distress is likely to have metastasized into full-blown economic distress. To fulfill its economic function, bankruptcy needs to intervene long before a municipality finally has become unable to service its debts.
Religious Accommodation, the Establishment Clause, and Third-Party Harm

Mark Storslee†

In the wake of Burwell v Hobby Lobby, religious accommodation has become increasingly controversial. That controversy has given rise to a new legal theory gaining popularity among academics and possibly a few Supreme Court justices: the idea that the First Amendment’s Establishment Clause condemns accommodations whenever they generate anything beyond a minimal cost for third parties.

The third-party thesis is appealing. But this Article argues that there are good reasons to believe it fails as an interpretation of the Establishment Clause. In its place, the Article offers a new theory for understanding the relationship between costly accommodations and the Establishment Clause. That theory begins with a simple assertion: the Establishment Clause is not a prohibition on generic harm but instead a ban on government attempts to promote a favored religious identity. Thus, the fundamental inquiry is not whether a private party bears some cost but instead whether the government is using its power to foster religious conformity.

Although largely overlooked in the literature, members of the Founding generation actually did equate accommodations with establishments on at least two occasions, both involving instances in which accommodations encouraged religious conformity. And as it turns out, the principles drawn from those incidents provide powerful explanations for many of the Court’s modern precedents—often more powerful than the Court’s own reasoning. But even more, viewing the Establishment Clause as a ban on government attempts to induce religious conformity also offers a more plausible way of thinking about the occasional costs of accommodation. This approach will be more deferential to legislative judgments than an approach focused squarely on harm. But that is not a reason for rejecting it, especially when the limits it provides have proven fairly reliable in dealing with the problem.

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INTRODUCTION

We occupy a unique moment in the story of American religious liberty. During the Founding period and for much of the twentieth century, it was widely accepted that religious accommodation—the practice of sometimes exempting religious individuals or groups from burdensome laws—was a desirable means of protecting free exercise. But as a matter of cultural consensus, that agreement seems to be quickly unraveling or at least entering a new period of uncertainty. As Professor Paul Horwitz has observed, “Contestation over religious accommodations has moved rapidly from the background to the foreground,” to the point that “[a]ccommodations by anyone—courts or legislatures—have been called into question.”

1 See, for example, Michael W. McConnell, The Origins and Historical Understanding of Free Exercise of Religion, 103 Harv L Rev 1409, 1466 (1990) (noting that religious accommodations in the Founding period were seen as a “natural and legitimate response to the tension between law and religious convictions”); Philip A. Hamburger, A Constitutional Right of Religious Exemption: An Historical Perspective, 60 Geo Wash L Rev 915, 916–17 (1992) (arguing that the Founding generation did not believe exemptions were constitutionally required, but observing that “many Americans sympathized with their neighbors who had pious scruples about oaths, military service, and a few other legal requirements, and, therefore . . . expressly granted religious exemptions”).

Of course, to anyone who reads the news with some regularity, this is no longer a groundbreaking pronouncement. *Burwell v Hobby Lobby Stores, Inc* was one of the more controversial cases in recent memory and seriously eroded support for accommodation among many political progressives.\(^4\) Moreover, many perceive proposals to create or clarify religious accommodation laws at the state level as broadside attacks on LGBTQ rights.\(^5\) *Masterpiece Cakeshop, Ltd v Colorado Civil Rights Commission*\(^6\) reinforced that perception, though it did not involve a religious accommodation law as such. Put simply, for a growing number of people, religious accommodation is increasingly reducible to three words: license to discriminate.

The tendency to view religious accommodation primarily in terms of the culture war is understandable. After all, religious liberty cases involving topics like contraception, gay rights, and abortion invariably draw greater media coverage than other disputes and thus play an outsized role in public consciousness. But thinking about accommodation solely or even mostly in terms of the culture war presents some profound dangers.

For one thing, it obscures the significant good that accommodation laws do for religious minorities. In addition to the federal Religious Freedom Restoration Act\(^7\) (RFRA) and the

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\(^1\) 134 S Ct 2751 (2014).


\(^4\) 138 S Ct 1719 (2018).

Religious Land Use and Institutionalized Persons Act (RLUIPA), there are twenty-one states that have similar general accommodation laws, colloquially known as mini-RFRAs. Yet the available evidence suggests that the vast majority of claims brought under these laws have nothing to do with topics like contraception, gay rights, or abortion. They are about hair length, headgear, horse-drawn buggies, beard trimming and so on. They are about making allowances for religious diets, or helping churches obtain suitable real estate, or allowing small sects to use some banned substance. The culture war has rendered this universe of cases—and with them, the workaday benefits of accommodation—almost totally invisible.

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10 See Luke W. Goodrich and Rachel N. Busick, Sex, Drugs, and Eagle Feathers: An Empirical Study of Federal Religious Freedom Cases, 48 Seton Hall L Rev 353, 356, 384 (2018) (conducting an empirical survey of cases in the Tenth Circuit thirty-two months after Hobby Lobby and concluding that there were “no RFRA challenges in the Tenth Circuit to any other medical procedures or drugs” and that “religious minorities are significantly overrepresented in the cases relative to their population”); Stephanie H. Barclay and Mark L. Rienzi, Constitutional Anomalies or As-Applied Challenges? A Defense of Religious Exemptions, 59 BC L Rev 1595, 1634–36 (2018) (noting that an empirical assessment of the federal caseload shows that, even when counting challenges to the “contraception mandate” of the Affordable Care Act separately, such cases made up less than one-third of the total RFRA claims decided in the three years since Hobby Lobby). See also Douglas Laycock, The Wedding-Vendor Cases, 41 Harv J L & Pub Pol 49, 50–51 (2018) (noting the relatively small number of culture war-related claims at the Supreme Court in free exercise cases decided since 1991).
11 A.A. v Needville Independent School District, 611 F3d 248, 272 (5th Cir 2010) (protecting the right of a kindergartener to wear his hair in accordance with his Native American religious beliefs).
13 State v Hershberger, 462 NW2d 393, 399 (Minn 1990) (protecting the right of the Amish to use horse-drawn buggies without slow-moving-vehicle signage).
14 Holt v Hobbs, 135 S Ct 853, 859 (2015) (protecting the right of a Muslim inmate to maintain a half-inch beard).
15 Willis v Commissioner, Indiana Department of Correction, 753 F Supp 2d 768, 782 (SD Ind 2010) (upholding a Jewish prisoner’s right to receive kosher meals).
16 Saints Constantine & Helen Greek Orthodox Church, Inc v City of New Berlin, 396 F3d 895, 901 (7th Cir 2005) (reversing summary judgment forbidding a church from building on a purchased parcel).
17 Gonzales v O Centro Espirita Beneficente Uniao do Vegetal, 546 US 418, 423 (2006) (upholding the right of a Brazilian religious group to use a hallucinogenic tea in its rituals).
But there is also a deeper problem. Viewing religious accommodation primarily in terms of the culture war has created profound confusion about the meaning of the Establishment Clause. Under statutes like RFRA and RLUIPA, courts are required to deny an accommodation when doing so is the least restrictive means of furthering a compelling interest. As Justice Anthony Kennedy recently noted, that inquiry necessarily requires courts to consider whether an accommodation “unduly restrict[s] other persons . . . in protecting their own interests.” In the shadow of Hobby Lobby, however, many have begun to argue that the Establishment Clause imposes a much more radical constraint. The proposal has been phrased in different ways and ornamented with different nuances, but we can summarize the position as follows: although legislatures may sometimes provide religious accommodations, the Establishment Clause forbids accommodations whenever they generate more than a minimal cost for “third parties,” meaning “persons who . . . do not believe or engage in the exempted religious practices.” Let’s call this the third-party thesis.

The third-party thesis is appealing because it coheres with a powerful intuition that religion should not be “a license to harm others.” It also offers one possible reading of Supreme Court precedents suggesting that the Establishment Clause somehow limits accommodations that impact nonparticipating citizens. Thus, it is no wonder that many distinguished scholars are embracing the thesis, and even a few Supreme Court justices have

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18 42 USC §§ 2000bb-1(a)–(b), 2000cc-1.
19 Hobby Lobby, 134 S Ct at 2787 (Kennedy concurring).
flirted with the idea. But there is a problem. Put simply, there are good reasons to believe the third-party thesis fails as an interpretation of the Establishment Clause.

At the level of principle, the third-party thesis relies primarily on the claim that costly accommodations “tax” unwilling citizens in ways akin to repressive state churches. But that analogy depends on both a dubious account of history as well as implausible arguments about religious coercion. Unlike Founding-era church taxes, the purpose and effect of religious accommodation is to leave religion alone, not actively evangelize. Moreover, although accommodations that produce private costs might sometimes create resentment, they do not force anyone to support religion in any way that the law actually recognizes.

Likewise, although the third-party thesis offers a nuanced set of rules for identifying forbidden accommodations, its framework is exceedingly difficult to square with the Court’s precedents. When considering cases involving both religious institutions and the religious conduct of individuals, the Court has repeatedly blessed accommodations that generate costs for others. Indeed, it has sometimes held that the Establishment Clause itself requires them. If the third-party thesis is right, much of our law—including some of the Court’s most celebrated religious liberty cases—would seem to be wrong.

This Article offers a new theory for thinking about the relationship between the Establishment Clause and cost-shifting religious accommodations. This theory begins with a simple claim: the Establishment Clause is not a prohibition on harm

24 See Holt, 135 S Ct at 867 (Ginsburg concurring). See also Part II.
25 See Part II.A.
26 See Part II.B.
but instead a ban on government attempts to promote a favored religious identity (either a particular religion or religion in general). More specifically, it suggests that, when evaluating the propriety of religious accommodations, the fundamental inquiry is not whether a private party bears some cost but instead whether the government is using its power to foster religious conformity.

Religious accommodations are attempts to protect minorities by making room for religious practices that are unfamiliar to or unaccepted by the majority. Thus, the idea that accommodations can somehow be equated with establishments is largely untenable—accommodations almost always weaken, rather than strengthen, the power of the state to promote a favored orthodoxy. But that is not the whole story. Although often overlooked in the literature on religious accommodation, members of the Founding generation did equate accommodations with establishments on at least two occasions, both of which involved objections that the accommodations encouraged religious conformity.27 And reflection on those incidents yields two principal rules for limiting religious accommodations today.

First, the Establishment Clause prohibits accommodations that seek to selectively subsidize the government’s preferred religious messages.28 Under this rule, although the government may provide accommodations to relieve burdens on religious practice, the Establishment Clause prohibits it from designing those accommodations to offer discriminatory support for the government’s preferred religious ideas. So, for example, although the government can make allowances for students in public schools to practice religion by providing release-time for religious instruction, it may not design the accommodation in a way that lends government prestige to the message being spoken while conditioning eligibility on the substance of the religious teaching.

Second, the Establishment Clause prohibits accommodations that provide exceptionally powerful incentives to adopt the religion being accommodated.29 Under this rule, when an accommodation operates in ways analogous to a coercive law mandating religious conformity, the Establishment Clause requires that it be struck down or, more likely, modified to dissipate the

27 See Part III.A.
28 See Part III.A.1.
29 See Part III.A.2.
incentive. So, for example, when a religious accommodation involves both objectively powerful incentives and widely held claims of conscience—as with exemptions from military service, for instance—there are heightened Establishment Clause concerns over induced conformity that will sometimes require removing or reducing the incentive.

The two limitations described above provide convincing explanations for many of the Court’s modern Establishment Clause precedents—in some cases, more convincing than the Court’s own reasoning. But more than this, viewing the Establishment Clause as a ban on government attempts to encourage religious conformity also offers a more plausible way of thinking about the occasional costs of accommodation. Specifically, it clarifies that, although these costs are not themselves a proper basis for an Establishment Clause objection, they can be relevant in determining whether a law is actually a genuine accommodation rather than merely a pretext for rewarding religious conformity. So, for example, when an accommodation offers gratuitous benefits to religious claimants or transgresses the limits that apply to similar constitutional claims, the Court has been right to suggest that the Establishment Clause is implicated.

To be sure, this approach to the Establishment Clause will be more deferential to legislative judgments than an approach focused squarely on third-party harm. But that is not a reason for rejecting it, especially when other limits have proven fairly reliable in dealing with that problem. For instance, many accommodation laws like RFRA and RLUIPA already contain a balancing test, the primary purpose of which is to safeguard other important interests. What is more, religious accommodations—like all cost-balancing legislation—are subject to amendment or repeal through the political process. That fact has been important in recent controversies involving religious liberty and LGBTQ rights, in which political majorities have been exceedingly active in shaping or limiting accommodations to protect those interests. A proper understanding of the Establishment Clause does not require ignoring the costs of accommodation. It simply requires that those costs be accounted for more carefully and managed through a variety of means.

30 See Part III.B.
31 See Part IV.A.
32 See Part IV.B.
This Article is organized as follows: Part I explains the basics of the law governing religious accommodation and its relationship to the Establishment Clause. Part II unpacks the problems with viewing the Establishment Clause as a prohibition on generic harm and offers a critique of the third-party thesis. In Part III, the Article offers a new approach for addressing the relationship between cost-shifting accommodations and the Establishment Clause, arguing that the principal inquiry is whether an accommodation has the purpose or effect of fostering religious conformity. This Part discusses some historical incidents often overlooked by scholars to introduce the principles governing the inquiry and goes on to explain their modern doctrinal implications. Finally, Part IV deals with some objections and explores other limits on religious accommodation. This Part begins by explaining the subsidiary role that costs sometimes play in identifying laws that transgress the Establishment Clause. Having done so, it goes on to consider other important limits on religious accommodation, especially those provided by the political process.

Before proceeding to the heart of the argument, however, a few important clarifications are in order. First, in making an argument in favor of the Establishment Clause theory I outline above, this Article deals only with religious accommodations. By “accommodations,” I mean laws specifically designed to remove burdens on private religious practice. Those laws take two forms. Most commonly, accommodations provide exemptions from laws that would otherwise burden religiously motivated conduct. Alternatively, they protect free exercise by mandating that employers take reasonable steps to facilitate their employees’ religious needs or that the government take steps to allow people in its care to practice their religion. Beyond these categories of laws, this Article makes no specific claims. Thus, although I note that a concern about government-induced conformity runs through the Court’s Establishment Clause jurisprudence, I do not attempt to offer a full defense of the principle as applied to other contexts.

Second, in arguing in favor of the Establishment Clause limits I outline above, I have largely set to one side an important additional concern: the requirement that religious accommodations be neutral among religions, or what the Court has
sometimes called “denominational neutrality.” To be sure, this concern plays some role in considering whether an accommodation selectively favors the government’s preferred religious messages. But the prohibition on denominational discrimination also entails additional limitations. Because these concerns are only tangentially related to the issue of costly accommodations, however, I leave them mostly to the side. A full exploration of the requirement that religious accommodations treat all religions equally will have to be left for another day.

I. CURRENT LAW AND ESTABLISHMENT CLAUSE BASICS

The law of religious accommodation has undergone dramatic change in the last few decades.

For much of the twentieth century, the Supreme Court interpreted the Free Exercise Clause to require exemptions when a law burdened religiously motivated conduct unless the government could demonstrate that requiring compliance was the least restrictive means of furthering a compelling interest. In Employment Division, Department of Human Resources of Oregon v Smith, however, the Court changed course. Specifically, it held that the Constitution does not require heightened scrutiny when a law burdens religious practice so long as the conflict results from a “neutral law of general applicability.” The Smith rule has generated significant confusion of its own, but the basic point is this: so long as a law does not treat religious conduct less favorably than analogous secular conduct or contain opportunities for governmental discretion, Smith says the Free Exercise Clause generally does not require exemptions.

34 For instance, it prohibits a legislature from limiting accommodations out of a desire to exclude a disfavored religious group, even when the accommodation itself is formally neutral. See id at 253–55.
35 US Const Amend I (“Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof.”).
36 See Employment Division, Department of Human Resources of Oregon v Smith, 494 US 872, 893 (1990) (O’Connor concurring in the judgment) (explaining the Court’s previous free exercise jurisprudence).
38 Id at 879, quoting United States v Lee, 455 US 252, 263 n 3 (1982) (Stevens concurring).
39 For a nice discussion of Smith and its possible meanings, see Douglas Laycock and Steven T. Collis, Generally Applicable Law and the Free Exercise of Religion, 95 Neb L Rev 1, 9–10 (2016). The Court itself has also complicated the Smith rule in ways that remain largely open-ended. See, for example, Hosanna-Tabor Evangelical Lutheran
Smith radically reduced the scope of protection for religious exercise provided under the Constitution. Yet as the Smith majority made plain, nothing in the ruling meant that such protections were thereby “banished from the political process.” On the contrary, in Smith and subsequent cases, the Supreme Court has repeatedly reaffirmed its long-standing view that legislatures may “accommodate religious practices . . . without violating the Establishment Clause.”

Legislatures have responded by enacting or strengthening many different kinds of religious accommodations. Some of these—such as laws allowing groups to use peyote in their religious services or the clergy-penitent privilege contained in most rules of evidence—extend protections in specific contexts. But even more important are so-called “general” accommodation laws like RFRA and RLUIPA. Under those statutes and state laws like them, when a claimant demonstrates that a law “substantially burden[s]” her religious exercise, the government must grant an exemption unless it can demonstrate that enforcing the law is the least restrictive means of furthering a compelling governmental interest.

Accommodations have sometimes been subjected to wholesale Establishment Clause challenges. Yet the Court has repeatedly rebuffed those arguments, and often without a single dissent. As an introductory matter, two of the Court’s conclusions are of particular importance.

*Church & School v Equal Employment Opportunity Commission*, 565 US 171, 190 (2012) (holding that the Free Exercise Clause prohibits applying employment discrimination laws to claims involving a religious institution and its ministers, and distinguishing Smith as concerning “government regulation of only outward physical acts” rather than “an internal church decision”).

40 Smith, 494 US at 890.


42 See 42 USC § 1996a(b)(1).

43 See *Cox v Miller*, 296 F3d 89, 102 (2d Cir 2002) (explaining that “every state has enacted the cleric-congregant privilege in some form”).

44 As Professor Kent Greenawalt explains, exemptions may be “specific” by applying to a particular law or “general” by offering a set of standards to a variety of laws. Kent Greenawalt, *Exemptions: Necessary, Justified, or Misguided?* 9 (Harvard 2016).


46 See 42 USC §§ 2000bb-1(a)–(b), 2000cc-1. See also Lund, 55 SD L Rev at 475–79 (cited in note 45).
First, the Court has repeatedly held that religious accommodations do not violate the Establishment Clause merely because they “single[ ] out religious entities for a benefit.” 47 That conclusion flows both from historical practice and from the text of the Constitution itself. Accommodations that single out religious exercise have always been ubiquitous in American law, before as well as after the adoption of the First Amendment. 48 Moreover, by its terms the Free Exercise Clause provides religious exercise with special protection not provided to other kinds of commitments. It follows as a matter of course that ordinary legislation adopting a similar approach is permissible under the Constitution. “Where . . . government acts with the proper purpose of lifting a regulation that burdens the exercise of religion,” the Court has said, “we see no reason to require that the exemption come packaged with benefits to secular entities.” 49

Second, religious accommodations do not violate the Establishment Clause merely because they “accommodate religion beyond free exercise requirements.” 50 The reason, the Court has explained, stems from the “play in the joints” between the Religion Clauses—a zone of discretion that allows for “state actions permitted by the Establishment Clause but not required by the Free Exercise Clause.” 51 Thus, although accommodations are not usually required by the Constitution after Smith, legislatures may choose to enact them without violating the Establishment Clause.

Of course, saying that religious accommodation is generally permissible under the Establishment Clause is not to say the Constitution provides no limits. That is because, although genuine accommodations cohere with the Constitution, attempts to promote the government’s favored religion do not. As the Court has put it, although the Establishment Clause provides “ample room” for religious accommodation, “[a]t some point, accommodation may devolve into ‘an unlawful fostering of religion.’” 52 In the shadow of Hobby Lobby, however, several scholars have

47 Corporation of the Presiding Bishop of the Church of Jesus Christ of Latter-Day Saints v Amos, 483 US 327, 338 (1987). See also Cutter, 544 US at 724.
48 See Horwitz, 128 Harv L Rev at 167 (cited in note 2) (“Accommodation of religion is an aboriginal feature of American public law.”). See also notes 169–71 and accompanying text (describing several religious accommodations during the Founding period).
49 Amos, 483 US at 338.
50 Cutter, 544 US at 713.
begun to suggest that the Establishment Clause imposes a much more stringent constraint. It is that theory, which I call the third-party thesis, that this Article turns to next.

II. THE THIRD-PARTY THESIS

The crux of the third-party thesis can be stated simply: although religious believers (the “first” party) may sometimes receive exemptions from government (the “second” party), the Establishment Clause forbids accommodations that generate costs or burdens for “third parties,” meaning “persons who derive no benefit from an exemption because they do not believe or engage in the exempted religious practices.”

Thus, the argument goes, although accommodations are sometimes permissible, the Establishment Clause condemns accommodations that “shift the costs” associated with an underlying activity from “one private citizen onto another private citizen,” at least when those costs are more than negligible.

The third-party thesis is an attractive theory, not least because it draws on a widely shared intuition that religion should not be a “license to harm others.” And of course, that intuition is true as far as it goes. To state the obvious, no one thinks that religious believers or anyone else have the right to engage in murder, theft, or trespass. Yet the third-party thesis goes much further by suggesting that accommodations are constitutionally prohibited when they alter the distribution of private burdens in much less radical ways. In the wake of Hobby Lobby, that view

53 Gedicks and Van Tassell, Of Burdens and Baselines at 323 (cited in note 20).
54 Tebbe, Religious Freedom in an Egalitarian Age at 50 (cited in note 23). Supporters of the third-party thesis claim that their rule is also grounded in free exercise, yet the specifics of their arguments differ. Professor Frederick Gedicks and Rebecca G. Van Tassell rest their assertion mostly on the claim that the Court has sometimes included dicta about harms to others in free exercise cases. See Gedicks and Van Tassell, Of Burdens and Baselines at 326 (cited in note 20) (arguing that two of the Court’s “free exercise decisions” have denied exemptions based on concerns over third-party burdens). By contrast, Professor Nelson Tebbe asserts that “the Free Exercise Clause itself . . . incorporate[s] the imperative of avoiding harm to others.” Tebbe, Religious Freedom in an Egalitarian Age at 59 (cited in note 23). In both accounts, however, the crucial claim is that costly accommodations “impose” one citizen’s faith on another. See id at 58, quoting United States v Lee, 455 US 252, 261 (1982); Gedicks and Van Tassell, Of Burdens and Baselines at 325 (cited in note 20). Because the Establishment Clause already prohibits impositions of religion, however, this Article deals with those arguments in that context. See Part II.A.
55 Neuborne, Madison’s Music at 135 (cited in note 21).
56 See text accompanying notes 114–18 (discussing the proposed thresholds to trigger an Establishment Clause objection under the third-party thesis).
has attracted support from a number of distinguished legal academics.\textsuperscript{57} But even more importantly, it is also beginning to gather at least tepid support among some members of the Supreme Court.\textsuperscript{58}

In \textit{Holt v Hobbs},\textsuperscript{59} the Supreme Court unanimously held that a Muslim inmate seeking to grow a half-inch beard was entitled to an exemption under RLUIPA from a prison grooming policy.\textsuperscript{60} In a brief concurrence joined by Justice Sonia Sotomayor, Justice Ruth Bader Ginsburg stated that she joined the Court’s opinion because, “[u]nlke the exemption this Court approved in . . . \textit{Hobby Lobby}, accommodating [the prisoner’s] religious belief . . . would not detrimentally affect others who do not share petitioner’s belief.”\textsuperscript{61} Justice Ginsburg did not explicitly mention the Establishment Clause in \textit{Holt}. Yet her citations suggest that she may have been relying on the clause as the basis for her view.\textsuperscript{62}

In at least one important sense, Justice Ginsburg’s concurrence in \textit{Holt} makes a valid point. In holding that religious businesses and their owners were entitled to an exemption from the “contraceptive mandate” under RFRA, the \textit{Hobby Lobby} majority asserted that the cost to Hobby Lobby’s employees would be “precisely zero” because they could receive contraceptives directly from the government.\textsuperscript{63} But that assertion skated over the fact that many women were left without contraceptive coverage while the agency created an alternative program to deliver it.\textsuperscript{64}

\textbf{Footnotes:}

\textsuperscript{57} See note 23 and accompanying text.
\textsuperscript{58} See note 24 and accompanying text.
\textsuperscript{59} 135 S Ct 853 (2015).
\textsuperscript{60} Id at 859.
\textsuperscript{61} Id at 867 (Ginsburg concurring).
\textsuperscript{62} See id (Ginsburg concurring). See also \textit{Hobby Lobby}, 134 S Ct at 2790 & n 8 (Ginsburg dissenting) (citing several Establishment Clause precedents to argue that “[a]ccommodations to religious beliefs or observances . . . must not significantly impinge on the interests of third parties”); id at 2801 (pointing out that the Court has said that the Establishment Clause requires courts to “take adequate account of the burdens a requested accommodation may impose on nonbeneficiaries”) (quotation marks and citation omitted). Admittedly, not everyone reads Justice Ginsburg’s statement in \textit{Holt} as linked to the Establishment Clause. For an alternative view, see Kevin C. Walsh, \textit{Did Justice Ginsburg Endorse the Establishment Clause Third-Party Burdens Argument in Holt v. Hobbs?} (Mirror of Justice, Jan 21, 2015), archived at http://perma.cc/8P63-DJM6.
\textsuperscript{63} \textit{Hobby Lobby}, 134 S Ct at 2760.
\textsuperscript{64} For elaboration on this point, see Tebbe, \textit{Religious Freedom in an Egalitarian Age} at 67–70 (cited in note 23).
fault. But it is nonetheless true that the *Hobby Lobby* majority understated the costs of its ruling.

At the same time, there is also reason for caution. Justice Ginsburg’s concurrence in *Holt*—like the academic argument in favor of the third-party thesis—proposes an aggressive Establishment Clause limit on religious accommodation as a direct response to *Hobby Lobby*. Yet as Professor Christopher Lund has noted, *Hobby Lobby* was an outlier.\(^{65}\) Most religious accommodation cases have nothing to do with topics like abortion or contraception. They are about things like protecting the right of the Amish to use buggies without signage,\(^{66}\) protecting the right of Native American and Muslim individuals to wear their hair or beards in accordance with their religion,\(^{67}\) protecting the right of churches to maintain their ministries in the face of onerous zoning regulations,\(^{68}\) and allowing clergy to maintain their confidences in the face of subpoenas.\(^{69}\) And when one considers that larger world of cases, the idea that the Constitution prohibits any accommodation that “detrimentally affects others” becomes exceedingly difficult to sustain.

Consider just a few examples. Laws regulating zoning protect the property values of specific homeowners. But they also regularly prohibit churches or mosques from carrying on their ministries, and especially from providing services to the homeless.\(^{70}\) Are exemptions from such laws, which RLUIPA regularly requires, now an Establishment Clause violation because they adversely affect neighborhood traffic flows or home values? Likewise, laws regulating animal slaughter instantiate the values of animal rights groups who believe certain practices are inhumane or environmentally irresponsible. Yet without specific exemptions, those laws conflict with the kosher requirements of

\(^{65}\) Christopher C. Lund, *Keeping Hobby Lobby in Perspective*, in Schwartzman, Flanders, and Robinson, eds, *The Rise of Corporate Religious Liberty* 285, 288–89 (cited in note 4) (observing that *Hobby Lobby* and other culture war cases are “highly unrepresentative” yet are “driving the discussion on both the left and the right”).

\(^{66}\) *State v Hershberger*, 462 NW2d 393, 399 (Minn 1990).

\(^{67}\) *A.A. v Needville Independent School District*, 611 F3d 248, 253 (5th Cir 2010) (protecting the right of a Native American kindergartener to wear his hair in accordance with his religious beliefs); *Holt*, 135 S Ct at 859 (protecting the right of a Muslim inmate to maintain a half-inch beard).

\(^{68}\) *Chosen 300 Ministries, Inc v City of Philadelphia*, 2012 WL 3235317, *26–27* (ED Pa) (allowing a church to continue its homeless ministry in the face of zoning challenges).

\(^{69}\) *Mockaitis v Harcleroad*, 104 F3d 1522, 1530 (9th Cir 1997).

\(^{70}\) See, for example, *United States v County of Culpeper*, 245 F Supp 3d 758, 769 (WD Va 2017); *Chosen 300 Ministries*, 2012 WL 3235317 at *26–27.
many observant Jewish communities. Are exemptions from such laws—which have been recognized and praised by the Supreme Court\(^71\)—actually unconstitutional? What about religious exemptions from the Americans with Disabilities Act?\(^72\) From the Copyright Act?\(^73\) From the Fair Housing Act?\(^74\) The list goes on and on.

To be sure, Justice Ginsburg probably did not have all these laws in mind when she penned her concurrence in *Holt*. But that is precisely the point. The argument that the Establishment Clause forbids any accommodation that “detrimentally affects others” might sound appealing when we are thinking only about *Hobby Lobby*. But when we widen the frame even slightly, it becomes apparent that such a rule would require a full-scale revolution in our law.

Of course, revolution might not be a bad thing. If the third-party thesis is a correct interpretation of the Establishment Clause, as several scholars now contend, such a change is long overdue. Thus, it is worth considering the arguments for the third-party thesis in more detail.

## A. The Church-Tax Analogy

At the level of Establishment Clause principle, the most prominent argument in favor of the third-party thesis relies on an analogy to mandatory tax support for churches. Specifically, proponents argue that religious accommodations violate the Establishment Clause whenever they shift burdens to others because such burdens “function[ ] as a tax on nonadherents to support someone else’s religious beliefs.”\(^75\) So for example,}

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\(^71\) See *Church of the Lukumi Babalu Aye, Inc v City of Hialeah*, 508 US 520, 539 (1993), citing 7 USC § 1902(b).


\(^73\) Pub L No 94-553 § 101, 90 Stat 2549 (1976), codified as amended at 17 USC § 110(3).

\(^74\) Pub L No 90-284 § 807, 82 Stat 84 (1968), codified as amended at 42 USC § 3607(a).

\(^75\) Gedicks and Van Tassell, *Of Burdens and Baselines* at 334 (cited in note 20). See also Tebbe, *Religious Freedom in an Egalitarian Age* at 52 (cited in note 23) (arguing that opposition to religious taxes indicates that “the founding generation . . . committed themselves to the idea that the costs of accommodating the faith of some citizens should not be imposed on citizens of other faiths or no faith”). The original version of this argument appeared in Ira C. Lupu, *Reconstructing the Establishment Clause: The Case against Discretionary Accommodation of Religion*, 140 U Pa L Rev 555, 583 (1991) (suggesting that accommodations involving costs can sometimes be analogized to “coercive taxation to support the religious practices of others”).
whenever an accommodation requires “the denial of employee entitlements and protections to facilitate an employer’s practice of religion, this denial functions as a tax on employees to support the employer’s religion.”

On a first read, the church-tax analogy is fairly convincing. Most obviously, it identifies an aversion to “paying for religion” that is common among some citizens, and it transforms that aversion into a legal argument by drawing an analogy between accommodation and a practice that virtually everyone agrees is unconstitutional. But on closer examination, the analogy between church taxes and accommodation is superficial. The purpose and effect of religious accommodation is to leave religion alone or, more specifically, to avoid impinging on free exercise by removing legal impediments or combatting private discrimination. In church-tax schemes, by contrast, the government uses its power not to protect religious freedom but instead to actively evangelize. And it was that fact—not the bare association of religion and unwanted cost—that motivated historical objections to religious taxes.

To illustrate the point, consider the debate over Virginia’s General Assessment. In the wake of American independence, members of the Virginia legislature proposed a tax on citizens to support clergy members of their choosing or educational institutions within the commonwealth. Opposing the assessment, supporters of religious liberty such as James Madison argued that requiring even “three pence” for support of a minister was indistinguishable from full-blown religious establishment. But that argument was not based on the idea that any undesired cost associated with religion should be prohibited. Instead, Madison’s argument was much simpler. Tax-support schemes were objectionable because they effectively deprived all citizens—those who gave to churches willingly and those who did

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76 Gedicks and Van Tassell, Of Burdens and Baselines at 335 (cited in note 20).
not—of the freedom to “render to the Creator such homage and such only as [they] believe[d] to be acceptable to him.” In other words, religious taxes were equivalent to establishment not because they forced some people to pay for religion they did not like but because they effectively forced everyone to engage in a religious observance—namely, tithing. Taxing people solely to support the religious functions of churches is no different from coerced worship. But no one in the Founding generation ever so much as hinted that this problem had anything to do with religious accommodations.

Of course, one possible response is to concede the historical point but argue that costly accommodations infringe on liberty in an analogous way. And indeed, supporters of the third-party thesis have suggested as much by arguing that accommodations generating costs “compel[ ] citizens . . . to support an article or manifestation of faith.” Here too, however, it is worth drilling down. Proponents of the thesis tend to be vague about how the costs of some accommodations coerce others to “support” an article of religious faith. But the claim seems to imply two possibilities: either these costs are a forced religious observance or they are compelled speech. Yet like the historical claim, both of these arguments become problematic on closer examination.

As we have already observed, forced payment to support a minister is a religious observance in the most literal sense—it is a tithe. But that is simply not the case for the incidental costs associated with religious accommodation. Granting a church an exemption from zoning laws might have a detrimental effect on home values or traffic flows, but it is a far cry from forcing anyone to practice a religion. Protecting a religious employee who wishes to attend a worship service might increase the cost of running a business, but it doesn’t require anyone to observe a

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80 Id at 56.
81 As part of that argument, Madison also denied that the law actually allowed individuals to avoid giving to a church by giving their money to education. See id at 56. Again, however, Madison’s argument was that the assessment denied non-Christians the “equal freedom” to refrain from worshipping. Id at 57. In Madison’s words, it forced them to “embrace, to profess and to observe” the Christian religion, presumably because even Virginia’s seminaries of learning possessed ecclesial ties. Id at 57. See also Frederick Rudolph, The American College and University: A History 16 (Georgia 1962) (observing that the president of the College of William and Mary was a representative of the Bishop of London and head of the Anglican Church of Virginia).
Sabbath. In these circumstances and others, a secular cost or burden is just that.

The argument about subsidized speech fares no better, though it probably lies closest to the heart of the church-tax analogy. Under the Court’s precedents, government is sometimes forbidden from forcing private individuals to “fund[] [the] speech of other private speakers or groups.” So for instance, individuals cannot be forced to pay for the speech of unions or for private advertising with which they disagree. In those cases, however, government is directly coercing one party to redistribute resources to another with the purpose of facilitating the latter’s expression. A law requiring public sector employees to pay for a union’s speech forcibly transfers wealth from the former to the latter, a law requiring lawyers to fund the ideological messages of bar associations takes money out of their pockets and puts it in the associations’ coffers, and so on. But when we are talking about the incidental costs of protecting rights, things are very different.

Think about just a few examples from the free speech context. Upholding a Nazi’s right to march in Skokie may be controversial, but no one thinks that, by doing so, the Supreme Court embraced a fascist ideology or required the citizens of Illinois to do so. Likewise, requiring a particular community to pay for increased police presence at a white supremacist rally—which the First Amendment does—will undoubtedly be unpopular. But we would never say that the First Amendment is “taxing” citizens to support the Ku Klux Klan. The First Amendment allows hate groups to protest at military funerals, but we do not think that means government has coerced attendees to “support” such speech. The reason for all these

83 See Micah Schwartzman, Nelson Tebbe, and Richard Schragger, The Costs of Conscience, 106 Ky L J 781, 787 & n 21 (2017–2018) (citing the Supreme Court’s compelled subsidy precedents to argue that, “when [ ] costs fall on a discrete group of citizens, they can rightly complain that they are being coerced as a matter of conscience”).
86 See Janus, 138 S Ct at 2464.
judgments is simple: in all these instances, although the costs associated with speech may generate frustration, they do not actually impinge on anyone’s right to refrain from speaking. The costs are ancillary to the protection of a freedom, not the product of a law compelling redistribution to pay for speech.\(^{91}\)

What is true of traditional free speech cases is also true of costly religious accommodations. Like protecting Nazi speech or funeral protesters, protecting someone else’s ability to practice her religion may sometimes be detested or even abhorred, especially when it entails costs. But in those instances—as in most free speech cases—the costs generated are purely incidental. A zoning accommodation for a mosque might impact a particular homeowner, but it doesn’t command a monetary transfer from one speaker to another. An accommodation requiring a private employer to accommodate her employee’s religious needs might invoke resentment. But it doesn’t require her to pay her employee for religious speech; it merely requires that she adjust workplace rules to account for things like religious dress or Sabbath observance. Those kinds of incidental costs do not force anyone to endorse a religion. They are simply part of the cost we all sometimes bear in a republic in which many sorts of freedom are prized and valued.\(^{92}\)

Like the historical claim, then, the arguments about religious coercion underlying the church-tax analogy sound plausible. But on further inspection, they also lack any real grounding. Although accommodations carrying costs sometimes generate resentment, they simply do not require anyone to “support” religion in any way that the law actually recognizes.

But is there yet another way to understand the church-tax analogy? As an add-on to their arguments about religious coercion, supporters of the third-party thesis have sometimes suggested that costly accommodations violate the Establishment

\(^{91}\) Direct government coercion requiring one speaker to subsidize another’s expression is an essential element of any subsidized speech case. See Micah Schwartzman, *Conscience, Speech, and Money*, 97 Va L Rev 317, 380 (2011) (observing that the “general logic of compelled support doctrine” begins with the claim that “government cannot force people to speak” and subsequently asserts that “financial contributions for expressive purposes are treated either as intrinsically expressive or as facilitating expression”). See also Wesley J. Campbell, *Speech-Facilitating Conduct*, 68 Stan L Rev 1, 37 (2016) (arguing that the logic of the Court’s compelled speech precedents involves asking “whether a compelled subsidy exacts a disproportionate sum for speech activities in light of any non-speech purposes”).

Clause by fostering “unequal citizenship” on the basis of religion.\textsuperscript{93} According to this argument, “When one group is ‘taxed’ so that another group may be accommodated in their observance, citizens are stratified on the basis of belief.”\textsuperscript{94}

As a matter of course, government may not punish or otherwise discriminate against citizens on the basis of their religion. To cite just one paradigmatic example, government may no more forbid a minister from holding elected office than it may prohibit an atheist from doing so.\textsuperscript{95} But it is doubtful that religious accommodations—even those that inadvertently generate costs for others—transgress this principle. We do not think that the government is stratifying according to sex when it accommodates pregnant women or commands private employers to do so.\textsuperscript{96} Nor do we think that government is fostering unequal citizenship in favor of individuals with disabilities when it requires accommodations under the Americans with Disabilities Act.\textsuperscript{97} Rather, the government is simply choosing to defend groups or activities that may be underprotected through free-market mechanisms. If the legislature adds a religious accommodation alongside these others, the inference of protection-not-stratification would seem to be no different, even if the accommodation—like these others—generates costs.

To be sure, one might respond by suggesting that, unlike these other categories, religion is especially dangerous and politically divisive.\textsuperscript{98} That intuition was the one that fueled some versions of Justice Sandra Day O’Connor’s endorsement test and its suggestion that the Establishment Clause prohibits “send[ing] a message to nonadherents that they are outsiders, not full members of the political community” and vice-versa.\textsuperscript{99} But there is a problem here too. As even some supporters of the third-party

\begin{itemize}
  \item \textsuperscript{93} Tebbe, \textit{Religious Freedom in an Egalitarian Age} at 54 (cited in note 23).
  \item \textsuperscript{94} Schwartzman, Tebbe, and Schrager, 106 Ky L J at 787 (cited in note 83).
  \item \textsuperscript{95} See \textit{McDaniel v Paty}, 435 US 618, 629 (1978) (holding that a state law barring ministers from serving as delegates to a state constitutional convention violated the Free Exercise Clause); \textit{Torcaso v Watkins}, 367 US 488, 496 (1961) (holding that a state constitutional provision requiring public officials to declare their belief in the existence of God violated the First Amendment).
  \item \textsuperscript{96} See Pregnancy Discrimination Act, Pub L No 95-555, 92 Stat 2706 (1978), codified at 42 USC § 2000e(k).
  \item \textsuperscript{97} 104 Stat 327, 42 USC § 12112(a)–(b).
  \item \textsuperscript{98} See Tebbe, \textit{Religious Freedom in an Egalitarian Age} at 54 (cited in note 23) (arguing that costly accommodations are especially objectionable because they risk “dividing and stratifying the political community along religious lines”).
\end{itemize}
thesis have recognized, an Establishment Clause rule focused on division and alienation is unworkable as a basis for constitutional decision-making.\textsuperscript{100} In a democracy in which majorities set the order of the day, it is all but inevitable that those in the minority will sometimes feel like outsiders. What is more, alienation and division seem inescapable when it comes to religion in particular. The Court’s School Prayer Cases undoubtedly protected religious liberty, but they also alienated those who believe that government-sponsored prayer or Bible reading are important features of public education.\textsuperscript{101} Rightly understood, a concern over government endorsement of particular religious views has merit. But the idea that we can build Establishment Clause jurisprudence around avoiding strife—and especially strife around religion—seems highly implausible.

But for the sake of argument, let’s entertain the idea. Even assuming a focus on alienation represents a workable method of constitutional adjudication, the argument derived from political divisiveness is at best indeterminate when applied to cost-shifting accommodations. Indeed, there is good reason to think it cuts in favor of such accommodations, not against them.

Critics emphasizing “religious stratification” or “unequal citizenship” highlight the perspective of a private party who bears some cost as a result of an accommodation.\textsuperscript{102} But why should we privilege that perspective? As already noted, in the post–New Deal world, government can and does redistribute costs to accommodate a variety of important interests: pregnancy, disability, and many others. And judged against this backdrop, the idea that it may never offer such protections to religious interests solely because they are religious does not avoid division. It

\textsuperscript{100} See, for example, Andrew Koppelman, Defending American Religious Neutrality 47 (Harvard 2013) (critiquing this version of the endorsement test on the grounds that “political division is an unavoidable part of life in a democracy”). See also Richard W. Garnett, Religion, Division, and the First Amendment, 94 Georgetown L J 1667, 1723–24 (2006) (providing the canonical version of this critique).

\textsuperscript{101} See School District of Abington Township v Schempp, 374 US 203, 223 (1963); Engel v Vitale, 370 US 421, 424 (1962). For a critique of the Court’s School Prayer Cases along these lines, see Steven D. Smith, The Rise and Decline of American Religious Freedom 131 (Harvard 2014) (observing that prohibiting school prayer necessarily “reject[ed] the views of citizens who believe on religious grounds that school prayer is desirable or obligatory”). There is no doubt that Justice O’Connor’s endorsement test condemns laws that alienate religious adherents just as much as those that alienate nonadherents. See Lynch, 465 US at 688 (O’Connor concurring) (noting that the test condemns “government endorsement or disapproval of religion”) (emphasis added).

\textsuperscript{102} See, for example, Tebbe, Religious Freedom in an Egalitarian Age at 54 (cited in note 23).
exacerbates it. Justice William Brennan memorably observed that “[t]he Establishment Clause does not license government to treat religion and those who teach or practice it, simply by virtue of their status as such, as subversive of American ideals and therefore subject to unique disabilities.”\textsuperscript{103} Singling out religion for special exclusion might strike some as enforcing equality. But it could just as well be—and increasingly is—considered evidence of outright hostility.\textsuperscript{104} Moreover, religious accommodation itself is designed to reduce social conflict by defusing clashes between government regulation and religious practice in situations in which the government’s interests can yield. To the extent that the church-tax analogy depends on arguments about “divisiveness” or “stratification,” it is a weak reason for revolutionizing our law.

\textbf{B. The Court’s Precedent}

There are good reasons to question whether the third-party thesis rests on a sound Establishment Clause theory. But even setting that point aside, it still remains to be seen whether the thesis is viable under the Court’s precedent.

Proponents of the third-party thesis rely primarily on two precedents as the basis for their theory. The first is \textit{Estate of Thornton v Caldor}.\textsuperscript{105} In \textit{Caldor}, the Supreme Court struck down a Connecticut law declaring that no employee could be required to work on a day that her religious tradition observed as a Sabbath.\textsuperscript{106} Writing for the Court, Chief Justice Warren Burger concluded that the law violated the Establishment Clause because of its “unyielding weighting in favor of Sabbath observers.”\textsuperscript{107} According to Chief Justice Burger, the statute improperly mandated that “Sabbath religious concerns automatically

\begin{footnotesize}
\textsuperscript{103} McDaniel, 435 US at 641 (Brennan concurring in the judgment).
\textsuperscript{104} See, for example, \textit{Trinity Lutheran Church of Columbia, Inc v Comer}, 137 S Ct 2012, 2025 (2017) (concluding that excluding a church from “a public benefit for which it is otherwise qualified, solely because it is a church, is odious to our Constitution . . . and cannot stand”). See also id at 2027 (Breyer concurring) (explaining that the Constitution forbids government from excluding churches from “participation in a general program designed to secure or to improve the health and safety of children” when “[t]he sole reason [ ] that explains the difference is faith”).
\textsuperscript{105} 472 US 703 (1985).
\textsuperscript{106} Id at 710–11.
\textsuperscript{107} Id at 710.
\end{footnotesize}
control over all secular interests” and risked placing “significant burdens” on employers and other employees.108

The second precedent is *Cutter v Wilkinson*.109 In *Cutter*, the Court unanimously concluded that RLUIPA, the accommodation applying to prisons,110 was permissible under the Establishment Clause. The Court reiterated its broad view that “government [may] accommodate religion beyond free exercise requirements, without offense to the Establishment Clause.”111 In so holding, the Court reasoned that RLUIPA complied with the Establishment Clause in part because the statute requires courts to “take adequate account of the burdens a[n] [ ] accommodation may impose on nonbeneficiaries.”112 Citing *Caldor*, the Court declared that “an accommodation must be measured so that it does not override other significant interests.”113

As should be apparent, *Caldor* and *Cutter* fall far short of offering an unambiguous pronouncement on the meaning of the Establishment Clause, much less a declaration about third-party harm as a core principle. But proponents of the thesis have offered three criteria to transform the language of these cases into a workable Establishment Clause test.

First, they insist that the Establishment Clause is violated only when an accommodation “shift[s] meaningful harms to identifiable others” as opposed to merely creating a cost for the public at large.114 So, for example, an accommodation for Sabbath observers that requires the government to pay additional unemployment benefits would not violate the Establishment Clause, but one that required specific employers to incur the same cost would. Let’s call this the *redistribution requirement*.

Second, they assert that their Establishment Clause limit does not apply when “a preexisting burden on third parties [i]s marginally increased” as a result of an accommodation.115 So, for example, although draft exemptions for religious objectors have

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108 Id at 709–10.
110 See text accompanying note 59–60.
111 *Cutter*, 544 US at 713.
112 Id at 720.
113 Id at 722, citing *Caldor*, 472 US at 709–10.
sometimes been thought to impose significant burdens on others, supporters of the third-party thesis reject this argument because “all potential draftees were already subject to a substantial risk of being drafted,” and the causal connection between exempting one person and drafting another is simply too attenuated.\textsuperscript{116} Let’s call this the \textit{causation requirement}. Third, supporters of the thesis argue that their Establishment Clause rule does not apply when costs or burdens on others fall below a minimal threshold. Some claim that the Establishment Clause prohibits any accommodation that imposes a “material” burden on others, meaning a burden that is “relevant to [...] decisions about how to act in some relevant way.”\textsuperscript{117} Others insist that the proper inquiry is whether an accommodation imposes an “undue hardship” on others, by which they mean a burden that is “more than [...] de minimis.”\textsuperscript{118} In either case, the point is the same: the Establishment Clause is triggered only when the burdens shifted to others cross a fairly low bar. Let’s call this the \textit{weightiness requirement}. Notwithstanding some conceptual overlap, these three requirements offer an elegant way of operationalizing the Court’s rather opaque language in cases like \textit{Caldor} and \textit{Cutter}. Yet on further examination, they also reveal significant problems with the third-party thesis. Indeed, it is difficult to avoid the conclusion that, if the third-party thesis is right, several of the Court’s most celebrated religious liberty cases are almost surely wrong.

1. The religious institution cases.

To begin, consider \textit{Corporation of Presiding Bishop of Church of Jesus Christ of Latter-Day Saints v Amos}.\textsuperscript{119} In \textit{Amos}, the Court unanimously concluded that Title VII’s exemption allowing religious organizations to hire only members of their own religion was permissible under the Establishment Clause.\textsuperscript{120} In


\textsuperscript{117} Gedicks and Van Tassell, 49 Harv CR–CL L Rev at 366 (cited in note 23).


\textsuperscript{119} 483 US 327 (1987).

\textsuperscript{120} Id at 339–40.
doing so, the Court squarely rejected the claim of a plaintiff who claimed that the exemption forced him to choose between “conforming to certain religious tenets or losing a job opportunity.”\textsuperscript{121}

If any case implicated the third-party thesis, \textit{Amos} was it. The situation in \textit{Amos} met the redistribution requirement because the cost of the accommodation was borne directly by the terminated employee. It satisfied the causation requirement because the exemption clearly placed a new burden on the employee by depriving him of an otherwise available statutory protection. And the facts of \textit{Amos} met the weightiness requirement because the cost to the employee as a result of the exemption was more than de minimis. Yet the Court explicitly rejected the Establishment Clause challenge. If the third-party thesis is right, \textit{Amos} is almost surely wrong.

An even more difficult version of the problem arises when one considers \textit{Hosanna-Tabor Lutheran Church & School v Equal Employment Opportunity Commission}.\textsuperscript{122} In \textit{Hosanna-Tabor}, a teacher at a church-affiliated school brought a discrimination lawsuit after the school dismissed her, claiming she was fired because of a medical condition. The Court unanimously rejected the teacher’s claim by applying what is known as the “ministerial exception,” a constitutionally mandated exemption that bars discrimination lawsuits relating to the hiring and firing of a religious organization’s leaders.\textsuperscript{123} In rejecting the teacher’s claim, the Court held that the ministerial exception is required under both Religion Clauses whenever a law creates “government interference with an internal church decision that affects the faith and mission of the church.”\textsuperscript{124}

Like \textit{Amos}, \textit{Hosanna-Tabor} falls squarely within the third-party thesis. The redistribution requirement was satisfied because the cost of the exemption was borne by the teacher whose discrimination claim was rejected. Moreover, there was no problem satisfying either the causation requirement or the weightiness requirement. On any reading of the case, the ministerial exception deprived the teacher of the right to prove she was discriminated against, and the cost to her financial and reputational interests was significant. Yet in \textit{Hosanna-Tabor}, the Court

\textsuperscript{121} Id at 340 (Brennan concurring in the judgment).
\textsuperscript{122} 565 US 171 (2012).
\textsuperscript{123} Id at 188–89.
\textsuperscript{124} Id at 190.
didn’t ignore the Establishment Clause. It unanimously declared that the Establishment Clause commanded this result.

Proponents of the third-party thesis have tried to explain these inconsistencies away. But their explanations are unconvincing. For instance, some argue that Amos is an “exception” to the third-party thesis that was justified by the need to protect “the church’s associational rights.” But the whole point of the Establishment Clause challenge in Amos was that the exemption went far beyond any association-based rationale—after all, the plaintiff was a janitor at the church-affiliated gym, not a religious leader. Likewise, others have suggested that Amos is consistent with the third-party thesis because it rests on a church autonomy right growing out of, but not mandated by, either the Free Exercise Clause or the Establishment Clause. But if the accommodation in Amos was not required by the Constitution, it is very difficult to see why an appeal to free exercise or nonestablishment “interests” should trump an actual Establishment Clause rule against third-party harm.

The explanations for Hosanna-Tabor are even less satisfying. Some proponents of the theory argue that the third-party thesis did not apply in that case because the result in Hosanna-Tabor was mandated by the Constitution, and “[i]t would make little sense to find that the affirmative command of the Free Exercise Clause facially violates the negative prohibition of the Establishment Clause.” But the fact that the thesis leads to a clash between the Religion Clauses is not a reason to apply one clause rather than the other. On the contrary, it is strong evidence that this interpretation of the Establishment Clause is likely incorrect. Perhaps recognizing this problem, others have

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125 Tebbe, Religious Freedom in an Egalitarian Age at 56–57 (cited in note 23). See also Gedicks and Van Tassell, 49 Harv CR–CL L Rev at 370–71 (cited in note 23) (arguing that Amos “gave [] religious nonprofit organizations the same right held by secular cause-based nonprofits to discriminate in favor of employees who affirm and live according to the principles on which the organization is founded”).

126 See Boy Scouts of America v Dale, 530 US 640, 648 (2000) (observing that an expressive association has the right to resist forced inclusion of an unwanted person but only if “the presence of that person affects in a significant way the group’s ability to advocate public or private viewpoints”). For an interesting take on the complicated relationships between religious organizations and nonadherents, especially in the context of providing social services, see generally Thomas C. Berg, Partially Acculturated Religious Activity: A Case for Accommodating Religious Nonprofits, 91 Notre Dame L Rev 1341 (2016).


128 Id at 356. See also id at 368 n 118 (noting that Hosanna-Tabor is a “mandatory accommodation”).
suggested that Hosanna-Tabor’s violation of the third-party thesis was justified by the church’s overriding interest in freedom of association, much like the argument about Amos. But as even proponents of that view acknowledge, the Court in Hosanna-Tabor explicitly rejected the association rationale as the basis for its decision. What is more, the Court unanimously held that its decision was commanded by the Establishment Clause. Thus, we are left mostly where we started. If the third-party thesis is right, the Court’s unanimous decisions in both Amos and Hosanna-Tabor must be wrong.

2. The religious conduct cases.

The third-party thesis also faces significant difficulties when compared to the Court’s cases involving accommodations for religious conduct. Here, a good starting place is Wisconsin v Yoder, one of the Court’s most celebrated free exercise cases. In Yoder, the Court held that the Free Exercise Clause required an exemption for Amish parents from laws requiring that children attend school until the age of sixteen. In ruling in favor of the religious claimants, the Court acknowledged that accommodations may at times be limited by the Establishment Clause. Yet the Court was adamant that “[such] danger cannot be allowed to prevent any exception no matter how vital it may be to . . . the right of free exercise.”

Supporters of the third-party thesis contend that their rule did not apply in Yoder because the causation requirement was not satisfied: the Court found that it was “highly speculative” that the exemption would leave children “ill-equipped for life.” But focusing on that language diverts attention from the more obvious cost-shifting that Yoder presented. As the Court observed, the mandatory school attendance regime was clearly designed to protect children and their “substantive right . . . to a

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129 Tebbe, Religious Freedom in an Egalitarian Age at 57 (cited in note 23).
130 See Hosanna-Tabor, 565 US at 189 (2012) (stating that the association rationale is “hard to square with the text of the First Amendment itself, which gives special solicitude to the rights of religious organizations”). See also Tebbe, Religious Freedom in an Egalitarian Age at 86 n 10 (cited in note 23).
132 See id at 220–21.
133 Id at 221.
134 Id at 224. See also Nelson Tebbe, Richard Schragger, and Micah Schwartzman, Reply to McConnell on Hobby Lobby and the Establishment Clause (Balkinization, Mar 30, 2014), archived at http://perma.cc/K4CE-T9GX.
secondary education.” Yet the Court did not view deprivation of this right as a reason to deny the exemption. On the contrary, the Court silently accepted that its ruling might well deny schooling to an unwilling child, but nonetheless concluded that the exemption was appropriate because it did not present “any harm to the physical or mental health of the child or to the public safety” sufficient to constitute a compelling interest. Once again, if the third-party thesis is right, Yoder seems to be wrong.

There is also a deeper sense in which the Court’s religious conduct cases present significant difficulties for the third-party thesis. Recall that, under the redistribution requirement, there is a firm distinction between accommodations that shift costs to discrete private parties and those that merely impose a cost on the government or the public at large. But as we have already seen, the primary Establishment Clause theory supporting the thesis involves an analogy to church taxes: accommodations that shift costs to others violate the Establishment Clause because they function like taxes requiring one person to pay for another person’s religion. Yet if the problem with cost-shifting accommodations is that they function like religious taxes, it is difficult to see why accommodations using actual tax dollars are acceptable but those that incidentally generate costs for some smaller group are not.

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135 Yoder, 406 US at 229.
136 Id at 230. In holding as much, the Court noted that only one of the three children involved in the case provided any testimony as to whether she shared her parents’ convictions. See id at 231 n 21; id at 237 (Stewart concurring).
137 See Part II.A.
138 Supporters of the third-party thesis argue in favor of the distinction by insisting that the Establishment Clause is not implicated when the costs of an accommodation are “widely distributed among a large and indeterminate class.” Gedicks and Koppelman, 67 Vand L Rev En Banc at 56 (cited in note 114). See also Schwartzman, Tebbe, and Schragger, 106 Ky L J at 786 (cited in note 83) (arguing that there is a firm distinction between “[g]overnment tax[ing] the public to provide kosher meals to Jewish inmates” and “[g]overnment tax[ing] nonreligious inmates to provide kosher meals to Jewish inmates”). But given their underlying theory, it is difficult to see why that matters. After all, Madison famously suggested that being forced to pay even “three pence” was just as objectionable as any other form of establishment. Madison, Memorial and Remonstrance at 57 (cited in note 79). As already noted, Madison’s argument is best understood as insisting that forced religious observances (even trivial ones) are odious to religious freedom. See notes 80–81 and accompanying text. But proponents of the third-party thesis read arguments like Madison’s as condemning all forms of unwilling support for religion. And if that is so, there seems little reason to think the objection dissipates because the cost to any particular citizen is minimal.

What is more, there is good reason to think that the distinction between accommodations involving general taxes and those involving targeted costs is itself largely illusory.
Of course, the most obvious way to address this difficulty would be to widen the third-party thesis to prohibit any accommodation that generates costs, no matter who bears them. The moment we do so, however, an even larger number of the Court’s religious conduct precedents become inexplicable. The Court has repeatedly upheld religious accommodations that involve state benefits despite the fact that they cost taxpayers money.\textsuperscript{139} It has endorsed accommodations that use tax dollars to provide kosher meals for inmates and provide chaplains for members of the military.\textsuperscript{140} And most recently, it has said that the government can pay for medical benefits like contraception when religious employers are exempted from doing so.\textsuperscript{141} Yet the third-party thesis would seem to imply that all those cases were also wrongly decided, or at least rest on dubious grounds.

A similar problem plagues the causation requirement. Remember that, under this requirement, a religious accommodation does not violate the Establishment Clause unless it imposes a \textit{new} burden (as opposed to a nontraceable increase in some existing burden). Proponents of the thesis have used this


\textsuperscript{140} See \textit{Cutter}, 544 US at 721 & n 10 (2005) (acknowledging that RLUIPA would likely require religiously compliant meals and indicating that such accommodations are appropriate). See also id at 722 (noting and praising the Army chaplaincy program). For an insightful discussion on this point, see Christopher C. Lund, \textit{Religious Exemptions, Third-Party Harms, and the False Analogy to Church Taxes}, 106 Ky L J 679, 681–82 (2017–2018).

\textsuperscript{141} \textit{Hobby Lobby}, 134 S Ct at 2781–82.
requirement to explain why draft exemptions from military service fit their rule: because individuals can’t draw a clear causal link between exempting a particular conscientious objector and being drafted themselves, the third-party thesis doesn’t apply. But this explanation is also illusory. As Professor William Marshall has shown, in modern draft lotteries like those used during the Vietnam War, we actually can draw a line between particular draftees and particular objectors.\textsuperscript{142} And in response, supporters of the thesis have quietly hinted that, under their rule, conscientious exemptions from military service (religious as well as secular) very likely violate the Establishment Clause as well.\textsuperscript{143} So the Court’s famous Draft Cases\textsuperscript{144} also appear to be wrongly decided. But more than this: the venerable practice of granting exemptions from military service that existed at the Founding and has continued throughout the country’s history has likely been unconstitutional all along.

There is a pattern here. Supporters of the third-party thesis claim the theory is consistent with the Court’s precedents. But on closer inspection, that claim—like the theoretical justification—falls short. To be sure, there is a sense in which the costs of accommodations are relevant to assessing their constitutionality, as I explain in more detail below.\textsuperscript{145} To make sense of the problem, however, we need to start in a different place.

III. LIMITING RELIGIOUS ACCOMMODATION

Neither constitutional principle nor the Supreme Court’s precedent supports the idea that religious accommodations violate the Establishment Clause because they generate costs. This is not to say, however, that the Establishment Clause has nothing to say about accommodations that impact others. On the

\textsuperscript{142} As Marshall explains, the lottery system involved assigning numbers seriatim to potential draftees, who were then drafted in numerical order until the government’s manpower needs were satisfied. Thus, exempting religious objectors with low numbers from combat service necessarily meant that some individuals with higher numbers would not have been called but for the exemptions. For more explanation on this point, see William P. Marshall, Third-Party Burdens and Conscientious Objection to War, 106 Ky L J 685, 706 (2017–2018).

\textsuperscript{143} See, for example, Schwartzman, Tebbe, and Schragger, 106 Ky L J at 805 (cited in note 83) (“[T]o the extent conscientious objectors to military service impose harms on identifiable third parties, others can rightfully complain about the fairness of having to carry those burdens.”).


\textsuperscript{145} See Part IV.A.
contrary, the Establishment Clause is deeply concerned with certain kinds of costs associated with accommodation—most fundamentally, those that play a role in fostering religious conformity. This Part explains that limitation first by discussing some general Establishment Clause doctrine, then by exploring several important incidents from Founding-era history involving the connection between accommodations and religious establishments. Having done so, it turns finally to a more detailed discussion of the Court’s precedents.

A. Against Religious Conformity

The word “establishment” implies social control. When people speak about the “literary establishment,” the “political establishment,” or even just “the establishment,” they mean not just that a group holds power but also that its power has a role in shaping the behavior of others. And whether the relevant orthodoxy involves social niceties, artistic conventions, or political opinions, all establishments do the same thing. They pressure people to conform.

This concern over social control—and especially government-induced conformity—was prominent in Founding-era descriptions of religious establishment. For instance, Baptist minister John Leland, one of the most important supporters of the Religion Clauses in James Madison’s home state of Virginia, observed that the aim of religious establishment is to “establish some standard of orthodoxy, to effect uniformity.”146 As Leland described it: “Uninspired, fallible men make their own opinions tests of orthodoxy, and use their own systems, as Pocrustes used his iron bedstead, to stretch and measure the consciences of all others by.”147

Others echoed the same point. In his famous statute for religious freedom, Thomas Jefferson complained that establishments stem from “the impious presumption of legislators,” who “set[,] up their own opinions and modes of thinking as the only true and infallible, and as such endeavoring to impose them on others.”148 Moreover, Jefferson made clear that his concern involved not just punishments but also government’s efforts to

147 Id at 182.
promote a favored religion by “bribing, with a monopoly of worldly honours and emoluments, those who will externally profess and conform to it.”

The emphasis on social control was also a central theme unifying the historical practices associated with religious establishments. As several scholars have observed, these practices—began in England and often carried over to the American context—including governmental control over religious doctrine, mandatory attendance at worship services, limitations on the religious activities of dissenters, public financial support for favored churches, and religious limitations on eligibility for office and participation in public life. The shape of these practices and their administration differed from colony to colony and also changed over time as Americans wrestled over the meaning of “establishment” and expanded rights for religious dissenters. But despite differences in application, it seems clear that these practices all aimed at “government control over religion” and, more specifically, “the promotion and inculcation of a common set of beliefs through government authority.” When rulers wanted to control their subjects, controlling the religious beliefs of the populace was—and continues to be—a powerful tool.

The same worry about government-induced conformity was also a primary motivating force behind the adoption of the Establishment Clause specifically. Many Anti-Federalists worried that, given the scope of the national government’s powers, Congress might, “if they shall think it for the ‘general welfare,’ establish an uniformity in religion throughout the United States.” Thus, when explaining the draft that eventually

149 Id at 546.
151 For one important account of these changes, see generally Thomas J. Curry, The First Freedoms: Church and State in America to the Passage of the First Amendment (Oxford 1986). See also Noah Feldman, The Intellectual Origins of the Establishment Clause, 77 NYU L Rev 346, 398–405 (2002) (exploring differences in colonial practice but emphasizing a common concern with liberty of conscience).
152 McConnell, 44 Wm & Mary L Rev at 2207, 2131 (cited in note 150).
153 Essay by Deliberator, Philadelphia Freeman’s Journal (Feb 20, 1788), reprinted in Herbert J. Storing, ed, 3 The Complete Anti-Federalist 176, 179 (Chicago 1981). For a discussion of Anti-Federalist arguments along this line and their relation to other arguments against the Constitution, see Vincent Phillip Muñoz, The Original Meaning of the
became the Religion Clauses, Madison stated that he believed the addition to the Constitution was necessary because “people feared one sect might obtain a pre-eminence, or two combine together, and establish a religion to which they would compel others to conform.” From the first, the Establishment Clause was understood as a limit on government’s ability to control the religious lives of its citizens.

But concern over government-induced religious conformity is not just a historical artifact. It has also been a prominent theme in the Court’s modern Establishment Clause jurisprudence. In the School Prayer Cases, for instance, the Court famously concluded that the Establishment Clause forbids government-initiated religious exercises in public schools. In so holding, the Court announced that the Establishment Clause prohibits government from exerting “indirect coercive pressure upon religious minorities to conform to the prevailing officially approved religion.” As Justice Brennan explained it, “[T]he Establishment Clause permits little doubt that its prohibition was designed comprehensively to prevent those official involvements of religion which would tend to foster . . . religious worship or belief.”

A similar theme condemning attempts to foster religious conformity runs through the Court’s cases regarding funding for religious institutions. In Zelman v Simmons-Harris, the Court made plain that government may choose to fund religious

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154 Annals of Congress 758 (Aug 15, 1789). Two printings exist of the first two volumes of the Annals of Congress. The first printing with the running head “History of Congress” conforms to the remaining volumes of the series, while the second printing with the running head “Gales & Seaton’s history of debates in Congress” is unique. See Checklist of United States Public Documents 1789–1909 1463 (Government Printing Office 3d ed 1911). All page citations herein are to the latter printing. Readers with the “History of Congress” printing can find parallel citations by referring to the date.

155 In this sense, the focus of the Establishment Clause has always been about limiting government power, not securing individual rights. See Carl H. Esbeck, The Establishment Clause as a Structural Restraint on Government Power, 84 Iowa L Rev 1, 3 (1998) (explaining that the Establishment Clause, like other structural provisions in the Constitution, protects rights by “constraining the . . . government to act only within the scope of [its] delegated powers”).


157 Schempp, 374 US at 234 (Brennan concurring).

schools alongside others without violating the Establishment Clause. Central to that holding, however, was the Court’s caveat that such programs must not “deliberately skew incentives” in favor of religious schools. While programs of “true private choice” are acceptable under the Establishment Clause, programs that are gerrymandered to encourage the state’s preferred religious activity are not.

Likewise, although the Court’s cases involving displays of religious symbols are often confused, they also can be read to follow the same pattern. Indeed, the recurring element in all these cases seems to be whether the “context of the display” indicates a “governmental effort substantially to promote religion.” To be sure, the justices do not agree as to what the relevant baseline should be. But whether it involves past historical practice, “ceremonial deism,” or a general version of the endorsement test, the limit seems to be the same: government may sometimes speak in ways that include religion, but it may not “proselytize on behalf of a particular religion.”

Given all of this, it should be no surprise that the Court has said that there is “ample room” for religious accommodation under the Establishment Clause. The reason is simple: accommodations almost always weaken, rather than strengthen, the power of the state to foster religious uniformity. Indeed, it is no exaggeration to say that, as a practice, accommodation stands in direct opposition to religious establishment. Whereas establishments exist to encourage the state’s preferred religion, accommodations preserve free exercise by minimizing the government’s power over religious activity.

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160 Id at 653.
161 Id at 650.
162 Id at 649.
163 Van Orden v Perry, 545 US 677, 701, 703 (2005) (Breyer concurring in the judgment).
164 See McCreary County v American Civil Liberties Union of Kentucky, 545 US 844, 894 (2005) (Scalia dissenting) (arguing that “[h]istorical practices” demonstrate that “there is a distance between the acknowledgment of a single Creator and the establishment of a religion”).
166 See, for example, Lynch v Donnelly, 465 US 668, 687–94 (1984) (O’Connor concurring) (explaining this approach).
167 County of Allegheny v American Civil Liberties Union Greater Pittsburgh Chapter, 492 US 573, 661 (1989) (Kennedy concurring in part and dissenting in part).
168 Amos, 483 US at 334.
That theme is also consistent with history. The earliest religious accommodations provided exemptions from state-sponsored worship.\(^{169}\) Those exemptions left dissenters free to practice their religion. But they also limited the ability of government to manage dissemination of religious ideas. Likewise, accommodations from oath requirements during the Founding period ensured that citizens with religious objections could still testify in court or hold public office.\(^{170}\) But more basically, they prevented government from cooperating with an established church to exclude religious minorities from political life. Even exemptions from militia service shored up the idea that, as Congress put it, government had the right to demand from its citizens only forms of service “consistent[ ] with their religious principles.”\(^{171}\) From the beginning, religious accommodation—like disestablishment—weakened the state’s power to promote a favored orthodoxy or link religious membership to political power.

But what about instances in which the relationship between accommodation and government-induced religious conformity was more complicated? Generally, commentators besides those advocating for the third-party thesis have focused on the fact that accommodations were “never part of the establishment.”\(^{172}\) But that emphasis has neglected an important subsidiary point: members of the Founding generation did equate accommodations with establishments on at least two occasions, both of which involved situations in which an accommodation risked promoting rather than discouraging religious conformity. My contention is that, although these historical incidents fall short of providing conclusive proof of the original meaning of the Establishment Clause, they nonetheless offer significant insight into how religious accommodations should be limited under the clause today.

\(^{169}\) See Laycock, 81 Notre Dame L Rev at 1803–04 (cited in note 150) (discussing these exemptions).

\(^{170}\) See McConnell, 103 Harv L Rev at 1467–68 (cited in note 1) (discussing these exemptions); Laycock, 81 Notre Dame L Rev at 1804–05 (cited in note 150) (same).


\(^{172}\) See, for example, Laycock, 81 Notre Dame L Rev at 1803 (cited in note 150). See also McConnell, 103 Harv L Rev at 1511 (cited in note 1) (suggesting that “[t]here is no substantial evidence that […] exemptions were considered constitutionally questionable […] as a form of establishment”).
1. Virginia’s General Assessment.

The first incident occurred during the debate over Virginia’s General Assessment. As observed in the discussion of the third-party thesis, the assessment was a targeted tax that would have required all citizens of Virginia to support “a Minister or Teacher of the Gospel . . . [or] places of divine worship.” Yet the bill also contained two provisions specifically designed to placate objections from dissenters. First, it provided citizens the right to direct their taxes to a church of their choice or, if no such designation was made, to “seminaries of learning within the Counties.” Second, it provided a specific exemption for Quakers and Mennonites that allowed them to use the funds collected for any purpose, rather than limiting their use to payment of a minister or the maintenance of church buildings.

The assessment drew support from many in Virginia, including George Washington, who favored its goal of “preserving the peace of society” through “the general diffusion of Christian knowledge.” But Madison and Jefferson took a different view. Madison made an impassioned speech to the Virginia legislature at the close of the 1784 session opposing the assessment.

Madison began his Memorial and Remonstrance by rejecting the conclusion of Washington and others that the assessment did not impinge on religious liberty. He first observed that “it is the duty of every man to render to the Creator such homage and such only as he believes to be acceptable to
him,” it is “the right of every man” to exercise religion only as conscience dictates. Madison subsequently argued that the assessment “abridged” that right because it required each citizen to tithe whether such an action was warranted by conscience or not. “Who does not see,” Madison reasoned, “that the same authority which can force a citizen to contribute three pence . . . may force him to conform to any other establishment in all cases whatsoever?”

Yet Madison also went much further. Specifically, he contended that, besides being a forced religious observance, the assessment also “violate[d] that equality which ought to be the basis of every law.” For our purposes, the most important part of that argument was Madison’s claim that the assessment granted “peculiar exemptions.” Madison continued:

Are the Quakers and Menonists the only sects who think a compulsive support of their Religions unnecessary and unwarrantable? Can their piety alone be entrusted with the care of public worship? Ought their Religions to be endowed above all others with extraordinary privileges by which proselytes may be enticed from all others?

Madison ended the argument by pleading with Quakers and Mennonites not to be seduced by the offer of “pre-eminences over their fellow citizens.”

There is little doubt that, by using the language of “pre-eminences” and “extraordinary privileges,” Madison intended to draw an analogy between the accommodation for Quakers and Mennonites and traditional religious establishments. Nonetheless, commentators have generally dismissed this section of the Memorial and Remonstrance as unprincipled political posturing. The reason, so it is said, is that Madison’s argument was disingenuous: Quakers and Mennonites had no formal clergy and thus would have had little use for money to

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179 Id at 56.
180 Id.
181 Id at 57.
182 Madison, Memorial and Remonstrance at 57 (cited in note 79).
183 Id.
184 Id.
185 In so arguing, Madison was explicitly rejecting the assessment’s assertion that it provided support for religion “without counteracting the liberal principle heretofore adopted and intended to be preserved by abolishing all distinctions of preeminence amongst the different societies or communities of Christians.” A Bill Establishing a Provision for Teachers of the Christian Religion at 188 (cited in note 78).
pay a minister. But that dismissal overlooks the crucial way in which Madison thought that accommodations offering “privileges by which proselytes may be enticed” could be analogized to establishments.

The important point concerns the contours of the exemption and its connection to proselytizing. Contrary to arguments by many commentators, the assessment didn’t just excuse Quakers and Mennonites from using tax revenues to pay a minister. It excused them from all limitations imposed on the funds and instead allowed them to use the money “in any manner . . . calculated to promote their particular mode of worship.” That permission had an important consequence. Whereas other religious groups were constrained to use the tax to pay for only internal church functions—clergy salaries or worship spaces—Quakers and Mennonites were free to use the money to actively recruit converts by financing missionary activities, pamphlets, or other forms of proselytizing. In short, the exemption resembled an establishment because it ensured that only those religious groups possessed the “extraordinary privilege[]” of using government money to propagate their message to those outside the faith.

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187 Madison, Memorial and Remonstrance at 57 (cited in note 79).

188 A Bill Establishing a Provision for Teachers of the Christian Religion at 189 (cited in note 78).

189 Madison, Memorial and Remonstrance at 57 (cited in note 79). See also Edward L. Bond, ed, Spreading the Gospel in Colonial Virginia: Sermons and Devotional Writings 27 (Lexington 2004) (noting that Quakers in eighteenth century Virginia were “energetic proselytizers, and they sought to draw converts . . . by distributing Quaker religious tracts to the colony’s many unchurched and underchurched settlers”).

190 The idea that members of the Virginia legislature would want to support Quakers and Mennonites over all other dissenting sects may seem curious. But a possible explanation is deducible from the religious situation in Virginia at the time the assessment was being debated. It was no secret that, like Quakers, Baptists in Virginia vehemently objected to church taxes for ministers. Yet Baptists were also hated by the Virginia gentry. Whereas by the 1780s Quakers had been accepted as a peaceful and industrious people, Baptists were described as “swarms” of gnats and radicals who “cannot meet a man upon the road . . . [without] ram[ming] a text of Scripture down his throat.” See id at 26, 35–36. Nonetheless, Baptists were easily the fastest growing religious group in Virginia. Id at 36. Allowing Quakers and Mennonites to proselytize using government dollars was unlikely to threaten the de facto Anglican establishment in Virginia. But supporters may have thought it could slow the “torrent” of Baptist converts. Id at 36.
To be sure, one might question whether this reading of Madison’s *Memorial and Remonstrance* is just wishful thinking. After all, Madison failed to explain his argument about the exemption for Quakers in any detail, which might suggest the rhetorical interpretation is the right one. But other evidence suggests that the problem is actually historical distance: Madison’s argument sounded much more familiar to his contemporaries than it does to us, making the need for elaboration unnecessary. Throughout the colonies but especially in Virginia, authorities had long limited the spread of disfavored religious ideas by requiring licenses to preach, then granting those licenses only to favored religious groups or using them to limit religious activity.\(^{191}\) And indeed, at least one notable contemporary in Virginia specifically referred to those licenses as “claimable Priviledges,” which were often denied to dissenters on the basis of false pretenses or bare hostility.\(^{192}\) Read against that background, it seems plausible if not likely that Madison’s readers would have understood his argument in a similar way. An exemption from the general assessment for Quakers and Mennonites might look like a reasonable accommodation. But in fact, it acted just like the licensing regimes of traditional establishments: it leveraged government power to grant special advantages to some kinds of religious messages over others, and by doing so, it increased government’s power over religious life more generally.

Madison ultimately won the debate over Virginia’s General Assessment, though it is impossible to say what role his argument about the exemption played in the victory. Yet its connection to the controversy over preaching licenses suggests that, at the very least, Madison’s argument drew on more general

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\(^{191}\) See McConnell, 44 Wm & Mary L Rev at 2163–66 (cited in note 150) (explaining this practice in Virginia and its impact on religious dissenters); id at 2119 (observing that as late as 1774, Baptist ministers in Virginia “were still being horsewhipped and jailed . . . for preaching without a license”).

\(^{192}\) Letter from Samuel Davies to Joseph Bellamy, *The State of Religion among the Protestant Dissenters in Virginia* (June 28, 1751), online at http://quod.lib.umich.edu/cgi/t/text/text-idx?c=evans;cc=evans;rgn=div1;view=text;idno= N05267.0001.001;node=N05267.0001.001:2 (visited Mar 16, 2019) (Perma archive unavailable) (recounting an instance in which a fellow minister’s request for certification was rejected “under Pretence” and contrasting this with the behavior of other officials who “always discovered a ready Disposition to allow us all claimable Priviledges”). See also Curry, *First Freedoms* at 99–100 (cited in note 151) (explaining Samuel Davies’s important role in challenging the licensing regime for ministers in Virginia).
arguments against religious establishments that were common by the time the Establishment Clause was adopted. Regardless of its precise impact, however, Madison’s argument offers a principle that can be extended beyond its specific historical context: although accommodations generally have little connection to establishment, when an accommodation selectively subsidizes the government’s preferred religious messages, it ought to be considered a pretext for fostering government-induced religious conformity.

Nonetheless, more still needs to be said. For although Madison’s argument offers an important insight, a second historical incident—this one following congressional debate over the Establishment Clause—offers a second significant example of how accommodations might be equated with religious establishments.

2. The Uniform Militia Act.

Leading up to the ratification of the Bill of Rights, Congress considered a religious exemption as part of what we now know as the Second Amendment. It guaranteed that “no person religiously scrupulous shall be compelled to bear arms” and was essentially identical to proposed language Madison had included in his draft bill of rights.\textsuperscript{193} The provision incited vigorous debate but ultimately failed to garner the necessary support.\textsuperscript{194} Commentators have rightly concluded that “[t]here is no hint in this debate of any issue concerning establishment.”\textsuperscript{195} Yet they have quite remarkably ignored the fact that the issue resurfaced again a little over a year later during debates over the Uniform Militia Act.

In its original form, the Uniform Militia Act created a general requirement of militia service among eligible males, but it

\textsuperscript{193} 1 Annals of Congress 778 (Aug 17, 1789). See also id at 451 (June 8, 1789) ("[N]o person religiously scrupulous of bearing arms shall be compelled to render military service in person.").

\textsuperscript{194} Different members opposed the amendment for different reasons, but the predominant reason seems to have been the belief that such an exemption should be left to legislative discretion. For instance, Egbert Benson of New York argued that “the Legislature will always possess humanity enough to indulge this class of citizens in a matter they are so desirous of; but they ought to be left to their discretion.” Id at 780 (Aug 17, 1789). Likewise, Thomas Scott of Pennsylvania suggested that the right to a militia exemption was “a legislative right altogether.” Id at 796 (Aug 20, 1789). See also McConnell, 103 Harv L Rev at 1500–03 (cited in note 1) (summarizing the debate).

\textsuperscript{195} Laycock, 81 Notre Dame L Rev at 1810 (cited in note 150).
provided an exemption for certain classes of citizens if they paid two dollars to the United States in lieu of service. Such monetary penalties were particularly worrisome to Quakers, who appeared in person before Congress and asserted that such payments “manifestly infringe[d] on the rights of conscience.”

Some members of Congress agreed. For instance, Representative Aedanus Burke of South Carolina insisted that it was “not [...] consonant with the principles of justice to make those conscientiously scrupulous of bearing arms to pay for not acting against the voice of their conscience.”

Others were not convinced. Most notably, Representative James Jackson, a hardened veteran of the Revolutionary War and one of the most prominent opponents of the original constitutional exemption, contended that if exemptions without payment were given, “very few would be found, if their own word was to be taken, not conscientiously scrupulous.” And when the bill came before the full House for debate, Jackson continued by offering the following argument:

[T]he operation of this privilege would be to make the whole community turn Quakers; and in this way it would establish the religion of that denomination more effectually than any positive law could any persuasion whatever.

Unlike earlier arguments opposing a constitutional exemption, which relied on claims about fairness or the role of the legislature, Jackson’s argument here explicitly raised a concern about religious establishment. Moreover, given that the argument occurred after the Establishment Clause had been debated in Congress, it seems exceedingly likely that Jackson specifically intended to invoke it. According to Jackson, even if the purpose of the accommodation was to relieve Quakers of the burden involved in either personal service or paying for a substitute, its “operation” would nonetheless create incentives toward religious conformity so overwhelming they ought to be considered an Establishment Clause violation.

Jackson’s argument was met with skepticism. Madison asserted that “[h]e did not believe that the citizens of the United

196 Nicholas Waln, An Address and Memorial (1790), reprinted in David M. Gross, ed, American Quaker War Tax Resistance 221, 222 (Gross 2011).
197 2 Annals of Congress 1865 (Dec 21, 1790).
198 Id.
199 Id at 1869 (Dec 22, 1790).
States would hypocritically renounce their principles, their conscience, and their God, for the sake of enjoying the exemption.\textsuperscript{200} He also moved to insert a religious exemption for those refusing to bear arms and indicated he also supported exempting Quakers from payments.\textsuperscript{201} Jackson responded that Madison “had not argued with his usual ingenuity and knowledge of the human heart.”\textsuperscript{202} According to Jackson, “The influence of conscience [was] a weak defence against the powerful temptations of pecuniary advantages,” and exempting Quakers from both militia service and monetary payment would render Quaker converts “ten times as numerous” as they otherwise would be.\textsuperscript{203}

Proponents of the exemption did not reject Jackson’s premise that the incentives of an unqualified exemption might sound in religious establishment. Instead, they sought to answer Jackson by blunting the inducements toward religious conformity. For instance, one of the most outspoken supporters of the exemption, Representative Roger Sherman of Connecticut, agreed with Madison that many Quakers would never submit to a fine. Yet in an apparent attempt to address Jackson’s concerns, Sherman cleverly suggested that perhaps Congress could “excus[e] part of the militia from a poll tax, so as to equalize the exemption.”\textsuperscript{204} Moreover, the following day, Madison himself offered a revised proposal that provided an exemption for religious objectors who declared their sincerity before the civil magistrate, with the caveat that such objectors would “be liable to a penalty of ___ dollars, to be appropriated as the moneys arising from the post-office are appropriated.”\textsuperscript{205} By requiring a declaration as well as a monetary penalty, it seems clear that Madison’s proposal aimed to address Jackson’s concern that citizens might feign Quakerism to benefit from an unqualified militia exemption. At the same time, by declaring that the money from the penalty “be appropriated as the moneys arising from the post-office are appropriated,” Madison sought to alleviate Quaker concerns at least in part by ensuring that no money paid by objectors would be used to fund the militia.\textsuperscript{206}

\textsuperscript{200} Id at 1872.
\textsuperscript{201} Id at 1872.
\textsuperscript{202} 2 Annals of Congress 1871 (Dec 22, 1790).
\textsuperscript{203} Id.
\textsuperscript{204} Id.
\textsuperscript{205} 2 Annals of Congress at 1874 (Dec 23, 1790).
\textsuperscript{206} Revenues generated from the post office were used to maintain the postal service and pay the relevant officials. See An Act for the Temporary Establishment of the
Ultimately, Congress elected to leave the matter of religious exemptions from militia service to the discretion of the states. Nonetheless, the debate over the Uniform Militia Act is highly suggestive—it indicates that the Establishment Clause may well be implicated by accommodations that encourage religious conformity by offering incentives to adopt the accommodated religion. What is more, it also offers several clues as to how such a rule might function in practice.

Consider first the question of the baseline against which incentives should be measured. In making the argument that an exemption without requiring payment could be analogized to a religious establishment, Jackson argued that the law would have the effect of inducing others to convert to Quakerism “more effectually than any positive law could any persuasion whatever.” As such, the argument was not simply that the exemption provided a modest benefit to religious dissenters. Instead, Jackson’s argument turned on the fact that the combination of avoiding military service and avoiding payment created an incentive so powerful that it was indistinguishable from “positive law[s]” associated with establishments—laws that, in Justice Antonin Scalia’s words, were characterized by “coercion under threat of penalty.” Generalizing the point, we might conclude that the Establishment Clause should not be understood as viewing every benefit accompanying an accommodation as raising constitutional concerns. Instead, the Establishment Clause is concerned only with accommodations whose likely effects on nonbeneficiaries are so pronounced that they are equivalent to coercive laws in their power to generate religious conformity.

Second, the debate surrounding the Uniform Militia Act suggests that, when the concern over an accommodation involves incentivizing religious conformity, the appropriate remedy is often to dissipate the incentive. Although Jackson

Post-Office, 1 Stat 70 (1789) (directing that regulations governing the post office be the same as they were under the Continental Congress); US Art of Confederation Art IX (declaring that postage on papers passing through the post offices be calibrated to “defray the expences of the said office”).

207 Id at 1875 (Dec 24, 1790). And indeed, a similar debate over militia exemptions for religious objectors had already been taking place in the states and continued contemporaneous with the debate in Congress. See Laycock, 81 Notre Dame L Rev at 1810–25 (cited in note 150) (documenting the debate in Pennsylvania).

208 2 Annals of Congress 1869 (Dec 22, 1790).

believed that the incentives created by an unqualified militia exemption could be equated with religious establishment, he did not believe that this problem rendered any exemption unconstitutional. Instead, he argued that those who are exempted “ought to pay a full equivalent”—a solution that Jackson argued accorded with “every principle of justice and equity” and blunted the problem of incentives.\footnote{210}

Commentators have overlooked the debate over the Uniform Militia Act when considering the relationship between religious accommodations and the Establishment Clause. But taken seriously, it adds a second principle to the one identified in Madison’s \textit{Memorial and Remonstrance}: when an accommodation provides an exceedingly powerful incentive to adopt the religion being accommodated, it can rightly be analogized to a religious establishment.

\textbf{B. Modern Doctrine}

The arguments surrounding Virginia’s General Assessment and the Uniform Militia Act by themselves do not offer conclusive proof of the Establishment Clause’s original public meaning. But they are some of the most important instances—to my knowledge, the only instances—in which members of the Founding generation directly equated accommodations with religious establishments. Thus, if one is inclined to seek evidence of original meaning on the question of accommodation and establishment, these incidents are some of the most important evidence we possess.\footnote{211} But that is not all.

\footnote{210} 2 Annals of Congress 1870 (Dec 22, 1790).
\footnote{211} To be sure, some originalists will question my use of these historical sources on the ground that any limits imposed by the Establishment Clause originally applied only to the federal government, not state legislatures. See, for example, Steven D. Smith, \textit{The Jurisdictional Establishment Clause: A Reappraisal}, 81 Notre Dame L Rev 1843, 1849–50 (2006) (emphasizing this point); Akhil Reed Amar, \textit{The Bill of Rights: Creation and Reconstruction} 34–45 (Yale 1998) (same); \textit{Elk Grove}, 542 US at 50 (Thomas concurring) (arguing that “the Establishment Clause is best understood as a federalism provision—it protects state establishments from federal interference but does not protect any individual right”). Yet there several reasons to believe that my proposal is fully compatible with an original public meaning approach to the Establishment Clause. First, although the Founding generation very likely understood the Establishment Clause as applying only to the federal government, the historical evidence is clear that the clause was more than just a protection for state establishments. On the contrary, as Professor Donald Drakeman has persuasively shown, whatever else the clause accomplished, it provided a substantive limit: Congress could not establish a national religion or a national church. See Donald L. Drakeman, \textit{Church, State, and Original Intent} 229–49 (Cambridge 2010). And the historical evidence—especially the debate in the first Congress over the Uniform
The Supreme Court has said that, although accommodations are generally permissible under the Establishment Clause, they must not “devolve into ‘an unlawful fostering of religion.’” But the Court has not been clear about how that line ought to be drawn. My claim is that the principles drawn from Madison’s and Jackson’s arguments offer attractive rules for implementing that limit and a more convincing way of reading the Court’s cases than an approach that foregrounds third-party harm.

1. Selective subsidies for favored religious messages.

Let’s begin with the principle, drawn from Madison’s Memorial and Remonstrance, that government may not foster religious conformity by using religious accommodations to selectively subsidize its favored religious messages. Although the Court has not explicitly relied on Madison’s argument in its case law, that argument nonetheless provides an attractive principle for organizing several of the Court’s cases.

In Texas Monthly, Inc v Bullock, for instance, the Supreme Court held that a law providing sales tax exemptions for religious publications violated the Establishment Clause. Writing for three members of the Court, Justice Brennan attempted to argue that the accommodation violated the Establishment Clause by “increasing the[] tax bills” of nonqualifying taxpayers in order to subsidize religious publications, thus “burden[ing] nonbeneficiaries markedly.” Yet as even proponents of the third-party thesis concede, the idea that the exemption actually affected anyone’s tax bill is implausible in the extreme. What is more, as we have already observed, the Supreme Court has approved a multitude of religious accommodations that involve taxpayer

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214 Id at 5 (Brennan) (plurality).
215 Id at 15, 18–19 n 8 (Brennan) (plurality).
dollars, many of which almost surely increase costs for a specific subset of individuals.\footnote{217}

But \textit{Texas Monthly} is eminently defensible on other grounds. Texas’s statute explicitly limited the sales tax exemption to “[p]eriodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith.”\footnote{218} That requirement undoubtedly implicated core free speech principles insofar as it authorized government to discriminate between publications on the basis of content.\footnote{219} But as Justice Harry Blackmun and Justice O’Connor correctly sensed but did not correctly explain, the law also worked a freestanding Establishment Clause harm.\footnote{220} By applying the accommodation \textit{only} to writings “promulgating the teaching of [a] faith,”\footnote{221} the law granted an exemption based not on the existence of a religious burden but instead on the \textit{substance} of a specific religious message. And structuring an accommodation that way allows the government to use accommodations to pick and choose the religious messages it favors.

\footnote{217 See notes 139–41. See also Volokh, 46 UCLA L Rev at 1513–14 n 154 (cited in note 138).
219 See id at 25–26 (White concurring in the judgment) (arguing that the sales tax exemption violated the Press Clause).
220 Justice Blackmun argued that the statute violated the Establishment Clause because it failed to include “philosophical literature distributed by nonreligious organizations devoted to such matters of conscience as life and death, good and evil, being and nonbeing, right and wrong.” Id at 27–28 (Blackmun concurring in the judgment). But the Court has repeatedly held that it is perfectly permissible for accommodations to single out religion. See, for example, \textit{Amos}, 483 US at 338 (declaring in reference to accommodations that, “[w]here . . . government acts with the proper purpose of lifting a regulation that burdens the exercise of religion, we see no reason to require that the exemption comes packaged with benefits to secular entities”); \textit{Cutter}, 544 US at 724 (reaffirming that view). To be sure, one might argue—as Justice Blackmun and Justice Brennan did—that the exemption in \textit{Texas Monthly} was not actually an accommodation but instead a generic subsidy that is constitutional only when it includes both religious and nonreligious beneficiaries. See, for example, \textit{Walz v Tax Commission of the City of New York}, 397 US 664, 673 (1970) (holding that general tax exemptions for churches are constitutional in part because they are “within a broad class of property owned by nonprofit, quasi-public corporations which include hospitals, libraries, playgrounds, scientific, professional, historical, and patriotic groups” that the state considers “beneficial and stabilizing influences in community life”). But that argument overlooks the fact that, unlike general tax exemptions, the exemption in \textit{Texas Monthly} was designed to relieve a direct burden on religious practice—namely, taxing citizens for evangelistic activities that many understand to be a matter of religious obligation.
221 \textit{Texas Monthly}, 489 US at 5 (Brennan) (plurality), quoting Tex Tax Code Ann § 151.312 (1982).}
To understand the point, imagine two different Catholic publications—one supporting the church’s teaching about an all-male priesthood and another opposing it based on a competing view about the proper interpretation of Catholic doctrine. As a matter of course, Texas’s sales tax regime would place an identical burden on the religious practice associated with both publications—citizens would be taxed for engaging in what they believed to be proclamation of the true faith. But under the plain language of the exemption in Texas Monthly, there’s good reason to believe that only the first publication was actually eligible for the exemption: after all, that’s the publication promulgating the teaching of a faith. And even if one were to disagree on the facts of that example, it is clear that the statute’s design authorized the government to grant accommodations only when it judged a claimant to espouse the particular religious message described in the statute. The Court in Texas Monthly rightly concluded that an accommodation structured in that fashion is unconstitutional. It gives government the power to encourage conformity by channeling accommodations only to claimants espousing its preferred religious ideas.

To be sure, there is a difference between exemptions like the one at issue in Texas Monthly and the one that Madison condemned in his Memorial and Remonstrance. Unlike Virginia’s General Assessment, the Texas exemption selectively subsidized a generic religious message rather than the messages of particular Christian denominations. But that fact makes little difference. The reason is simple: although Madison’s argument arose in the context of an accommodation discriminating among Christian sects, his argument was not limited to that context. Madison objected to the exemption in the assessment not just because it offered Quakers and Mennonites preferential treatment compared to other Christian denominations but because it served as a form of government-backed thought control—a

222 Texas Monthly, 489 US at 20 (Brennan) (plurality) (observing that the statute’s plain language “require[d] that public officials determine whether some message ... is consistent with ‘the teaching of the faith’”).

223 The Texas Comptroller’s Office tried to assuage that concern by simply ignoring the statute’s requirement and creating a policy that allowed religious publishers to determine for themselves whether their publication qualified for the exemption. See id at 20–21 n.9. But as Justice Brennan correctly observed, that informal policy was both contrary to the statute’s plain text and subject to change at any time as a matter of administrative discretion. Id.
means “by which proselytes may be enticed.” And that logic applies with equal force to any accommodation that allows the government to skew the marketplace of religious ideas toward its preferred orthodoxy, even an orthodoxy not associated with any single denomination.

Understanding Texas Monthly in light of Madison’s argument is also illuminating for another reason: it reconciles the case with wider free speech doctrine. In *Rosenberger v Rector and Visitors of University of Virginia*, the Supreme Court held that when the government offers subsidies for private speech on particular topics, it may not exclude religious speech on those same topics simply because the speech contains an evangelistic message. Critics of *Rosenberger* have argued that the decision is in tension with anti-establishment values because it sanctioned the direct funding of private religious speech. But a correct reading of *Texas Monthly* suggests that, in cases involving private speech, the primary Establishment Clause concern is not “harm” to taxpayer conscience, much less funding for religion. Rather, the concern is with attempts to manipulate the public’s religious views to mirror the government’s own view. Reading *Texas Monthly* in light of Madison’s argument clarifies that—in both accommodation cases and funding cases involving private speech—it is government-induced conformity, not paying for religion, that the Establishment Clause aims to prevent.

Consistent with Madison’s argument in the *Memorial and Remonstrance*, then, *Texas Monthly* stands for the proposition that the Establishment Clause condemns accommodations that provide selective subsidies for a preferred religious message. But the principle also extends to other kinds of efforts on the part of government to enhance the religious messages it favors. Here, the important example involves the Court’s rulings in some of its first accommodation cases about release-time programs in public schools.

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226 Id at 842–46.
227 See id at 868 (Souter dissenting) (arguing that the Establishment Clause prohibits “[using public funds for the direct subsidization of preaching the word”). See also, for example, Tebbe, *Religious Freedom in an Egalitarian Age* at 189 (cited in note 23) (arguing that “commitments to . . . nonestablishment” were a valid reason for denying funding in *Rosenberger*).
In *McCollum v Board of Education*,\(^{228}\) the Court struck down an accommodation that would have allowed public school students to be released from class to receive religious instruction on school grounds.\(^{229}\) Although the instruction was voluntary and required parental consent, the Court nonetheless held that the program violated the Establishment Clause.\(^{230}\) But just a few years later in *Zorach v Clauson*,\(^{231}\) the Court upheld a similar release-time program in which the religious instruction took place off school grounds.\(^{232}\)

The reasoning in these cases is opaque. In *McCollum*, the majority suggested that use of the state’s “tax-established and tax-supported public school system” rendered the program unconstitutional.\(^{233}\) But that argument—like the plurality’s argument in *Texas Monthly*—relies on unpersuasive claims about taxpayer harm. Other justices suggested that the key element in the cases involved the harm that release-time programs caused nonparticipating students.\(^{234}\) But that claim also seems overdrawn, at least as a doctrinal matter. Providing students with an hour of study hall while some of their peers engage in religious instruction does not seem like a constitutionally significant imposition—especially because the religious students undoubtedly still had to complete all the same assignments as their peers.

Here too, Madison’s argument against selective subsidies for favored religious messages provides the most convincing rationale for the Court’s decisions. As Justice Brennan later observed, the Court’s attempt to explain *McCollum* by reference to public expenditures was wholly unconvincing—using “classrooms, heat and light and time” simply does not add any real cost for anyone nor would such a cost even be relevant.\(^{235}\) Instead, what distinguished the release-time program in *McCollum* from the program in *Zorach* was the fact that the former “lent . . . sectarian instruction all the authority of the

\(^{228}\) 333 US 203 (1948).
\(^{229}\) Id at 211–12.
\(^{230}\) Id at 207–08.
\(^{231}\) 343 US 306 (1952).
\(^{232}\) Id at 315.
\(^{233}\) *McCollum*, 333 US at 210.
\(^{234}\) See, for example, *Zorach*, 343 US at 324 (Jackson dissenting) (arguing that the release-time program “serve[d] as a temporary jail for a pupil who will not go to Church”).
\(^{235}\) *Schempp*, 374 US at 261 (Brennan concurring).
governmentally operated public school system”\(^\text{236}\) while giving school officials unbridled discretion to deny those benefits to disfavored religious messages. By holding the release-time program in the regular public school classrooms, the \textit{McCollum} program effectively underwrote the authority of religious teachers by “plac[ing] [them] . . . in precisely the position of authority held by the regular teachers of secular subjects.”\(^\text{237}\) But even more importantly, it left the decision about which religious groups could participate solely to the school superintendent, who would “determine whether or not it [was] practical for said group to teach in said school system.”\(^\text{238}\) By contrast, the program in \textit{Zorach} allowed any “duly constituted religious body” to conduct offsite instruction, and prohibited all school officials from “comment[ing] . . . on attendance or nonattendance of any pupil.”\(^\text{239}\) Madison’s argument in the \textit{Memorial and Remonstrance} dealt only with monetary subsidies. But the insight of the Court’s release-time cases is that the Establishment Clause also prohibits accommodations that grant the government unfettered discretion to use its “prestige and capacity for influence”\(^\text{240}\) to promote some religious ideas over others.

In sum, although the Court’s precedents have not always been clear in explaining the point, modern Establishment Clause doctrine echoes Madison’s argument in the \textit{Memorial and Remonstrance}. Although accommodations are generally permissible, the Establishment Clause prohibits accommodations that foster religious conformity by selectively subsidizing the government’s preferred religious messages. But that is not all. The Court’s precedents—like Jackson’s argument about the militia accommodation—also suggest a second limit focused on incentives.

2. Incentives to adopt the accommodated religion.

The second principle, drawn from Jackson’s argument about the Uniform Militia Act, suggests that the Establishment Clause limits accommodations that create exceedingly powerful

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\(^{236}\) Id at 263 (Brennan concurring).
\(^{237}\) Id at 262 (Brennan concurring).
\(^{238}\) \textit{McCollum}, 333 US at 208 n.3.
\(^{239}\) \textit{Zorach}, 343 US at 308 n 1.
\(^{240}\) \textit{Schempp}, 374 US at 263 (Brennan concurring).
incentives to adopt the accommodated religion. Like Madison’s argument, this limiting principle has not always been clearly articulated by the Court. Nonetheless, it illuminates several other cases setting limits on religious accommodations, including some invoked by supporters of the third-party thesis.

To unpack the point, let’s return to the Supreme Court’s famous Draft Cases, which involved exemptions from combat service during the Vietnam War. In *United States v Seeger*, the Court considered an Establishment Clause challenge to the Selective Service Act. The Act allowed individuals “conscientiously opposed to participation in war in any form” to obtain an exemption, provided their objection was based on “religious training and belief.” The law further defined “religious belief” as a belief concerning “a Supreme Being involving duties superior to those arising from any human relation” rather than “essentially political, sociological, or philosophical views.”

Daniel Seeger applied for an exemption but was denied after stating that his objection was based on “a religious faith in a purely ethical creed.” The Supreme Court reversed. The Court reasoned that the law’s reference to beliefs involving a “Supreme Being” should be interpreted broadly to include any belief that “occup[ies] the same place in the life of the objector as an orthodox belief in God.” According to the Court, because Seeger’s beliefs occupied a “parallel position[ ]” to beliefs associated with traditional religion, he was eligible for the exemption.

Just a few years later in *Welsh v United States*, the Court widened its reading of the Selective Service Act even further. Like Seeger, Elliott Welsh maintained that he was agnostic as to the existence of God. Unlike Seeger, however, Welsh emphatically rejected the characterization of his beliefs as “religious.” Instead, he claimed that his opposition to war stemmed from a belief that

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243 62 Stat 604 (1948), codified at 50 USC § 3801 et seq.


246 Id at 166.

247 Id at 184.

248 Id at 166.

“human life is valuable in and of itself.”\textsuperscript{250} The Supreme Court nonetheless held that Welsh was also entitled to the exemption. Glossing over the statute’s explicit refusal to grant exemptions based on “political, sociological, or philosophical views,” a plurality of the Supreme Court held that the statute mandated an exemption for \textit{any} opposition to war arising from “deeply held moral, ethical, or religious beliefs.”\textsuperscript{251}

As a matter of statutory interpretation, the reasoning in \textit{Seeger} and \textit{Welsh} is exceedingly dubious. Accordingly, many commentators view these cases as rooted in the Establishment Clause. Yet if that is so, what kind of Establishment Clause rule did the Draft Cases actually announce? One possibility might be that the Establishment Clause forbids singling out “religion” for accommodation, rather than also accommodating all equivalent moral or philosophical convictions.\textsuperscript{252} But that explanation is improbable. For one thing, only Justice John Marshall Harlan adopted anything like this view.\textsuperscript{253} But even more importantly, that interpretation stands at odds with the Court’s repeated insistence that a religious accommodation need not “come packaged with benefits to secular entities” to comply with the Establishment Clause.\textsuperscript{254}

Jackson’s argument about incentives provides a much more plausible explanation. By denying an exemption from combat service to everyone but religious pacifists, the Selective Service Act clearly created an inducement to adopt the required religion. First, the nature of the material benefit—avoiding the perils of war and maintaining basic bodily security—is itself an objectively powerful inducement. And given that the stigma surrounding pacifism has decreased from the Founding era to today, it seems reasonable to view that inducement as equivalent to a coercive law, even absent an accompanying monetary incentive.\textsuperscript{255}

\textsuperscript{250} Id at 343 (Black) (plurality).
\textsuperscript{251} Id at 344 (Black) (plurality).
\textsuperscript{253} See Welsh, 398 US at 356–61 (Harlan concurring).
\textsuperscript{254} Amos, 483 US at 338. See also Cutter, 544 US at 724.
\textsuperscript{255} Compare Philip A. Hamburger, \textit{Religious Freedom in Philadelphia}, 54 Emory L J 1603, 1609 (2005) (observing that during the Founding period “Quakers, Mennonites, and other pacifists found themselves at the mercy of resentful mobs . . . who occasionally
Moreover, like the Founding-era exemption, the exemption in the Selective Service Act involved deep claims of conscience about particular topics—unjust killing and participation in war generally—that members of the first Congress recognized as deeply powerful in their own day and that we recognize as similarly powerful in ours.\textsuperscript{256} Finally, the Court chose to solve the problem by applying exactly the remedy Jackson and others suggested—namely, dissipating the incentive toward religious conformity, in this case by widening the exemption. The reasoning in the Draft Cases is obscure. But read in the most persuasive way possible, they echo Jackson’s theory exactly: when an accommodation provides exceptionally powerful incentives to adopt the religion being accommodated, the Establishment Clause demands that it be modified to dispel the inducement.

To be sure, the Draft Cases might seem a fragile basis for suggesting that modern Establishment Clause doctrine limits accommodations that provide exceptionally powerful incentives to adopt a religion. But many parts of the law consistently take this same shape, expanding accommodations that involve a similar combination of strong material incentives and weighty matters of conscience. For example, the law protects employees in state and federal prisons from disciplinary action for refusing to engage in virtually any form of participation in the death penalty that is “contrary to their moral or religious convictions.”\textsuperscript{257} Similar protections exist for health care providers whose “religious beliefs or moral convictions” prohibit them from performing sterilizations or abortions.\textsuperscript{258} Likewise, all six states educated their fellow Americans as to the cost of ignoring their civic duties”), with Bill Zimmerman, \textit{The Four Stages of the Antiwar Movement} (NY Times, Oct 24, 2017), online at http://www.nytimes.com/2017/10/24/opinion/vietnam-antiwar-movement.html (visited Mar 26, 2019) (Perma archive unavailable) (noting that by 1967, a protest against the war in Vietnam attracted no fewer than 500,000 people, and “[s]elf-interested draft avoidance evolved into morally driven draft resistance”).

\textsuperscript{256} For example, Representative Roger Sherman observed that “persons conscientiously scrupulous of bearing arms could not be compelled to do it; for such persons will rather suffer death than commit moral evil.” 2 Annals of Congress 1872 (Dec 22, 1790).

\textsuperscript{257} 18 USC § 3597(b) (providing that “[n]o employee . . . shall be required . . . to be in attendance at or to participate in any prosecution or execution under this section if such participation is contrary to the moral or religious convictions of the employee,” and specifying that “participation” includes “personal preparation of the condemned individual and the apparatus used for execution and supervision of the activities of other personnel in carrying out such activities”). See also Mark L. Rienzi, \textit{The Constitutional Right Not to Kill}, 62 Emory L J 121, 139–42 (2012) (discussing this provision and similar state laws).

\textsuperscript{258} 42 USC § 300a–7(b) (also known as the “Church Amendment”). Similarly, the Affordable Care Act prohibits the government from discriminating in its qualified health
that currently permit physician-assisted suicide provide protection for physicians who refuse to participate, whether their objections are religious or not. And those examples again mirror the draft example: they involve an objectively powerful incentive—here, losing one’s job—and also claims of conscience that are both deeply powerful and widely held. And although the connection to the Establishment Clause is only implicit, the fact that the law already avoids inducements toward religious conformity in instances like these is highly suggestive.

But how far does the principle extend? After all, read in a less nuanced way, Jackson’s concern with the Quaker exemption could be seen as focused not on things like bodily security or the moral weightiness of war but instead only on the “pecuniary advantages” that would result from excusing Quakers from paying for a substitute.

And indeed, in response to the Court’s decision in Hobby Lobby, several commentators raised a similar concern, claiming that the “financial incentive” to avoid regulation created by the Court’s decision would encourage many corporations to become religious in order to avoid various costs.

Undoubtedly, the worry over financial incentives is appropriate. After all, massive economic incentives can certainly be a potentially potent tool in fostering conformity. Yet there are also plans against “any individual health care provider or health care facility because of its unwillingness to provide, pay for, provide coverage of, or refer for abortions.” 42 USC § 18023(b)(4). See also 42 USC § 18023(c)(2)(A) (expressly stating that nothing in the Affordable Care Act shall be construed to have any effect on federal laws regarding conscience protection and “willingness or refusal to provide abortion”).

See Cal Health & Safety Code § 443.14(e)(1)–(2) (providing a right not to participate in physician-assisted suicide to “a person or entity that elects, for reasons of conscience, morality, or ethics,” including a right to refuse to inform patients of the practice or refer them to physicians who engage in it); Colo Rev Stat Ann § 25-48-117(1)–(2) (providing that, when a health care provider is “unable or unwilling to carry out an individual’s request for medical aid-in-dying,” she may refuse); Hawaii Rev Stat § 327L-19(a)(4) (providing that no health care provider or facility “shall be under any duty, whether by contract, statute, or any other legal requirement” to provide medication to end a patient’s life); Or Rev Stat Ann § 127.885 (same); 18 Vt Stat Ann § 5285(a)–(b) (providing that no person shall be “under any duty . . . to participate in the provision of a lethal dose of medication,” nor can they be disciplined by any health care facility or provider for refusal to do so); Wash Rev Code Ann § 70.245.190(b), (d) (providing that “[o]nly willing health care providers shall participate in the provision to a qualified patient of medication to end his or her life” and providing various other protections).


good reasons to approach arguments focused exclusively on financial incentives with care. For one thing, it is easy to overestimate the influence that supposed monetary benefits will exert over potential claimants. Contrary to the fears expressed after *Hobby Lobby*, there is now mounting empirical evidence that the Court’s ruling did not actually produce the tidal wave of follow-on religious liberty claims that critics predicted. Indeed, there is even evidence that, in the months and years following *Hobby Lobby*, the number of religious liberty cases being brought actually declined. If strong financial incentives to challenge wide swaths of regulation were actually created by the *Hobby Lobby* ruling, one would expect to see different results.

There is also a subtler point here. Financial incentives can appear powerful, especially when considered in isolation. But that perspective can obscure the ways that those incentives, even significant ones, are frequently overshadowed by other concerns. Seeking a religious exemption from employment regulations or other laws might offer modest cost-savings in theory. But it also risks alienating one’s workforce, sparking public controversy, and weathering robust inquiries into the sincerity of one’s beliefs. Moreover, unlike the draft example, in these cases there is no temptation to feign religion to avoid what might seem to be an even more egregious moral wrong. On the contrary, in cases involving only financial incentives, concerns about conscience cut decidedly the other way. And given all of that, the relative paucity of corporate religious liberty litigation after *Hobby Lobby* is unsurprising. When the social and moral costs of seeking a religious accommodation are high—as they almost always are—the idea that financial incentives alone will be sufficient to raise Establishment Clause worries can be overdrawn.

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262 See Goodrich and Busick, 48 Seton Hall L Rev at 356, 384 (cited in note 10) (documenting RFRA claims in the Tenth Circuit and concluding that such cases “remain scarce” and that there were no new RFRA challenges “by any for-profit corporations—or any organization for that matter” thirty-two months after *Hobby Lobby*); Barclay and Rienzi, 59 BC L Rev at 1642 (cited in note 10) (noting that an empirical assessment of the federal caseload shows that religious freedom claims have remained “fairly constant”).

263 See Barclay and Rienzi, 59 BC L Rev at 1643 (cited in note 10) (documenting a decline in religious liberty cases as a percentage of the reported federal cases following *Hobby Lobby*).

264 See Nathan S. Chapman, *Adjudicating Religious Sincerity*, 92 Wash L Rev 1185, 1232–33 (2017) (noting “the costs—financial, emotional, and otherwise—entailed in . . . seek[ing] a religious accommodation,” and observing that “[t]he specter of litigation alone could deter the fainthearted, much less the false”). In this sense at least, Madison may
A more promising approach would focus less on money and more on situations in which government has powerful tools to encourage conformity by exerting significant control over day-to-day life. And indeed, courts have already recognized as much in contexts like prisons. In Cutter, the Supreme Court noted that, although religious accommodations for prisoners are generally constitutional under the Establishment Clause, there is nonetheless cause for concern when “the opportunity to assemble in [prison] worship services, might attract joiners seeking a break in their closely guarded day.”

Accordingly, lower courts have sometimes augmented religious accommodations to allow atheists or secular humanists to form clubs on similar terms with religious groups. Likewise, courts have also extended Cutter’s observation to other contexts by concluding that the Establishment Clause requires prison officials to refrain from attaching valuable benefits, such as early release or “good time” credits, to participation in religious treatment programs, at least when a secular alternative is unavailable.

But what about instances in which the Court has held an accommodation is permissible or even required despite the fact that it could be seen as creating incentives for religious practice? In Amos, for instance, the Court unanimously upheld Title VII’s exemption allowing religious organizations to hire only members of their own religion despite the fact that it might entice present or future employees to comply with a church’s teachings. Likewise, one might suggest that the ministerial exception at issue in Hosanna-Tabor incentivizes religious leaders to behave according to their church’s beliefs. Why, then, doesn’t the Establishment Clause prohibit it?

The answer, quite simply, is that Amos and Hosanna-Tabor do not stand at odds with the concern over religious incentives.

have had the better of the argument over the Quaker exemption. See 2 Annals of Cong 1872 (Dec 22, 1790) (silently accepting Jackson’s proposed connection between religious establishment and induced conformity, but arguing that citizens would not “renounce their principles, their conscience, and their God” for the sake of modest monetary advantages).

265 Cutter, 544 US at 721 n 10.
266 See, for example, Kaufman v McCaughtry, 419 F3d 678, 683–84 (7th Cir 2005).
267 See generally, for example, Griffin v Coughlin, 673 NE2d 98 (NY 1996) (family visitation); Kerr v Farrey, 95 F3d 472 (7th Cir 1996) (consideration for parole); Manson v Norris, 435 F3d 877, 880–81 (8th Cir 2006) (extra work detail); Warner v Orange County Department of Probation, 115 F3d 1068 (2d Cir 1996) (probation).
On the contrary, they validate it. But they do so by relating that concern to larger worries over government-induced religious conformity.

To understand the point, the best place to begin is *Amos*. It is true that allowing religious organizations to discriminate in their hiring might occasionally result in an inducement for a potential employee to adopt or feign a religion. But unlike exemptions from the draft or similar examples, the inducement is not triggered by government action. Rather, as the Court in *Amos* correctly observed, the decision to leave religious organizations with discretion about whom to hire and fire simply removes government control—any subsequent incentive is the result of contingent action by a private group, not action by the government. But even if one disagrees, there is also a deeper insight here. Situations like those in *Amos* present a choice: either allow legislatures to exempt religious organizations knowing that doing so might unintentionally alter the choices of a few employees, or face a regime in which all religious groups must repeatedly litigate which of their positions are “religious” and which are not. And not surprisingly, when faced with that choice, every single justice in *Amos* opted to uphold the exemption. That approach is the one less likely to foster control over religious practice and the one that actually reduces governmental incentives to conform in the mine run of cases.

The argument is even stronger when one considers *Hosanna-Tabor*, which held that the Religion Clauses prohibit courts from entertaining certain kinds of employment lawsuits involving a religious organization and its leaders. As in *Amos*, there was a sense in which that approach might create an incentive insofar as it put clergy on notice that failure to adhere to their church’s doctrine might lead to termination without legal recourse. But again, that incentive is not of the government’s own making: a church’s decision about whom to retain as its minister is one of the clearest examples of private action one could imagine. Moreover, the worry that the ministerial exception might incentivize religious leaders to comply with their church’s teaching—if that

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270 *Amos*, 483 US at 337 & n 15 (observing that the employee in the case had his “freedom of choice in religious matters . . . impinged upon,” but that “it was the Church . . . not the Government” who exerted that pressure by terminating him from his job).

271 As Justice Brennan observed, that regime would “chill[] religious activity” by inducing religious groups to organize themselves in ways that minimize their litigation risk rather than maximize their faith. *Amos*, 483 US at 345 (Brennan concurring).
even counts as a worry\textsuperscript{272}—pales in comparison to the risks associated with giving government the power to effectively select a church’s ministers. Church autonomy decisions like those in \textit{Amos} and \textit{Hosanna-Tabor} further the Establishment Clause concern over incentives by providing more latitude for religious choice, not less.

Policing accommodations that create powerful incentives is an important part of the Establishment Clause. But it is also part of a much broader goal: preventing government from deciding what kind of religion the populace will or will not practice. It is that evil, above all others, that the Establishment Clause is intended to prevent.

\textbf{IV. RECONSIDERING HARM}

At this point, it is worth briefly recapitulating the argument as it stands so far.

First, I have argued that, although the third-party thesis is relatively popular among academics and perhaps even gaining ground among a few members of the Supreme Court, there are good reasons to believe it fails as an interpretation of the Establishment Clause. Its analogy between accommodations that inadvertently generate costs and church taxes is both historically and conceptually weak, and the thesis is foreclosed by many of the Court’s precedents.

Second, I have argued that, when evaluating religious accommodations under the Establishment Clause, the fundamental inquiry ought to be whether the government is using its power to foster religious conformity. Under that principle, the Establishment Clause prohibits accommodations that selectively favor the government’s preferred religious messages as well as accommodations that provide exceedingly powerful incentives to adopt the religion being accommodated. Those limits provide satisfying explanations for many of the Supreme Court’s precedents, and they ground Establishment Clause analysis in an


When one joins a church, one accepts the religious choices made by the church. People can leave or stay. But so long as they choose to stay, they accept how the church handles its religious affairs. Dissenters cannot use the coercive force of the government to compel a change in the church’s religious views, practices, or governance.
approach that is more historically and doctrinally plausible than one that emphasizes third-party harm.

But my position is open to some significant objections. Most importantly, some readers will surely worry that my view of the Establishment Clause is too narrow and perhaps even dangerously so. If the Establishment Clause is fundamentally a prohibition on government-induced conformity, what are we to do with accommodations that threaten other interests in important ways? To take just one obvious example, what about an accommodation from homicide laws for a religious group that engages in ritual killings? Such a law seems unlikely to induce others toward religion. But if the Establishment Clause is best read as a ban on attempts to induce religious conformity, does that mean the Constitution has nothing to say about this fanciful law—and others like it—when the harms are striking?

These concerns are real. But more than that, I think that, as a matter of substance, they are well founded. There are and should be limits on laws that harm others, and religious accommodations are no exception. But objections like these tacitly assume that an Establishment Clause principle focused squarely on third-party harm is the only possible source of those limits. That assumption is false. Indeed, as this Part explains, viewing the Establishment Clause as a ban on government-induced conformity does not mean ignoring the costs of accommodation. On the contrary, it actually provides a more plausible way of thinking about such costs and the various ways that the law limits them. This Part explains that insight first in relation to the Establishment Clause and goes on to discuss other limits on religious accommodation.

A. The Establishment Clause

To begin, let’s return to the most basic point. Although accommodations are generally permissible under the Establishment Clause, the Supreme Court has said they must not “devolve into ‘an unlawful fostering of religion.’”\(^{273}\) As we have seen, that rule is clearly violated when accommodations provide unfair advantages for the government’s favored religious ideas or create powerful incentives to engage in religious practice. But there are also subtler forms of manipulation. Most obviously, government may unlawfully foster religious conformity

by using accommodation as a pretext to reward those who have already chosen to conform.

Recall that as a historical matter, religious accommodations have always been coextensive with disestablishment: they remove government power over private religious practice and thereby serve the larger goal of preserving religious freedom. But it is important to remember that not all exceptions for religion fell into that category. In medieval England, “benefit of clergy” exemptions allowed leaders of the established church to avoid prosecution in civil courts for serious crimes, including murder and rape.\footnote{274} In colonial New York and elsewhere, the established church possessed special legal privileges allowing it to hold property while other churches could not.\footnote{275} In Virginia, ministers of the Church of England who wished to conduct marriages were exempted from licensing requirements that applied to all other groups,\footnote{276} and so on.

The point here is a simple one: there is an important difference between exemptions protecting religious freedom and exemptions designed to favor or reward religious people of one sort or another. Genuine accommodations are aimed at alleviating burdens on religious practice and thus are part of the broader project of ensuring religious liberty for all. But some exemptions serve the opposite function—they grant privileges or benefits not to relieve a burden but instead simply to reward the government’s preferred form of religiosity. And as the Court’s modern cases suggest, one important factor in distinguishing these kinds of laws from constitutionally permissible accommodations involves their redistributive effects.

To see what I mean, let’s return to Caldor, the case most often invoked by supporters of the third-party thesis. There, the Supreme Court considered an Establishment Clause challenge to a Connecticut law guaranteeing that no person could be required to work on a day designated as his Sabbath.\footnote{277} Donald Thornton, a manager at a department store, sought an accommodation under the statute after his employer began

\footnote{274} See Berg, 38 Harv J L & Gender at 144–47 (cited in note 77) (describing these laws).
\footnote{276} See McConnell, 44 Wm & Mary L Rev at 2175–76 (cited in note 150) (explaining licensing regimes for conducting marriages).
\footnote{277} 472 US at 706.
opening its stores on Sunday. His employer argued that the accommodation violated the Establishment Clause, and the Supreme Court agreed.\footnote{278 Id at 710–11.}

Supporters of the third-party thesis focus on Chief Justice Burger’s observation about the “significant burdens” the law placed on employers and employees as the dispositive feature of the case.\footnote{279 Id at 710. See, for example, Gedicks and Koppelman, 67 Vand L Rev En Banc at 54 (cited in note 114). They also point to Chief Justice Burger’s statement—taken from Judge Learned Hand—that “[t]he First Amendment . . . gives no one the right to insist that in pursuit of their own interests others must conform their conduct to his own religious necessities.” \textit{Caldor}, 472 US at 710, quoting \textit{Otten v Baltimore & Ohio Railroad Co}, 205 F2d 58, 61 (2d Cir 1953). See also Tebbe, \textit{Religion in an Egalitarian Age} at 55 (cited in note 23); Gedicks and Van Tassell, 49 Harv CR–CL L Rev at 358 (cited in note 23) (same). Yet as others have rightly observed, reading that statement in context casts doubt on the idea it was meant to express concern over generic third-party harm. See, for example, Sepinwall, 82 U Chi L Rev at 1968–69 n 259 (cited in note 4) (explaining that the statement originally stood for the idea that “one cannot claim First Amendment protections against nonstate actors” and was used by Chief Justice Burger to emphasize the law’s “formal favoring of religious interests,” not its impact on third-parties).}

But as we have already seen, the Court has repeatedly blessed accommodations that generate costs for others.\footnote{280 See notes 114–41 and accompanying text.} Moreover, a focus on harm alone is also a poor fit on \textit{Caldor}’s own facts. Prior to the Sabbath law, Thornton’s employer had already adopted an internal policy that granted almost all of its employees the right to refrain from Sunday work if such work was “contrary [to the employee’s] personal religious convictions.”\footnote{281 Id at 706 n 4.} Admittedly, Thornton was a manager, not a generic employee. But there was no evidence that alternatives like finding a substitute had even been tried, much less found wanting. Harm alone is not a sufficient basis to explain the decision.

Now consider the case in a more holistic way. The law at issue in \textit{Caldor} provided a day off for anyone “who state[d] that a particular day of the week is observed as his Sabbath.”\footnote{282 Id at 708, quoting Conn Gen Stat § 53-303e(b).} By its terms, that command extended beyond relieving a burden on religious practice. By providing a day off for anyone who stated that a particular day “is observed” as his Sabbath, the statute also appeared to mandate a full day’s absence even when the relevant religious need involved nothing more than attending a worship service lasting a few minutes.\footnote{283 See id at 709 (characterizing the law as “arm[ing] Sabbath observers with an absolute and unqualified right not to work on whatever day they designate as their...})
law required private parties to take affirmative steps to relieve that nonexistent burden even when the costs of doing so were exceedingly high. The majority in *Caldor* concluded that Connecticut’s Sabbath law amounted to an “unyielding weighting in favor of Sabbath observers,” not because it incidentally harmed third-parties but because it provided an unjustified reward for some religious claimants with no regard for the costs that requirement might impose.

A similar logic explains much of the Court’s language in *Cutter*, the other case most frequently cited by supporters of the third-party thesis. In *Cutter*, the Court upheld RLUIPA, a general accommodation statute that allows prisoners to seek case-by-case religious accommodations for things like kosher food or religious dress. In so holding, the Court observed that RLUIPA requires courts to “take adequate account of the burdens a requested accommodation may impose on nonbeneficiaries.” More specifically, the Court noted that the burden-shifting analysis mandated by RLUIPA’s text indicated that it would not “elevate accommodation of religious observances over an institution’s need to maintain order and safety.” Concluding its opinion, however, the Court cautioned that, “[s]hould inmate requests for religious accommodations . . . impose unjustified burdens on other[s],” prisons would be right to resist them.

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284 See *Caldor*, 472 US at 709 (suggesting that the law in *Caldor* “command[ed] that Sabbath religious concerns automatically control over all secular interests at the workplace” irrespective of “the convenience or interests of the employer or those of other employees”). See also *Amos*, 483 US at 337–38 & n 15 (suggesting that the statute in *Caldor* had “given the force of law to the employee’s designation of a Sabbath day and required accommodation by the employer regardless of the burden which that constituted for the employer or other employees”).

285 *Caldor*, 472 US at 710.

286 Admittedly, the Court in *Caldor* was probably wrong to strike down the Sabbath law rather than dealing with the concern about gratuitous burden-shifting in an as-applied challenge. But that error was part of the Court’s larger failure to distinguish between facial and as-applied challenges in its Establishment Clause jurisprudence—a problem it has since remedied. See *Bowen v Kendrick*, 487 US 589, 602 (1988) (acknowledging the appropriateness of distinguishing between facial and as-applied challenges under the Establishment Clause).

287 *Cutter*, 544 US at 720.

288 Id at 722.

289 Id at 726.
Proponents of the third-party thesis point to this discussion as evidence of an Establishment Clause rule prohibiting generic harm.\textsuperscript{290} But again, there is a more plausible reading. \textit{Cutter} held that RLUIPA was constitutional because it both “allevi-[\textit{ate}[d] . . . burdens on private religious exercise” and “[\textit{took}] 
adequate account of the burdens . . . on nonbeneficiaries.”\textsuperscript{291} In other words, unlike the Sabbath law in \textit{Caldor}, laws like RLUIPA and RFRA do not command gratuitous burden-shifting. On the contrary, they mandate accommodations only when a claimant demonstrates a “substantial burden” on her religious exercise—an actual conflict between one’s religious practice and the policy at issue.\textsuperscript{292} Moreover, even if one might worry about an overbroad reading of that test, these statutes also contain a compelling interest limitation, ensuring that the kind of “unyielding weighting” at issue in \textit{Caldor} will never arise.\textsuperscript{293} True, the Court in \textit{Cutter} cautioned that, if RLUIPA were used to impose “unjustified burdens,” the Establishment Clause would prohibit it.\textsuperscript{294} But the point of that observation, as in \textit{Caldor}, was about redistribution that is both baseless and costly. Were RLUIPA used as a pretext to command significant cost-shifting unconnected to relieving any burden on religious practice, there is no doubt the Establishment Clause would prohibit it.

Read together, \textit{Caldor} and \textit{Cutter} suggest that there is indeed a special Establishment Clause concern arising from accommodations that shift costs. But that concern is not over the

\textsuperscript{290} See notes 114–16 and accompanying text.

\textsuperscript{291} \textit{Cutter}, 544 US at 720. The Court also noted that RLUIPA’s text indicated that it would be “administered neutrally among different faiths.” Id.

\textsuperscript{292} See 42 USC §§ 2000bb-1(a)–(b), 2000cc-1. To be sure, the question as to how exactly courts ought to approach the substantial burden inquiry is itself an area of vigorous scholarly disagreement. For a few different perspectives, see Ira C. Lupu, \textit{Where Rights Begin: The Problem of Burdens on the Free Exercise of Religion}, 102 Harv L Rev 933, 966 (1989) (arguing that a substantial burden occurs when “religious activity is met by intentional government action analogous to that which, if committed by a private party, would be actionable under general principles of law”); Michael A. Helfand, \textit{Identifying Substantial Burdens}, 2016 U Ill L Rev 1771, 1793 (arguing that courts ought to focus on the “substantiality of the civil penalty”); Chad Flanders, \textit{Substantial Confusion about “Substantial Burdens”}, 2016 U Ill L Rev Online 27, 29 (arguing that a substantial burden on religion involves “the quantum of pressure that is put on a person to violate his religious beliefs—that means any part of his religious beliefs, and for any amount of time”).

\textsuperscript{293} See 42 USC §§ 2000bb-1(a)–(b), 2000cc-1. See also \textit{Hobby Lobby}, 134 S Ct at 2781 n 37 (observing that a concern over “the burdens a requested accommodation may impose on nonbeneficiaries . . . will often inform the analysis of the Government’s compelling interest and the availability of a less restrictive means of advancing that interest”).

\textsuperscript{294} \textit{Cutter}, 544 US at 726.
presence of third-party harm. Rather, it is over the connection between an accommodation’s costs and the lifting of an actual burden on religious practice. When claims for accommodation outrun any actual burden on free exercise while also imposing significant costs, there are good reasons to believe they are unjustified attempts to reward a favored religious identity. By contrast, when an accommodation incidentally redistributes costs as part of a transparent effort to protect religious freedom, there is generally no reason to believe it raises any Establishment Clause concern. Rather, it is just one more instance—like accommodations for disability, pregnancy, and so on—in which the law adjusts benefits and burdens to account for things many people care about.

But of course, there is also another potential problem. In most instances, bestowing a gratuitous and costly benefit on a religious claimant will be sufficient evidence that an accommodation is a pretext to reward religious conformity. But what about instances in which a burden on free exercise is actually present, but an accommodation’s costs seem radically disproportionate? A religious exemption for a group that engages in human sacrifice would undoubtedly lift a religious burden, but no one would ever think such a carve-out from homicide laws is justified. And indeed, that kind of concern seems at least vaguely implied by Cutter’s observation that “an accommodation must be measured so that it does not override other significant interests.”

How are we to think about such laws?

One possibility, and the one most closely resembling the third-party thesis, would be to insist that an accommodation is a pretext for favoritism whenever it results in more than a minimal cost, no matter the religious interest at issue. The Court has never endorsed that approach as a matter of Establishment Clause doctrine. But it has sometimes employed it as a matter of statutory interpretation. In *Trans World Airlines, Inc v Hardison,* for instance, the Court considered the meaning of Title VII’s command that employers provide “reasonable accommodations” for their employees’ religious needs. Notwithstanding the fact that the statute explicitly requires accommodation unless the employer “demonstrates [ ] he is unable to . . .

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295 Id at 722.
297 Id at 69. See also 42 USC § 2000e(j).
[provide them] without undue hardship," the Court insisted that any cost that is "more than . . . de minimis" presents such a hardship. According to the Court, requiring costs above this threshold without "giv[ing] other employees the days off that they want" risked "unequal treatment" on the basis of religion.

The Court’s holding in *Hardison* is dubious for a number of reasons. By definition, de minimis costs are not hardships (much less "undue" hardships), and the statutory context provides no reason to think that Congress meant otherwise. But even setting this point aside, the Court’s reasoning seems callous and wooden. The majority worried that applying Title VII’s religious accommodation as written could mean that other employees may not get "the days off that they want." But not all scheduling requests are of similar magnitude. Requesting an absence to observe Yom Kippur or Good Friday is different from a request to attend a beer festival, and it trivializes the former to suggest that they are not. Moreover, the Court’s approach to the problem ignored the ways that many employment-related accommodations—for disability, pregnancy, and other things—regularly generate more than de minimis costs. These are the kinds of needs analogous to religious ones in seriousness and importance. Yet the Court in *Hardison* focused solely on the cost side of the equation with no regard for the significance of the activity being protected or the usual rules applying to such laws.

A more plausible approach to the problem would begin by recognizing that legislatures possess broad discretion to protect important interests, and religious interests are no exception. Yet that discretion is not limitless. Since the Founding, the right to free exercise has always been considered defeasible in the face of exceedingly powerful threats to "private rights or the public peace." Indeed, as Professor Michael McConnell has observed, no fewer than nine state constitutions at the Founding included

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299 *Hardison*, 432 US at 84.
300 Id.
301 See id at 92 n 6 (Marshall dissenting) (“As a matter of law, I seriously question whether simple English usage permits ‘undue hardship’ to be interpreted to mean ‘more than de minimis cost.’”). See also *Adeyeye v Heartland Sweeteners, LLC*, 721 F3d 444, 455 (7th Cir 2013) (observing that, by its plain language, “Title VII requires proof not of minor inconveniences but of hardship, and ‘undue’ hardship at that”).
302 *Hardison*, 432 US at 84.
303 Letter from James Madison to Edward Livingston (July 10, 1822), in Gaillard Hut, ed, 9 The Writings of James Madison 1819–1836 100 (G.P. Putnam’s Sons 1910).
provisions limiting the right to free exercise to “actions that were ‘peaceable’ or that would not disturb the ‘peace’ or safety’ of the state.”\textsuperscript{304} The same basic idea appears repeatedly in Founding-era arguments about free exercise in the courts.\textsuperscript{305} And in terms of modern doctrine, that traditional limitation is most clearly analogous to the requirement—made explicit in statutes like RFRA—that an accommodation ought to be denied when applying the law to a claimant is the least restrictive means of furthering a compelling governmental interest.

Viewing the compelling interest test as the outer boundary for even for accommodations that relieve genuine burdens on religious practice makes sense for several reasons. First, it grounds the inquiry about disproportionate accommodations in historical practice. As a general matter, attempts to weigh burdens on religious practice against other kinds of interests suffer from an obvious difficulty—namely, the lack of a shared baseline.\textsuperscript{306} We simply lack a common measure for weighing the importance of practicing one’s religion against other important concerns. The compelling interest test deals with that problem by overruling the legislature’s power to grant accommodations in only the most extreme cases—cases in which the law at issue lies outside the traditional pattern of religious accommodation and thus cannot be seen as simply one more policy choice by the legislature.

Second, viewing the compelling interest test as the key to identifying disproportionate accommodations provides a sensible way of pinpointing illegitimate attempts to reward religious conformity. As we have observed, religious accommodations are clearly designed to protect a constitutional interest in free

\textsuperscript{304} McConnell, 103 Harv L Rev at 1461 (cited in note 1). To be sure, the precise meaning of these provisions has been the subject of intense debate. Compare Hamburger, 60 Geo Wash L Rev at 918–21 (cited in note 1) (arguing that these provisos in state constitutions implied that government could “deny religious freedom, not merely in the event of violence or force, but, more generally, upon the occurrence of illegal actions”), with Michael W. McConnell, \textit{Freedom from Persecution or Protection of the Rights of Conscience?: A Critique of Justice Scalia’s Historical Arguments in City of Boerne v. Flores}, 39 Win & Mary L Rev 819, 841–46 (1998) (arguing that Professor Philip Hamburger’s interpretation cannot be squared with the text and drafting history of numerous state constitutions).

\textsuperscript{305} See McConnell, 103 Harv L Rev at 1503–05 (cited in note 1) (describing several of these court cases)

\textsuperscript{306} See Michael W. McConnell, \textit{Accommodation of Religion: An Update and a Response to the Critics}, 60 Geo Wash L Rev 685, 705 (1992) (suggesting that such inquiries suffer from “the problem of comparing apples and oranges”).
exercise whether the Free Exercise Clause strictly requires them or not. Yet the constitutional claims most closely analogous to that interest—namely, claims under the Free Speech Clause and the Equal Protection Clause—are also limited by the strict scrutiny inquiry as a matter of course. Viewing religious accommodations as bounded by these same standards suggests that government may adjust benefits and burdens to protect religious interests only as far (but no further) than the law protects other kinds of analogous constitutional rights. And in this way, it guarantees that accommodations are not just a pretext for rewarding religious behavior.

To be sure, there is more to be said. But at the very least, the basic point should be clear. Far from being indifferent to the costs of accommodation, the Establishment Clause takes them into account. But in separating permissible accommodations from impermissible ones, the key question is not whether an accommodation produces “harm.” Rather, the question is whether an accommodation aims at inducing religious conformity by offering unjustified rewards.

B. Other Considerations

Let’s return to the initial objection. The most obvious argument against my proposal that the Establishment Clause is best seen as a ban on government-induced religious conformity is that such a proposal does not account for the costs of accommodation. But that objection fails. Properly understood, the Establishment Clause ban on government-induced conformity includes not only attempts to entice citizens toward religion but also attempts to use accommodations as a pretext for rewarding groups of citizens who have already chosen to conform. More specifically, the Establishment Clause prohibits accommodations that offer benefits to religious claimants far outstripping any supposed burden on private free exercise as well as accommodations that command burden-shifting so disproportionate that the inference of unjustified favoritism is undeniable. When a law commands those things, the Establishment Clause clearly prohibits it.

But does that explanation really go far enough? For instance, although it is rare, accommodations do sometimes authorize significant harms that might not be prohibited by the compelling interest test. To use one example that I find particularly troubling, a nontrivial number of states exempt parents
from child neglect prosecutions if they fail to seek basic medical treatment for their children for religious reasons. Yet enforcing those laws against every unwilling parent may not actually be mandated by the strict scrutiny inquiry, primarily because in many cases there will be a less restrictive alternative: a state could merely require religious parents to report the situation and provide treatment directly. In situations like these, even the strict scrutiny limitation may leave us with unsatisfying results.

Moreover, even assuming that the Establishment Clause limits disproportionate accommodations in the ways I suggest, the question about how certain kinds of conflicts ought to be analyzed under the strict scrutiny test can itself be a matter of vigorous disagreement. For example, the question of how this inquiry relates to claims for exemptions from public accommodations laws continues to divide scholars—even those deeply committed to eradicating discrimination. And as someone who supports both same-sex marriage and religious freedom, it seems clear to me that both sides of that debate have a point. Repeated denials of service do work a profound and significant harm—and one that is not reducible to material considerations like the opportunity to obtain the service elsewhere. At the same time, denying exemptions can also be profoundly damaging, forcing religious individuals to endure financial ruin or worse, and often in urban areas where they may already face

307 See, for example, Ind Code § 35-46-1-4(c)(2); NH Rev Stat Ann § 639:3; NY Penal Law § 260.15; Utah Code Ann § 76-5-109(6); Idaho Code Ann § 18-1501(4).

308 Compare, for example, Ind Code § 35-46-1-4 (lacking any such requirement), with Minn Stat § 626.556(g)(5) (providing an exemption from prosecution for child neglect when a person “depends upon spiritual means or prayer for treatment or care of disease,” but requiring that such persons “report if a lack of medical care may cause serious danger to the child’s health”).

309 Compare, for example, Andrew Koppelman, Gay Rights, Religious Accommodations, and the Purposes of Antidiscrimination Law, 88 S Cal L Rev 619, 652 (2015) (arguing that dignitary harm is real and serious but that “the human costs of refusing accommodation are [also] serious” and sometimes justify exemptions), with NeJaime and Siegel, 124 Yale L J at 2580 (cited in note 23) (arguing that government’s burden under strict scrutiny is usually satisfied when granting an accommodation would “inflict . . . dignitary harm on those the statute is designed to protect”).

310 See, for example, Roberts v United States Jaycees, 468 US 609, 625 (1984) (noting that discrimination can “deprive[ ] persons of their individual dignity” and inflict “stigmatizing injury”). See also Koppelman, 88 S Cal L Rev at 645 & n 127 (cited in note 309) (documenting studies linking experiences of discriminatory treatment to negative impacts on mental and physical health among LGBTQ people).
significant hostility. In those contexts, weighing the strength of the government interest can be difficult.

Providing answers to these questions would require a far more extensive discussion than can be offered here. Even without definitively resolving these issues, however, there are a few things we can say. The first is that, as a matter of actual practice, judges are extremely squeamish about commanding accommodations that involve significant harm to others. Legislatures might be willing to grant carte blanche exemptions from child neglect laws, vaccination requirements, and the like. But judges presented with those same claims under RFRA and similar laws almost never do. And indeed, that aversion is so strong that even the majority in Hobby Lobby could not bring itself to grant an exemption without effectively suggesting that the government “pick up the tab” and pay for the contraception, although nothing in RFRA actually mandated that result. To be sure, there may be outliers. But the extant evidence suggests that, by and large, when judges are empowered to protect the public interest, they do not do so lightly.

But there is also a second, equally important point. A judge faced with an accommodation claim under RFRA or similar statutes might ultimately conclude that the government lacks a compelling interest in enforcing a law or possesses a less restrictive means of furthering its interest. But that judgment does not invest courts with the final word on harm. Accommodations are ordinary laws. And like all other kinds of legislation, they are responsive to the popular will. They can be revised, limited, amended, or repealed. And the real-world evidence clearly demonstrates that this fact provides an additional and exceedingly powerful limit on the excesses religious accommodations

311 See, for example, Thomas C. Berg, Minority Religions and the Religion Clauses, 82 Wash U L Q 919, 945 (2004) (describing repeated efforts of New York–area public school officials “to exclude evangelical groups from meeting in the schools on the same terms as other voluntary groups”). See also Berg, 38 Harv J L & Gender at 112 (cited in note 77) (noting recent polling suggesting that American voters now view evangelical Christians substantially less favorably than gays and lesbians).

312 See, for example, Workman v Mingo County Board of Education, 419 Fed Appx 348, 353–54 (4th Cir 2011) (denying a religious exemption from requirement that children be vaccinated to attend public school); Sherr v Northport-East Northport Union Free School District, 672 F Supp 81, 99 (EDNY 1987) (same); People v Hodges, 10 Cal App 4th Supp 20, 30–33 (1992) (denying a religious exemption from laws requiring reporting of known child abuse).

313 Hobby Lobby, 134 S Ct at 2787 (Ginsburg dissenting).
sometimes threaten, especially in cases involving public accommodations or LGBTQ rights.

Consider just a few of ways that political majorities have shaped or revised religious accommodations to soften some of the harder edges. Long before *Hobby Lobby*, legislatures in Pennsylvania and Louisiana limited their state RFRAs to apply only to nonprofit organizations. Those limitations have invited some confusion due to drafting problems, but they do have an obvious upside. If the concern is that accommodations risk giving businesses rather than churches or religious individuals the power to seek exemptions, that limitation takes care of the problem.

Or consider another strategy that has already been implemented in two very red states. Texas and Missouri both have state RFRAs that provide powerful protections for religious minorities. Yet voters in both states drew limits by making those RFRAs inapplicable to lawsuits involving civil rights laws. Those limits might stand in some tension with the purpose of religious accommodation laws by stacking the deck against especially unpopular religious claimants. But they could also be seen as simply clarifying that the people of Texas and Missouri believe that the government’s interest in enforcing its civil rights laws is per se compelling. And that is a choice that the citizens of those states are undoubtedly empowered to make.

A third strategy accomplishes the same end but through slightly different means. Recall the firestorm in Indiana a few years ago about its newly passed RFRA. Critics of the law labeled it as a Jim Crow–style assault on LGBTQ rights because it explicitly applied to lawsuits brought by private parties, which by implication included suits brought under various public accommodations laws. The likelihood that any judge would actually validate a RFRA defense in such lawsuits was

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314 See 71 Pa Stat Ann § 2403 (defining “person” as “[a]n individual or a church, association of churches or other religious order, body or institution which qualifies for exemption from taxation”); 13 La Stat Ann § 5234(1) (same).
315 See Lund, *Keeping Hobby Lobby in Perspective* at 303–04 n 79 (cited in note 65) (explaining that the statutes invite significant confusion about whether they apply to religious schools and other nonprofits because such entities are not always eligible for tax-exempt status under the Internal Revenue Code).
316 See Tex Civ Prac and Remedies Code Ann § 110.011; Mo Ann Stat § 1.307(2).
317 For a reminder, see Robertson and Pérez-Peña, *Bills on Religious Freedom* (cited in note 5).
disputed. 319 But in the end, Indiana’s representatives responded by amending its RFRA to exclude discrimination lawsuits from its reach, including those involving claims of discrimination based on sexual orientation or gender identity. 320

People will differ as to whether these policy choices strike the correct balance between religious freedom and other important concerns. Some will say that they leave religious dissenters without adequate protection. Others will say that they don’t go far enough in validating LGBTQ rights or employee protections. But the fact that people will disagree over how harms ought to be distributed is precisely the point. Speaking honestly, I think the Court was wrong to read the Free Exercise Clause as narrowly as it did in *Smith* and offload many decisions about religious exemptions to legislatures, where the risk of majoritarian bias is high. But whatever one thinks about that issue, one advantage of religious accommodation statutes is that they allow democratic majorities greater flexibility in how their commands will be implemented. And indeed, the evidence is fairly clear that, when it comes to the most controversial questions, political majorities have been exceedingly active in exercising that judgment.

## Conclusion

Ours is a particularly crucial moment in the story of American religious liberty. For many important periods in our history, religious accommodation has been a laudable feature of the American experience. But in the wake of *Hobby Lobby*, we are now asking ourselves whether the cases in which religious accommodation and the culture war collide are sufficient reason to rethink our tradition.

In large measure, whether we will choose to retain or abandon robust religious accommodation laws will depend on whether there is willingness left—among progressives, but more

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319 See Letter from Douglas Laycock, Robert E. Scott Distinguished Professor of Law, University of Virginia School of Law, to Brent Steele, Chair of the Judiciary Committee, Indiana Senate *5* (Feb 3, 2015), archived at http://perma.cc/NK6K-4LG7 (arguing that “[p]rotecting Americans from discrimination is generally a compelling interest, and few claims to exemption from anti-discrimination laws are likely to succeed”).

320 See Ind Code § 34-13-9-0.7. The law applies to numerous municipalities within Indiana that protect sexual orientation and gender identity through local ordinance. See *Indiana: LGBT Non-discrimination in the States* (Freedom for All Americans, Feb 7, 2018), archived at http://perma.cc/YR85-VHRC (listing municipalities in Indiana that provide such protections).
importantly among conservatives—to see accommodation as something more than a symbolic weapon in the culture war. Indeed, the fate of religious accommodation as a practice may well depend on whether we can find ways to preserve the role of accommodations in protecting religious minorities without running roughshod over other important interests—especially those surrounding nondiscrimination and LGBTQ rights.

In the meantime, however, we do well to resist certain temptations. Justice Oliver Wendell Holmes famously remarked that “hard cases make bad law.”\textsuperscript{321} We ought to heed his advice, especially when interpreting the Establishment Clause. The idea that the Establishment Clause prohibits “harmful” accommodations might sound appealing, especially when we are thinking about culture war issues. But it is ultimately unworkable as a legal rule and is at odds with our tradition and the best of our practices. The debate over religious accommodations will be resolved sooner or later, and probably in a way that leaves purists on both sides unsatisfied. But however that happens, it is to our benefit to develop an interpretation of the Establishment Clause that is faithful to history and sensible in light of precedent.

The Establishment Clause is not a cure-all for the problems sometimes accompanying religious accommodation. Rather, it is a guarantee that government can’t use its power to control the religious lives of its citizens. As such, Establishment Clause limits on accommodation—like accommodations themselves—are about furthering freedom for everyone, religious or not. They ensure that, whether one chooses to practice a religion or refrain from practicing one, the choice to do so is really one’s own. And in that way, they preserve religious freedom, a freedom that has always has been, in James Madison’s words, “the glory of our country.”\textsuperscript{322}

\textsuperscript{321} Northern Securities Co v United States, 193 US 197, 400 (1904) (Holmes dissenting).
\textsuperscript{322} 2 Annals of Congress 1871 (Dec 22, 1790) (“It is the glory of our country . . . that a more sacred regard to the rights of mankind is preserved than has heretofore been known.”).
When a state utility wishes to cross land located within a Native American reservation, but the landowners refuse to allow it, the utility in most circumstances may exercise eminent domain over the land. Under the authority of a federal statute, 25 USC § 357, states may generally condemn allotments, plots owned by individuals that lie within the sovereign boundaries of a tribal reservation. Courts have long recognized that the state authority to condemn these allotments under § 357 arises from the principle that individually owned allotments are no longer “tribal” land and, as a result, they are not protected by tribal sovereignty.

Congress’s failure to transition away from the allotment system has resulted in an ownership structure for certain plots of reservation land that it did not anticipate when it enacted § 357. Today, not all allotments are held entirely by individuals, and many now contain fractional, undivided interests that belong to tribes themselves. This status of joint ownership between individuals and tribes, which this Comment refers to as “partially tribal,” leads to considerable complications with respect to the scope of § 357. Courts have routinely held that land owned by a sovereign Native American tribe is not subject to state condemnation and that this principle protects tribal interests in allotments. Unresolved, however, is whether a tribal interest in an allotment—which can be as small as a fraction of 1 percent—should immunize even the nontribal interest in the plot from state condemnation proceedings. In other words, should a fractional tribal interest place an entire parcel out of the state’s reach?

This Comment argues that it should. The courts that have attempted to allow condemnations to proceed against partially tribal allotments run into the problem that all ownership interests in an allotment are undivided; each owner holds an undivided share of the whole parcel. This means there is no way to divide the tribal interests from the nontribal ones without effecting some kind of incursion on a tribal land interest without the tribe’s or Congress’s consent, a result that principles of tribal sovereignty squarely reject. This Comment recognizes that Congress’s intent when it passed § 357 was to eliminate tribal landholdings, but it argues that Congress has since changed course such that courts should disregard that original intent. This Comment also concedes that diminishing eminent domain power may lead to holdout problems, though it argues that protecting tribal sovereignty is the
more important interest. Consistent with the principle that states may not diminish any tribal sovereignty without Congress’s consent, this Comment concludes that a state utility has multiple avenues for seeking access to a partially tribal allotment, including opportunities for negotiation with the tribe and the federal government. Courts should not permit states to use § 357 unilaterally to divest a nonconsenting tribe from its interest in land.

INTRODUCTION

When a state government pursues a utility project, utility lines must often cross land owned by private individuals. Though the state’s power to condemn property is ordinarily sufficient to allow the government to construct such a line through the property, special difficulty emerges when the utility lines are to cross tribal lands. What, in such circumstances, ought to occur when tribal landowners—invoking principles of tribal sovereignty—refuse to allow condemnation? Or, more commonly, what ought to
result when a public utility’s temporary right-of-way expires and the present tribal landowners withhold their consent to renew the right-of-way?

Congress has authorized the condemnation of tribal lands allotted to individual landowners but not of lands held by a tribal entity. Left unclear, however, is whether plots held in common ownership between a tribe and various individuals can be condemned for this purpose. This Comment refers to such plots as “partially tribal,” a status that implicates complicated questions about the scope of laws that apply to tribes but not to individuals, and vice versa. In this case, does the tribe’s undivided, fractional share in an allotment immunize the entire parcel from condemnation? Or may the condemnation action proceed against only the shares held by the individuals?

Because reservation land is “subject to plenary control by Congress,” answering these questions is an exercise in statutory interpretation. But courts have struggled to interpret and apply 25 USC § 357, the statute governing state condemnation actions concerning tribal lands allotted to tribes and individuals. Through § 357, Congress has permitted the state’s condemnation power to extend to allotments, parcels that are contained within tribal reservations but usually held by individual landowners instead of the tribal entity itself. This statute permits state condemnations of “[l]ands allotted in severalty to Indians . . . for any public purpose under the laws of the State or Territory where located in the same manner as land owned in fee may be condemned.” As the Ninth Circuit has noted, § 357 was not designed to provide “special protection” from condemnations of allotments

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2 The Supreme Court has clarified that Congress has the power to authorize condemnations of tribal lands by passing a statute that explicitly permits the exercise of eminent domain power. See, for example, Cherokee Nation v S Kansas Railway Co, 135 US 641, 656–57 (1890). See also United States v Clarke, 445 US 253, 255 (1980) (condemnation under § 357 may proceed only through judicial proceedings to acquire title, not through an “inverse condemnation” by which a government action occupies land, creating a right of action for damages ex post).
4 The allotment creates a trust relationship, under which the federal government is required to “hold the land ‘in trust for the sole use and benefit of the Indian’ allottees for a 25-year-period.” Poafpybitty v Shelly Oil Co, 390 US 365, 368 (1968), citing 25 USC § 348.
5 25 USC § 357.
held entirely by individuals. Parcels owned entirely by individuals are unquestionably within a state’s condemnation authority.

But certain statutory mechanisms have enabled tribal entities themselves to acquire undivided interests in allotted parcels over time. In *Public Service Co of New Mexico v Barboan*, for example, the Navajo Nation claimed respective interests of 13.6 percent and 0.14 percent in two allotted plots. The question presented was whether these allotments, in each of which the tribe itself owned a small fractional interest, remained plots “allotted in severalty to Indians” within the scope of § 357.

The three federal circuit courts that have addressed this question—the Eighth, Ninth, and Tenth Circuits—have held that, when a tribe holds an undivided fractional interest in an allotment, the tribal interest cannot be condemned. District courts in these circuits have adopted a more nuanced approach with respect to the nontribal interest, asking whether a court, a public utility, or a tribal entity can separate the tribal interest in the allotted plot from the nontribal interest. At least one district court has carried out the condemnability analysis for the individually owned, nontribal “portion” of an allotment jointly held between individuals and a tribe. Another court has reached a different conclusion, holding that principles of tribal sovereignty and immunity from suit prevent the fragmentation of the plot and prevent the court from forcing the tribe to litigate the matter.

Interpreting § 357 brings into tension the plain text of the statute, traditional interpretive canons, congressional purpose, economic efficiency concerns, and historic principles of tribal sovereignty. Courts addressing this issue often face a delicate balancing act: principles of tribal sovereignty dictate that plots held even fractionally by a tribe should remain uncondemnable, but holding entirely in favor of the tribe allows landowners to extract

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6 *S California Edison Co v Rice*, 685 F2d 354, 356 (9th Cir 1982).
8 Id at 1106.
9 Id at 1105.
10 *Nebraska Public Power District v 100.95 Acres of Land in County of Thurston, Hiram Grant*, 719 F2d 956, 961 (8th Cir 1983).
11 *United States v Pend Oreille Public Utility District No. 1*, 28 F3d 1544, 1551–52 (9th Cir 1994).
12 *Barboan*, 857 F3d at 1105.
disproportionate payment or entirely veto a project in the course of land negotiations.\textsuperscript{15} This particular form of holdout problem—in which a party with disproportionate bargaining power refuses to reach a land agreement absent a high payout—is particularly troublesome because the result of these negotiations can dramatically affect the public’s or the tribe’s receipt of important utilities, such as drinking water or electricity.

This Comment argues that the best reading of § 357 permits state authorities to condemn only allotments in which the tribal entity claims zero undivided interest. In other words, the condemnation power should extend only to plots held entirely by individuals. Any other reading has the effect of allowing a partition, often against the tribe’s wishes, that runs against principles of tribal sovereignty. Even requiring the tribe to litigate the matter is often a violation of its sovereignty interest.\textsuperscript{16}

Settling this area of law would provide clarity to three highly interested constituencies: tribes, individual allotment holders, and public utilities. This is particularly true when utilities have already constructed power lines and other projects under authority from the Bureau of Indian Affairs (BIA) right-of-way process, as losing a condemnation action after failing to receive consent to renew easements means that the utility suddenly can be subject to massive liability for trespass.\textsuperscript{17} Whether this typically leads to bargaining or an actual shutdown of the project is not clear.\textsuperscript{18} Any answer to this unresolved question, of course, must consider not only the cost of moving utility lines and the purpose of § 357 (which both seem to militate in favor of allowing some way to condemn the nontribal interest) but also the “extremely compelling interest”\textsuperscript{19} in tribal sovereignty that courts are inclined to respect.

\begin{itemize}
\item \textsuperscript{16} See note 34–35 and accompanying text.
\item \textsuperscript{17} See, for example, \textit{WBI Energy}, 2017 WL 523381 at *6 (“If WBI fails to pay the just compensation awarded to Mrs. Plainbull following a trial on the merits, WBI will become a trespasser.”); \textit{Davilla v Enable Midstream Partners LP}, 913 F3d 959, 970–71 (10th Cir 2019).
\item \textsuperscript{18} Given that \textit{WBI Energy} does not have any public documents available related to appellate proceedings, a reasonable assumption is that the utilities and the tribes tend to negotiate in the shadow of a district court order denying a condemnation, as opposed to the assumption that the utility simply accepted the loss and abandoned its power line after exhausting all appeals.
\item \textsuperscript{19} \textit{Enable Oklahoma}, 2016 WL 4402961 at *5 (finding the tribe’s sovereign immunity to be an “extremely compelling interest favoring dismissal”).
\end{itemize}
This Comment proceeds in three Parts. Part I discusses the history of congressional land policy with respect to Native Americans. Initially motivated by a desire to expand available areas for white settlement, Congress eventually changed course and enacted policies that gave increasing deference to tribal sovereignty. Part II describes the division of authority: district courts have not uniformly determined whether they should refuse to partition the nontribal portion of a tribal land parcel. Part III concludes that the best reading of the statute requires courts to dismiss condemnation actions against entire plots in which a tribe claims any fractional interest. The Conclusion summarizes this Comment’s contribution and discusses some implications for more complicated or invasive public works that cross and use partially tribal land.

I. HISTORY OF TRIBAL LAND AND THE CONDEMNATION POWER

Tribes are “separate sovereigns pre-existing the Constitution” and are generally unconstrained by constitutional provisions intended to limit federal or state authority.\(^20\) They retain their sovereignty unless Congress modifies it by altering the “substantive law applicable to the tribe.”\(^21\) All “aspect[s] of tribal sovereignty” therefore are “subject to plenary federal control and definition” and are subject to diminution by a state only with federal authorization.\(^22\) The Supreme Court has justified tribal immunity by explaining that tribes are “‘domestic dependent nations’ that exercise ‘inherent sovereign authority,’”\(^23\) and retain their “pre-existing” sovereignty over their territory “unless and until Congress acts” to the contrary.\(^24\)

Various overlapping congressional acts, amended and reamended over time, have created the often-uncertain interest in parcels allotted to tribes. This Part explains that a cohesive congressional strategy for allotted parcels never fully materialized or lasted for more than a few decades. As a result, there is confusion about the proper status of allotted parcels splintered

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\(^{21}\) Id at 58.

\(^{22}\) Three Affiliated Tribes of the Fort Berthold Reservation v Wold Engineering, 476 US 877, 891 (1986) (emphasis added).


\(^{24}\) Bay Mills Indian Community, 134 S Ct at 2030 (quotation marks and citations omitted).
between coexisting undivided interests belonging to individuals and to a tribe.

A. Congressional Approaches to Tribal Land and Sovereignty

1. Tribal sovereignty.

The sovereign authority of Native American tribes is expansive but not without limitation. The Supreme Court has established that, as a background assumption, tribes retain the constitutional features of self-governance and immunity that attach to independent and sovereign nations. Tribes are generally exempt from “constitutional provisions framed specifically as limitations on federal or state authority.”

Expounding on this historical principle, federal courts have recognized tribes’ rights to govern the affairs of tribal members within tribal territory, free from interference by state and federal authorities or the limitations on state power contained in the Constitution.

Tribes “have long been recognized as possessing the common law immunity from suit traditionally enjoyed by sovereign powers.” In United States v United States Fidelity & Guaranty Co, for instance, the “sovereign immunity of Indian tribes was equated with that of the United States, [meaning] neither tribal governments, nor tribal officials acting within the scope of their authority, are subject to nonconsensual suit.”

Despite the Supreme Court’s deference to principles of tribal independence, tribal sovereignty extends only as far as Congress permits. Courts have interpreted the Constitution to mean that federal authority expressed by Congress is “superior and plenary”

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25 Santa Clara Pueblo, 436 US at 56. See also id (“[T]he Fifth Amendment did not ‘operat[e] upon’ the powers of local self-government enjoyed by the tribes.”), citing Talton v Mayes, 163 US 376, 384 (1889). But see Alvin J. Ziontz, After Martinez: Civil Rights under Tribal Government, 12 UC Davis L Rev 1, 2 & n 2 (1979) (discussing a federal statute, the Indian Civil Rights Acts of 1968, which requires tribes to honor most of the individual rights and liberties secured in the US Constitution, including the freedom of speech and religion, the right against self-incrimination, the right to just compensation when land is taken for public use, and more).


27 Id at 58.

28 309 US 506 (1940).

with respect to tribal rights to self-governance. When Congress enacts legislation that constitutes an “unequivocal[ ] expression[ ]” of its intent to waive a tribe’s sovereign rights, courts defer entirely to Congress’s determination of the tribe’s right to self-governance. Congress may even dissolve tribal governments and reservations entirely. The inquiry into whether a particular tribe retains sovereignty over a particular area of the law or within a physical territory, then, depends on the scope of congressional action and the interpretation of the statute diminishing tribal power. Preexisting sovereignty yields when a court determines that Congress has deprived a tribe of those historical rights. As a result, tribes are sovereign, but courts consider that sovereignty to be dependent on Congress’s actions.

Recent Supreme Court jurisprudence has clarified the scope of tribal sovereignty. Although federal power over tribes is plenary, courts should exercise extreme deference to tribal sovereign interests. For example, in Michigan v Bay Mills Indian Community, the Court stressed that requiring a tribe to defend a suit—absent explicit congressional authorization, tribal consent, or a waiver—violated its sovereign rights. In Solem v Bartlett, the Court held that Congress may terminate tribal governments and reservation land status only through explicit language effectuating the termination.


32 See, for example, Solem v Bartlett, 465 US 463, 470–72 (1984) (holding that reservations are terminated only when Congress enacts text explicitly effectuating termination).

33 See Bay Mills Indian Community, 134 S Ct at 2030 (“Thus, unless and until Congress acts, the tribes retain their historic sovereign authority.”) (quotation marks omitted).

34 134 S Ct 2024 (2014).

35 Id at 788.


37 See id at 470–72. The Solem line of cases has solidified a strict plain statement rule that requires explicit language from Congress to terminate reservations, giving little regard to the subsequent history of the land, including cases in which there are zero remaining tribal residents on land once set aside as a reservation. See, for example, Nebraska v Parker, 136 S Ct 1072, 1081–82 (2016) (holding that a tribe’s absence “from the disputed territory” cannot “overcome the statutory text, which is devoid of any language indicative of Congress’ intent to diminish” the reservation). In Parker, the Court clarified that while a court may use the subsequent demographic history of a land’s occupants in considering whether a reservation has been terminated, “the Court has never
Courts continue to recognize that tribal sovereignty is an “extremely compelling interest,” permitting incursions only when there is clear evidence of congressional intent or a tribe’s waiver of its immunity.38 Such cases include matters in which a state government, a public utility, or the federal government seeks to condemn tribal land for a public interest. Therefore, against a backdrop principle of preexisting tribal sovereignty, two questions emerge in cases in which a tribe seeks to avoid the jurisdiction of a state or federal court. First, courts ask whether a tribe’s sovereign immunity is at issue at all.39 When courts do find that the case implicates tribal sovereignty, they ask whether Congress has altered the background assumption that a tribe may refuse to have its interest adjudicated against its wishes in federal and state courts.40

relied solely on this [ ] consideration to find diminishment” in the absence of supporting evidence from the statutory text. Id at 1081.


39 Courts do not always find that tribal sovereignty is implicated at this first stage. See, for example, National Labor Relations Board v Little River Band of Ottawa Indians Tribal Government, 788 F3d 537, 555 (6th Cir 2015) (finding that the National Labor Relations Act applies to Native American tribes because the law applies to all employers, including tribal entities). But see id at 556 (McKeague dissenting) (noting that the court created a circuit split, contrary to Congress’s instructions, by applying the Act to tribes in the absence of clear statutory language). See also Harrison v PCI Gaming Authority, 251 S3d 24, 26–34 (Ala 2017) (ruling that the Poarch Band of Creek Indians were not entitled to sovereign immunity to avoid tort liability under Alabama’s Dram Shop Act, and sharply criticizing the Supreme Court’s jurisprudence favoring sovereign immunity).

40 A recent bankruptcy appeal in the Sixth Circuit Court of Appeals highlights the special caution with which courts treat claims that Congress has abrogated tribal sovereignty or that a tribe has waived it. See In re Greektown Holdings, LLC, 917 F3d 451, 456–67 (6th Cir 2019). In the case, a tribe asserted a sovereign immunity defense to a fraudulent transfer action, which otherwise might have resulted in the tribe needing to return certain funds it had acquired from the debtor. The court clarified that immunity from suit is a “baseline position” that lies within the “core” of tribal sovereignty until Congress expressly abrogates it. Id at 456 (quotation marks and citations omitted). It determined that Congress had not abrogated tribal sovereignty, even by including the phrase “other foreign or domestic government” in the relevant statute, because that phrase did not unequivocally include tribes. Id at 460. Further, the court was unwilling to find the tribe had waived its immunity. Even though the debtor was entirely owned by the very same tribe that sought to avoid the court’s jurisdiction in this appeal, the court found that even filing for bankruptcy in federal court had not waived the tribe’s immunity from the fraudulent transfer action, which is a separate legal action from the bankruptcy petition. Id at 463–67.
2. Shifting congressional approaches to tribal lands.

Congressional action with respect to Native American land has generally resulted in massive deprivations of tribal sovereignty and land. Notably, though, the mechanisms by which Congress effectuated and then eventually partially rolled back this land loss have evolved significantly over time. The District of Nebraska recently described Congress’s “shifting policy goals” with respect to allotments as “at most inconsistent and at times irreconcilable.”41 Scholars and courts have divided shifting congressional policies into distinct eras that tend to summarize the federal government’s treatment of Native American land.

The first era of note, almost certainly the darkest chapter of US history with respect to Native American land holdings, was the Forced Relocation Era of the early nineteenth century. During this time, Congress sanctioned pushing Native American tribes west into “Indian Country” with the purpose of “segregat[ing] [them]—both territorially and politically—from the rest of society.”42 As Professor Stacy Leeds has noted, the “history of federal Indian policy is replete with examples of land taken from” Native Americans with the purpose of redistributing it to others who would “presumably make better use of the land.”43

Prior to the Forced Relocation Era, land could leave Native American hands only through purchase, acquisition, or “as the spoils of a ‘just war.’”44 As “ownership conflicts arose” and white settlement crept westward, however, the Supreme Court eventually ruled in Johnson and Graham’s Lessee v McIntosh45 that Native Americans held merely a right of occupancy in their land that was subject to the state and federal governments’ “exclusive power to extinguish that right.”46 There are “literally thousands

41 Natural Gas Co v 80 Acres of Land in Thurston County, 2018 WL 3586527, *2 (D Neb).
43 Stacy L. Leeds, By Eminent Domain or Some Other Name: A Tribal Perspective on Taking Land, 41 Tulsa L Rev 51, 59 (2005). See also id at 52 (noting that in many federal cases concerning takings of Native American land, “the underlying rationale for the taking was the belief that Indians were not using the land as efficiently as another owner would,” leading to the conclusion that “the ‘public good’ necessitated the taking of land from the Indians”).
45 21 US (8 Wheat) 543 (1823).
46 Id at 585.
of stories” of forced removal at the hands of the federal government that followed.\textsuperscript{47} The Forced Relocation Era reveals a dying justification for the tribal land laws drafted during this time.

Following the Forced Relocation Era came the Allotment Era, in which Congress largely changed course from its explicit policy of forced relocation. During this time, whites had settled across the western United States, including over areas Congress had initially designated as Indian Country. Congress began to terminate tribal collective ownership in reservations, replacing the segregation of Native Americans through the reservation system with a policy of “allotting those lands to tribe members individually.”\textsuperscript{48} The General Allotment Act of 1887,\textsuperscript{49} among others,\textsuperscript{50} created allotments by leaving in place the outer boundaries of the affected reservations but transferring the ownership of individual plots from title held collectively by the tribe to subdivided plots held individually by Native American allottees.\textsuperscript{51} The stated purpose of the allotment policy was to achieve integration between tribes and the rest of the United States, with the eventual goal of dissolving the tribal government entirely and “assimilating” its members into majoritarian society through a system of private land ownership.\textsuperscript{52}

This allotment process granted specific quantities of land to each head of a Native American family. Smaller parcels were doled out to Native Americans aged eighteen and older and orphans younger than eighteen.\textsuperscript{53} In the event that there were lands leftover from the allotment process, the federal government retained the surplus and offered it for sale on behalf of the tribes.\textsuperscript{54}

\begin{footnotes}
\item 47 Leeds, 41 Tulsa L Rev at 63 (cited in note 43).
\item 50 See, for example, Curtis Act, 30 Stat 495 (1898); Burke Act, 34 Stat 182 (1906).
\item 52 See Barboan, 857 F3d at 1105 (10th Cir 2017) (suggesting that this strange land ownership system might be due to the fact that Congress “anticipated the imminent demise” of the reservation at the time and therefore thought there would soon be no tribal lands that might fall under § 357), quoting Solem, 465 US at 468.
\item 53 See Oneida Tribe of Indians of Wisconsin v Village of Hobart, 542 F Supp 2d 908, 911 (ED Wis 2008).
\item 54 Royster, 27 Ariz St L J at 9 (cited in note 51) (“Indians were to receive allotments of land in severality, and the remaining surplus lands were to be opened to settlement.”).
\end{footnotes}
Given that the stated congressional goal of the allotment process was the assimilation of tribal members, it is unsurprising that this policy resulted in massive losses of land for tribes and members. The Allotment Era policy of selling off lands through “surplus land” acts resulted in a loss of roughly ninety million acres of Native American landholdings between 1887 and 1934.\textsuperscript{55}

The policy also imposed strict limitations on the alienability of allotments, limitations that remain in place today.\textsuperscript{56} When a parcel is allotted to a tribe, the United States retains the fee title and holds the land in trust. The land cannot be sold or partitioned, and it can be alienated only according to the intestate succession laws of the state or territory in which the parcel is located.\textsuperscript{57} This might not have been especially difficult to manage at the time of the allotment acts: after twenty-five years, the fee title was intended to pass to individual allotment holders and out of the trust relationship with the United States. Congress anticipated that, through this scheme, allotted plots would eventually “assimilate” into the ordinary real property laws of the various states.\textsuperscript{58} Indeed, Congress specifically designed the allotment system to assimilate tribal land holdings into nontribal systems of individual land ownership.

As the deadline for tribal dissolution approached, the initial congressional plans to terminate tribal governments entirely and fold tribal members and landholdings into the general laws of the states surrounding them proved to be costlier than anticipated. The transfers also garnered less congressional support than they had initially. For some tribes, the process of completing the allotment transfers to individuals took longer than Congress had planned; this required Congress to extend the tribal government,

\begin{footnotes}
\textsuperscript{55} Royster, 27 Ariz St L J at 12 (cited in note 51).
\textsuperscript{56} Jessica A. Shoemaker, No Sticks in My Bundle: Rethinking the Indian Land Tenure Problem, 63 U Kan L Rev 383, 385 n 8 (2015) (“Most trust property today still cannot be transferred, alienated, or leased without the approval of the Secretary of Interior. . . . Some new exceptions for tribal leases of tribal lands now exist, but these do not apply to individually owned trust allotments.”).
\textsuperscript{57} N Natural Gas Co, 2018 WL 5386527 at *2, citing Hodel v Irving, 481 US 704, 707 (1987).
\textsuperscript{58} See Barboan, 857 F3d at 1104.
\end{footnotes}
along with the trust relationship Congress maintained over allotted plots, on a case-by-case basis.\textsuperscript{59} For example, in \textit{Murphy v Royal},\textsuperscript{60} Congress’s initial allotment act with respect to the Muskogee (Creek) reservation had planned for the trust relationship to end and for the tribal entity to be terminated in March 1906.\textsuperscript{61} When Congress could neither complete the allotment process nor resolve how to terminate the tribal government, however, it passed a resolution temporarily extending the tribal government and delaying the termination of the trust relationship of the allotted parcels.\textsuperscript{62}

This is just one example of how tribal allotment, which Congress intended only as a temporary measure, resulted in allotment status continuing to exist for large swaths of tribal land. As a result, Congress left the reservation boundaries intact and continued the system of allotting reservation lands to individuals. The Creek tribe provides an example of how impactful this decision may turn out to be for the present allotment status of these lands. In 2017, the Tenth Circuit held that the initially temporary 1906 extension of the Muskogee (Creek) reservation was still in effect.\textsuperscript{63} The Tenth Circuit noted that Congress had failed to complete its mission to terminate the tribal government that it had set out to dissolve in 1906. The Creek reservation is just one of many reservations in the western United States that still are subject to the century-old allotment policy.\textsuperscript{64}

\textsuperscript{59} Courts have noted that during this period, the reason for extending the existence of the tribe as a separate legal entity was often to complete the process of deeding allotment interests to individuals and winding down the business of the tribe. As a result, while Congress extended the existence of tribes, this likely reflected its desire to continue the work of winding them down rather than rebuilding what had already been lost. See, for example, \textit{Murphy v Royal}, 875 F3d 896, 935 (10th Cir 2017), cert granted, \textit{Carpenter v Murphy}, 138 S Ct 2026 (2018) (noting that “[a]s the termination date approached [for the Five Tribes of Oklahoma], much remained to be done . . . [and] [i]t was apparent that the affairs of the tribe could not be wound up by the date set”) (quotation marks and citations omitted), citing \textit{Harjo v Kleppe}, 420 F Supp 1110, 1126 (DDC 1976). As of publication, this case is pending in the Supreme Court, but the question presented does not call into doubt this historical observation in the courts below.

\textsuperscript{60} 875 F3d 896 (10th Cir 2017), cert granted, \textit{Carpenter v Murphy}, 138 S Ct 2026 (2018).

\textsuperscript{61} \textit{Murphy}, 875 F3d at 935, citing the Creek Allotment Agreement § 46, 31 Stat 872.

\textsuperscript{62} Act of March 2, 1906, 59th Cong, 1st Sess, 34 Stat 822 (1906).

\textsuperscript{63} \textit{Murphy}, 875 F3d at 966.

\textsuperscript{64} The BIA and Bureau of Labor Management (BLM) still retain the ability to issue allotments, although it is no longer the prevailing policy goal of the federal government to transfer tribal land holdings to individual allottees. Indeed, this policy is considerably more controversial in the twenty-first century. See, for example, US Government Accountability Office, \textit{Report to the Senate Committee on Appropriations concerning Indian Issues: BLM’s Program for Issuing Individual Indian Allotments on Public Lands}. 
Extending the trust relationship—and its resulting severe restrains on alienability—beyond the twenty-five-year period resulted in a “splinter[ing]” of “multiple undivided interests with some parcels having hundreds, and many parcels having dozens, of owners” over generations of intestate succession. Because the Allotment Era statutes imposed severe restrains on alienation over allotted plots, individual holdings in allotments could be alienated only through intestate succession, a restriction that survived long after the initially intended completion of the allotment process. Multiple heirs might end up claiming dozens, or even hundreds, of undivided interests in the same parcel, depending on the applicable intestate succession laws of the state in which the reservation was located. And this all occurred well after Congress had anticipated terminating the allotment system. In 1934, Congress officially ceased its allotment transfers of title with the Indian Reorganization Act of 1934. While the Allotment Era that began in 1887 ended with the passage of this statute, and Congress largely no longer explicitly intended to terminate reservations, the allotments themselves—including their restrains on alienation—remained.

As the Allotment Era gave way to the contemporary system of general territorial tribal sovereignty, vestiges of the restrictive system of alienation and succession remained. Interests in allotments continued to splinter into dozens or hundreds of undivided interests through generations of intestate succession, and many parcels risked becoming mired in questions about ownership and manageability. When hundreds of cotenants claim undivided interests in the same plot, the potential for uncertainty and conflict arising from unequal contributions to the plot’s maintenance are likely to deprive the owners of the economic benefits of the land, not to mention their ability to pursue the quiet enjoyment of their property.

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65 N Natural Gas Co, 2018 WL 3586527 at *2.
66 Id.
68 See Hodel, 481 US at 708–09.
69 See Evelyn Alicia Lewis, Struggling with Quicksand: The Ins and Outs of Cotenant Possession Value Liability and a Call for Default Rule Reform, 1994 Wis L Rev 331, 349 (discussing economic disproportionality problems that arise when a cotenant either fails to contribute her portion of expenses or when one cotenant receives a disproportionate share of the benefits).
To resolve some of the potential uncertainty and conflict, Congress eventually granted tribal entities the power to acquire small, fractional, undivided interests in highly fragmented allotted plots through the Indian Land Consolidation Act of 1983.\textsuperscript{70} Tribes may acquire interests that constitute small percentages of the plot as a whole, which generally are so splintered that individual owners would have little use for them.\textsuperscript{71} While this system has returned some land to the tribes, it has also resulted in a “checkerboard of tribal, individual Indian, and individual non-Indian land interests.”\textsuperscript{72} Many allotments today are held jointly by tribes and individuals, some of whom have no tribal affiliation. The federal government estimates that the allotment process issued “millions” of acres of tribal lands to individuals between 1887 and 1934, and many allotments remain mired in this status today.\textsuperscript{73}

Tribes can still acquire undivided interests in allotments to consolidate holdings in lands that once belonged entirely to tribal entities. In addition to the Land Consolidation Act, Congress created other vehicles through which tribes can collect fractional interests in allotted plots. These options arose in response to a major class action brought by various Native American representatives against the Departments of Interior and Treasury. In \textit{Cobell v Salazar,}\textsuperscript{74} the DC Circuit approved a class action settlement in a land-loss dispute, which created a $1.9 billion “Trust Land Consolidation Fund for the purchase of fractional interests from willing sellers to consolidate property rights in Indian tribes.”\textsuperscript{75} In 2010, Congress “ratified that settlement in

\textsuperscript{70} Pub L No 97-459, 96 Stat 2517, codified at 25 USC § 2201 et seq. See also \textit{Babbit}, 519 US at 243 (holding that, when a fractional interest of any size escheats to the tribe upon an owner’s death under § 207 as amended, the Takings Clause requires just compensation).

\textsuperscript{71} This is how, for example, the Navajo Nation was able to acquire its interest in the disputed plots at issue in \textit{Barboan}. 857 F3d at 1106.

\textsuperscript{72} Id at 1105.

\textsuperscript{73} \textit{See Report concerning Indian Issues} at *1 (cited in note 64).

\textsuperscript{74} 679 F3d 909 (DC Cir 2012).

\textsuperscript{75} \textit{Cohen’s Handbook of Federal Indian Law} § 15.07[2] n 45 (cited in note 44). See also \textit{Cobell}, 679 F3d at 916, 924. The \textit{Cobell} settlement arose out of a class action alleging that the Secretary of the Interior had breached his duty to account for the funds held in trust for individual Native Americans through federal land management programs. Id at 912. The trust proceeds in that case came from transactions relating to land allotted to individuals under the General Allotment Act of 1887, the act that deprived tribes of millions of acres of land as the plots were allotted to individuals. The proposed settlement, which the DC Circuit eventually upheld, provided for the billions of dollars to go toward “Indian Education Scholarship” funds; tax exempt status for settlement funds flowing to
the Claims Resolution Act of 2010.”

As of April 2017, through the “Cobell land buy-back program,” more than $1.1 billion has been paid to landowners to consolidate more than 680,000 fractional interests, transferring almost 2.1 million acres of land to tribal governments.

A tribe’s ability to buy back land through the acquisition of fractional interests is almost certainly a benefit: the various buy-back systems allow tribes to consolidate the smallest fractional interests that generate essentially no utility for individual holders while also permitting tribes to regain some of their lost property interests. But the status of plots held by individual and tribal owners brings the scope of § 357 into some doubt. The statute clearly gives state authorities the power to bring eminent domain actions against allotments “in severalty to Indians.” But once a tribe claims an interest, the statute runs into the problem of tribal sovereignty, which covers immunity from any suit “absent congressional authorization (or a waiver).”

The question then becomes whether § 357 provides congressional authorization for states to condemn parcels in which the tribe holds a fractional, undivided interest, or whether the statute functions only to allow state condemnation against allotments as they stood before these land buyback programs permitted tribes to repurchase certain fractional holdings.

B. 25 USC § 357 and State Condemnation Authority

The above history provides necessary context for an examination of federally enabled takings by a state utility of tribally and individually owned parcels, and it informs this Section’s examination of a state’s power to take tribal lands for public purposes. The state’s power of eminent domain is often necessary to solve the holdout problems that result when providers of public goods must negotiate with individual landholders for access to land. A broad grant of authority to state utilities to condemn tribal land means that state decisionmakers may have too much

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78 Bay Mills Indian Community, 134 S Ct at 2031.
power to decide what constitutes the public interest regarding tribal land.

When Congress enacted § 357 in 1901, it did not intend to grant allotted plots any “special protection.” Since then, Congress has changed course and become far more solicitous of tribal rights and sovereignty. This change makes the utilities’ preferred interpretation of § 357—one that creates an unrestricted condemnation power—less obvious.

Public utilities typically do not rely initially on their condemning authority to access “tribal lands.” They instead turn to a separate statutory scheme under 25 USC § 323 that authorizes the BIA to grant time-limited rights-of-way over tribal land. Under 25 CFR § 169, the BIA may transfer interests in tribal property while acting pursuant to the federal government’s trust relationship with the tribe (maintaining the lands in the tribe’s best interests and holding funds for the benefit of the tribe). In 2015, the BIA substantially updated § 169 to “better support tribal self-determination,” imposing additional deadlines on the BIA to act on requests for rights-of-way and requiring the consent of a majority of landowners to grant certain rights of access. Additionally, construction for service lines no longer requires a formal right-of-way but does require a “service line agreement” that first obtains the consent of the landowner(s) and is then filed with the BIA.

At issue in Barboan, for example, was a fifty-year right-of-way over allotted land within the Navajo Nation, which the BIA had granted to a utility to construct a high-voltage electric line. While the right-of-way had been the utility’s preferred method of

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79 S California Edison Co v Rice, 685 F2d 354, 356 (9th Cir 1982).
80 The federal government’s current definition of “tribal land” can be found in 25 CFR § 169.2:

Tribal land means any tract in which the surface estate, or an undivided interest in the surface estate, is owned by one or more tribes in trust or restricted status. The term also includes the surface estates of lands held in trust for a tribe but reserved for BIA administrative purposes and includes the surface estate of lands held in trust for an Indian corporation chartered under section 17 of the Indian Reorganization Act of 1934.

(emphasis added).
84 Barboan, 857 F3d at 1104.
using the allotted parcels because it did not require costly or politically fraught condemnation proceedings, the process required the consent of a majority of the individual holders and the tribe itself.\footnote{See 25 USC § 324. The BIA considers the tribe’s consent, regardless of its percentage of ownership, to be necessary to grant a right-of-way over tribal land. As a result, an undivided interest of any size seems to give a tribe veto power. Rights of Way on Indian Land, 80 Fed Reg 72492, 72509 (Nov 19, 2015), codified at 25 CFR § 169.101(b).}

Courts generally view § 323 and § 357 as alternate means of obtaining easements across Native American land.\footnote{While these three cases announced the same principle of law (that § 357 does not reach tribal interests), they discussed property interests differently. \textit{Nebraska Public Power} involved a future interest belonging to the tribe, \textit{Pend Oreille} involved land presently held in trust by the federal government, and \textit{Barboan} discussed a tribal interest in the easement using more explicit lines of tribal sovereignty.} When, as was the case in \textit{Barboan}, the tribe revokes its consent to renew the right-of-way, utilities may be subject to high damages in subsequent trespass actions brought against the existing utility projects constructed under the revoked right-of-way. Utility companies placed in this position typically argue that the state is left with no choice but to exercise its authority to condemn the utility’s way across the plot. But when the tribe itself holds a fractional, undivided interest in the plot at issue, this generally uncontroversial assertion of power becomes far more complicated: it is unclear whether, under § 357, the tribe may use its small interest to veto any state-enabled taking of the entire plot.

The Eighth, Ninth, and Tenth Circuits have all held that a public utility has the authority to condemn land that is allotted to individual Native Americans but not land allotted to tribes.\footnote{A reversionary interest is nonpossessory, meaning it does not permit the tribe to actually enter, cross, or use the land at the time of the conveyance. Rather, the tribe may obtain the remainder in a life estate, by which an individual landowner holds the plot for the remainder of his life, and the tribe obtains the fee simple interest in the land upon the individual’s death. \textit{Restatement (First) of Property § 154 (1936).}} In 1983, the Eighth Circuit held in \textit{Nebraska Public Power District v 100.95 Acres of Land in Thurston County, Hiram Grant} that even when a tribe’s fractional interest is limited to a future reversionary interest\footnote{\textit{Nebraska Public Power}, 719 F2d at 961.} in the plot, it is no longer within the scope of § 357, which reaches lands allotted to individuals.\footnote{See, for example, \textit{Nicodemus v Washington Water Power Co}, 264 F2d 614, 618 (9th Cir 1959) (“In our opinion Section 323 and Section 357 offer two methods for the acquisition of an easement across allotted Indian land for the construction of an electric transmission line.”); \textit{Nebraska Public Power District v 100.95 Acres of Land in County of Thurston, Hiram Grant}, 719 F2d 956, 960 (8th Cir 1983).}
Tribal land, the court held, includes “land or any interest therein, title to which is held by the United States in trust for a tribe.”

Eleven years later, in United States v Pend Orielle Public Utility District No 1, the Ninth Circuit held that a “[u]tility may be able to condemn land held in trust by the United States for the benefit of individual Indian allottees under 25 USC § 357, but this statute does not apply to land held in trust for the Tribe.” Recently in Barboan, the Tenth Circuit relied on principles of tribal sovereignty to conclude that the utility lacked the authority to condemn two allotments because they were owned by the Navajo Nation and considered “tribal land.” The court upheld the lower court’s decision without much discussion. The district court found that the Navajo Nation was an indispensable party to the action because of its immunity from state condemnation actions; therefore, its “interest in adequate compensation [could not] be adequately protected” unless it participated in the suit, but the district court dismissed the entire action under principles of tribal sovereign immunity.

The unsuccessful petition for certiorari in Barboan identifies the tensions between tribal sovereignty and condemnation of tribal land for public utilities. Tribal land can arguably be “created” when an allotment holder transfers some small, undivided, and potentially nonpossessory interest to a tribal entity. Simply by “recording a deed—rather than leaving that decision to Congress”—the tribes may be able to effectively declare large swaths of land held by individuals immune from condemnations for necessary public-utility projects. A simple transfer of some interest to the tribe then creates an entirely new “tribal” land status in the absence of authorization by Congress, which retains plenary control over tribal land. Allowing this result, the utilities argue, makes negotiations over necessary public works vulnerable to holdouts. Generally, the process of eminent domain is

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91 Id at 961–62.
92 28 F3d 1544 (9th Cir 1994).
93 Id at 1551–52, citing Nebraska Public Power, 719 F2d at 961.
94 Barboan, 857 F3d at 1110–11, citing Nebraska Public Power, 719 F2d at 961–62.
95 Barboan, 857 F3d at 1111–12, affg Public Service Co of New Mexico v Approximately 15.49 Acres of Land in McKinley County, 155 F Supp 3d 1151 (D NM 2015).
96 Public Service Co of New Mexico,155 F Supp 3d at 1169–70.
98 PNM Petition at *28 (cited in note 97).
99 See id at *13–15. See also Richard A. Posner, Foreword: A Political Court, 119 Harv L Rev at 93–94 (discussing the problem of holdouts).
thought to be an efficient—and often necessary—solution to this particular problem, as it revokes veto power from the nonconsenting party.  

The principle underlying the Eighth, Ninth, and Tenth Circuit opinions introduces an entirely new set of questions: When the tribe holds an undivided interest in the surface estate of an allotment, has the previously nontribal allotment been transformed into tribal land? Does the land become tribal even though the allocation of possessory interests does not differ at all from a plot allotted entirely to individuals? How much of an interest must the tribe claim in order to transform a plot that is, in effect, allotted to individuals and perhaps intended to be within the scope of § 357, into tribal land?

II. THE TENSION AMONG DISTRICT COURTS: DOES § 357 PERMIT CONDEMNATION OF THE NONTRIBAL INTEREST?

*Barboan, Pend Oreille,* and *Nebraska Public Power* all stand for the proposition that allotments held in part by a Native American tribe cannot be condemned under § 357. That clear rule, however, has not resolved whether a fractional tribal interest in an allotment immunizes the entire plot from state condemnation. District courts within the Ninth and Tenth Circuits disagree over how courts must treat nontribal interests in plots jointly held by tribes and individuals. These courts have yet to clearly articulate a rule with respect to the nontribal interests in a partially tribal allotment.

District courts’ divergent approaches might be explained in one of two ways. On the one hand, it may be that circuit courts simply have not reached the question whether a nontribal interest must receive immunity from condemnation when there is a tribal interest in the same allotment. On the other, it is possible that circuit courts intended to foreclose that possibility, but lower courts have not applied that precedent and instead have carved out methods by which certain interests in partially tribal parcels may be condemned. This Comment argues that, at the very least,

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questions of tribal sovereignty create some disagreement regarding the condemnability of nontribal interests in these plots, which remains an open question among district courts.

This Comment considers district courts’ approaches and argues that allowing a partition and condemnation constitutes an unacceptable infringement on tribal sovereignty through the creation of a de facto partition against the tribe’s wishes.

A. The WBI Energy Approach: Condemn the Interests of Private Allottees in Partially Tribal Plots

At first glance, it appears that the Ninth Circuit adopted the Eighth Circuit’s reasoning and held that an entire allotment subject to a § 357 dispute is immune from condemnation when the tribe claims any undivided interest in the plot. The District of Montana, however, seems to disagree with that conclusion. In WBI Energy Transmission Inc v Easement & Right-of-Way, the district court concluded that § 357 protects only the tribe’s interest in the allotted parcel, permitting condemnation actions to proceed against the private allottees’ interests. In WBI Energy, the United States held undivided, fractional ownership shares in the allotted parcel on behalf of an individual member of the Crow tribe and the Crow tribe. WBI operated a public pipeline on this parcel under authority of a right-of-way granted by the BIA. When the allottee refused to renew her consent at the expiration of the right-of-way period, the pipeline operator sought the ability to continue operation of the pipeline through a condemnation action under § 357.

The court ruled that any § 357 condemnation would have “no force with respect to the Crow Tribe’s interest” in the allotments because the Crow tribe held an undivided interest in the contested parcels. But WBI nevertheless had a right to enter, cross,

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101 See Pend Oreille, 28 F3d at 1551–52 (“The Utility may be able to condemn land held in trust by the United States for the benefit of individual Indian allottees under 25 U.S.C. § 357, but this statute does not apply to land held in trust for the Tribe.”), citing Nebraska Public Power, 719 F2d at 961. See also notes 92–93 and accompanying text.

102 2017 WL 532281 (D Mont).

103 Id at *4.

104 Id at *2.

105 Id at *1.


107 Id at *4.
and use the property because it had “established its right to condemn the Subject Property,” but the condemnation had force and effect “only to the extent of [the private allotment holder’s] interest.” The district court cited to Pend Oreille, but only for the proposition that the law does not permit condemnation over “tribal trust lands.”

The court granted WBI an easement to continue operating its pipeline, concluding that a preliminary injunction allowing the condemnation to proceed was justified. Despite noting the tribe’s immunity from any litigation over the plot, the court went on to describe, in detail, the legal description of the easement it granted to permit continued operation of the pipeline over the allotment holder’s objection. The court’s description of that easement specifically established WBI’s ability to cross the entire plot and run the pipeline without the allottee’s consent.

Given that the definition of “tribal land” includes any “undivided interest in the surface estate,” and the court made no attempt to partition the parcel into tribal and nontribal portions, the court in effect authorized § 357 to extend over the tribe’s undivided interest in the parcel. By doing so, the court permitted a condemnation of the nontribal interest without requiring any sort of partition or meaningful carve-out for the tribal interest. Because the tribal interest was an undivided stake in the whole plot, the court’s order cannot be reasonably interpreted as having no force or effect with respect to the tribe’s interest. The WBI Energy court thus permitted a condemnation of nontribal interests in a plot in which the tribe held an undivided interest in the surface estate.

108 Id at *5.
109 Id at *4.
111 See id at *4–5, citing Ranchers Cattlemen Action Legal Fund United Stockgrowers of America v United States Department of Agriculture, 415 F3d 1078, 1092 (9th Cir 2005).
113 25 CFR § 169.2.
114 The court did not specify what kind of legal relationship between allotment holders its order would create, except that its decision would have no force or effect with respect to the tribe’s fractional interest. In the Barboan petition, the utility categorized the relationship in WBI Energy as similar to a cotenancy relationship, in which (1) “those who hold interests in the same allotment parcel are tenants in common”; and (2) each cotenant has “a right to enter upon, explore and possess the entire premises” with or without the consent of the other cotenants as long as he does not do so “to the exclusion” of other cotenants. PNM Petition at *33, citing 2 Tiffany Real Property § 426 (Callaghan 3d ed 1947).
B. The Enable Oklahoma Approach: Hold the Entire Plot Immune When the Tribal Entity Claims Any Interest

In Enable Oklahoma Intrastate Transmission, LLC v 25 Foot Wide Easement, the Western District of Oklahoma took a different approach from the District of Montana. At the heart of the dispute was an allotment in which the Kiowa tribe held a 1.1 percent undivided interest. At the expiration of a right-of-way in 2000, a public utility initiated a condemnation action to continue operation of a twenty-five-foot-wide natural gas pipeline. The tribe asserted that the action should be dismissed because of its sovereign immunity. But the court noted that it “[c]learly [ ] would have subject matter jurisdiction over a condemnation action regarding lands that are allotted in severalty to Indians.” The court used that reading of the statute to interpret § 357 as authorizing a state diminution of tribal land holdings, following Congress’s instructions, only when the tribal interest is zero. The court rejected the utility’s § 357 condemnation of the entire plot because the tribe’s 1.1 percent undivided interests removed all of the interests from the scope of § 357.

The court broke from the WBI Energy court by holding that it could not exercise subject matter jurisdiction over any part of the plot because the tribe would have been a required party to the case, and the court would be powerless to adjudicate the tribe’s interests without its consent. While the court noted it would have had subject matter jurisdiction under § 357 if the land were completely owned by individuals, the small tribal interest deprived the court of jurisdiction over the entire plot.

The court relied in part on the definition of tribal land in 25 CFR § 169.2. Lacking any ability to partition the already-allotted allotment interests in the disputed plots, the court found itself compelled to dismiss the entire action, effectively allowing the private allotment-holders to stop a condemnation action because of the tribe’s small, fractional interest.

115 2016 WL 4402061 (WD Okla).
117 Id at *2.
118 Id at *4.
119 Id at *3–4, citing FRCP 19(1)(1), 71.1(c)(3).
120 Enable Oklahoma, 2016 WL 4402061 at *3–4.
121 See note 80.
The \textit{WBI} court allowed the condemnation despite the tribe’s interest, but the \textit{Enable Oklahoma} court failed to reach the merits of the decision and held only that § 357, as informed by principles of sovereign immunity, served as an absolute bar to its subject matter jurisdiction.\footnote{Compare \textit{WBI Energy}, 2017 WL 532281 at *4 (allowing condemnation), with \textit{Enable Oklahoma}, 2016 WL 4402061 at *3 (dismissing the § 357 action on sovereign immunity grounds).} Ultimately, the \textit{Enable Oklahoma} court found “that equity and good conscience mandate” dismissal, for “sovereign immunity is an extremely compelling interest.”\footnote{\textit{Enable Oklahoma}, 2016 WL 4402061 at *5.}

C. The Implication of This Division of Authority for Nontribal Interests

There is a clear lack of uniformity in how courts weigh and analyze the plain text of § 357, principles of tribal sovereignty, and the arguments put forward by state utilities regarding the economic importance of maintaining established public-utility projects. Without some ability to exercise condemnation authority after the consent-based right-of-way process has failed, bargaining will likely fail or be heavily lopsided when a court denies condemnation and permits holdouts to determine the fate of the entire project.\footnote{See Atriam, 18 Berkeley J Afr Am L & Pol at 53 (cited in note 100).} An owner who withheld consent to construct a right-of-way would seem highly unlikely to engage in productive bargaining. Following this reasoning, the utilities state that the only way to construct necessary projects—or to maintain those that already exist—is through condemnation. Condemning the land both serves § 357’s purpose of opening allotments to state condemnation and provides the public writ large with beneficial public goods that need to cross private lands.

Interestingly, both the \textit{WBI Energy} and \textit{Enable Oklahoma} courts cited \textit{Nebraska Public Power}, out-of-circuit precedent, to support their different conclusions. There are two possible explanations for this. First, perhaps both courts superficially agree on the proper interpretation of § 357 even though their holdings with respect to the proper partition of undivided interests indicate otherwise. Second, the courts might disagree on the proper interpretation of § 357—perhaps one court believes that § 357 permits condemnation of the nontribal interest, while the other finds the statute to be a jurisdictional bar to state condemnation actions over partially tribal land. The \textit{Enable Oklahoma} court refused to
adjudicate the question at all, but the *WBI Energy* court permitted condemnation of a portion of the allotment to proceed against the tribe’s wishes. The latter approach, while nominally lacking force or effect with respect to the tribe’s interest, permitted the utility to cross and utilize land in which the tribe holds an undivided interest.

This does not appear to be district courts simply misapplying precedent. Instead, it appears that the scope of the settled law regarding § 357 is rather narrow, and courts have simply left open the issue whether condemnation actions may proceed against the interests of the private interest-holders. Neither *Barboan* in the Tenth Circuit nor *Pend Oreille* in the Ninth clearly requires courts to rule in either direction on this particular question of nontribal land condemnability.

The stakes of this question are high. Depending on the form of the state’s desired taking, the resulting liability from a successful trespass action could be substantial. For example, in *Pend Oreille*, the project was a hydroelectric dam that trespassed on allotments by flooding the plots. If the land had been considered partially tribal and immune from § 357 takings, the state would be subject to significant liability (in addition to its ex ante obligation not to flood the land).

Additionally, the three circuits that have faced this question are located in areas where nearly all tribal land disputes concerning § 357 take place. As a technical matter, this question remains unresolved in many circuits, although it seems especially important to seek uniformity across district courts in these three western circuits. There are more than fifty million acres of Native American trust lands in the United States, the majority of which are located in the western half of the country. The western United States is, of course, overseen by the three circuits that have addressed these questions about the scope of § 357. Other circuits have, albeit rarely, confronted tribal land takings issues

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126 A § 357 condemnation action is not the only type of dispute that occurs almost entirely in the western portion of the country. See, for example, *Solem v Bartlett*, 465 US 463, 466–67 (1984) (regarding tribal disestablishment on appeal from the Eighth Circuit); *Murphy*, 875 F3d at 896 (regarding tribal sovereignty in the context of a habeas corpus appeal under the Major Crimes Act and applying the *Solem* factors).
raised by allotments, including § 357 questions. Those other circuits have not addressed whether courts may permit a condemnation of the nontribal interest under § 357.

III. THE HOLDOUT “PROBLEM” THAT ISN’T A PROBLEM: RESOLVING THE AMBIGUITY THROUGH DEFERENCE TO TRIBAL SOVEREIGNTY

The text of § 357 leaves ambiguous whether tribal land in which tribes hold an undivided, fractional interest can be condemned. This Part first briefly discusses the text of § 357. It then considers other methods of interpretation that courts have deemed relevant and argues that the best interpretation prohibits state utilities from advancing condemnation proceedings when a tribe holds any undivided interest in an allotment.

Reading the statute in this way upholds tribal sovereignty and permits the tribe to assert its own condemnation powers in the appropriate case. While there may be cases in which the equities weigh so heavily in favor of condemnation that immunizing an entire allotment appears absurd, a narrow reading of a state’s § 357 power still permits takings by both the federal government and the tribe.

A. Ambiguous Language in § 357 Exacerbates Courts’ Problems with Statutory Interpretation

Courts have often addressed questions related to the status of tribal land by engaging in traditional modes of statutory interpretation. The reasons that scrutinizing the words enacted by Congress matters so much in this area are at least twofold. First, because congressional control over tribal land is plenary, the words enacted by Congress may often be the only sources of authority concerning whether certain land may be considered tribal. Courts simply must determine precisely what Congress meant when it took actions related to tribal land status. Second, when a relevant statute is unclear, modes of interpretation assist in resolving any potential ambiguity. For example, the Solem line of

127 See, for example, Lac Courte Oreilles Band of Lake Superior Chippewa Indians v Federal Power Commission, 510 F2d 198, 208–09 (DC Cir 1975) (holding that § 15 of the Federal Power Act permits the issuance of an interim annual license on reservation land); Tuscarora Nation of Indians v Power Authority of the State of New York, 257 F2d 885, 891–92 (2d Cir 1958) (holding that Congress had implied power to take tribal land by eminent domain).
cases explicitly engages with a plain text view of the relevant statute, requiring a clear statement from Congress effecting a diminishment of tribal land before a court may hold that reservation territory has been shrunk or eliminated.\textsuperscript{128} In the context of partially tribal allotments, a court’s view of the status of the contested land—whether it is sufficiently “tribal” to be outside the scope of § 357—also depends on statutory interpretation. This Comment therefore assesses the statute through the lens of some modes of interpretation that courts commonly apply to issues of tribal land, including § 357 in particular.

As courts do in nearly every case, it is prudent to begin with the statute’s plain meaning, especially as the Supreme Court has made clear that the “plain meaning” rule applies to § 357.\textsuperscript{129} In relevant part, the statute provides: “Lands allotted in severalty to Indians may be condemned for any public purpose under the laws of the State or Territory where located in the same manner as land owned in fee may be condemned, and the money awarded as damages shall be paid to the allottee.”\textsuperscript{130} This text alone almost certainly has animated the Eighth, Ninth, and Tenth Circuits’ decisions to prohibit state condemnations of land that is clearly tribal. The phrase “allotted in severalty to Indians” on its face does not include the “allotment interest of a tribal entity.” An interest “allotted in severalty to Indians” does not plainly include the tribal interest, a separate category of interest holder from the individual “Indians” who held allotments at the time of the statute’s enactment. If courts are to draw the conclusion that the parcel may be condemned under the statute, that conclusion does not flow from the statute’s plain text.

But does the statute also abrogate tribal sovereignty by applying § 357 condemnation to all allotted plots as some utilities have argued? As the Ninth Circuit has indicated, the statute may appear to favor the utilities’ interpretation by providing these

\textsuperscript{128} See, for example, Nebraska v Parker, 136 S Ct 1072, 1079–89 (2016) (affirming and applying the Solem test, which reads the relevant statute for plain language effecting a diminishment, considers the circumstances surrounding the act’s passage, and, least importantly, reviews the subsequent demographic history and treatment by government officials); Wyoming v EPA, 875 F3d 505, 512–25 (10th Cir 2017) (holding that the reservation was diminished by utilizing the three-part Solem test). See also Grant Christensen, A View from American Courts: The Year in Indian Law 2017, 41 Seattle U L Rev 805, 881–86 & 882 n 56 (2018) (describing four Supreme Court cases in the last three decades that have had to determine whether a reservation was diminished).

\textsuperscript{129} United States v Clarke, 445 US 253, 254 (1980).

\textsuperscript{130} 25 USC § 357 (emphasis added).
partially tribal allotments “no special protection” from a state’s ordinary condemnation power. Is it consistent with the “plain meaning” to hold that a state may not act against a plot at all because there is a small, undivided tribal interest that removes the entire plot from condemnability under the statute? Alternatively, could the utilities be correct that this result is absurd and undermines the statute’s function? Such interpretations surely cannot be gleaned from the statute’s plain text. Whatever conclusions one may draw about the equivalency between the statute’s reference to “Indians” and its reach to tribal interests, courts must look beyond the statute’s plain meaning to resolve that ambiguity.

B. The Utilities’ Standard Arguments in Favor of Condemnation: Statutory Purpose and the “Indian Canon”

Because the text of § 357 is ambiguous, the next question is whether courts have aligned on any particular statutory canon of interpretation to determine the boundary line at which Congress has abrogated tribal sovereignty with respect to allotments. In other words, do any interpretive tools provide special assistance in determining the precise scope of § 357 with respect to partially tribal allotments? No standard canon of interpretation proves particularly dispositive. But in light of the relevant history and the specific arguments made by utilities, two particular methods of interpretation must be considered initially and rejected: purposivism and the “Indian canon.”

Utilities seeking condemnation of partially tribal allotments have argued that Congress’s purpose in enacting § 357 was to abrogate all tribal sovereignty in the precise way that the Court in Bay Mills Indian Community explained: tribal sovereignty extends only as far as Congress expresses no unequivocal intent to abrogate it. Under this reading, Congress has already waived the tribe’s sovereignty, and as a result, the plots could be condemned irrespective of any tribal interest because § 357 extends to all allotments. While important to consider in the face of ambiguous text, purposivism does little to solve this problem because, through intervening legislation, Congress has renounced

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131 S California Edison Co v Rice, 685 F2d 354, 356 (9th Cir 1982).
132 Bay Mills Indian Community, 134 S Ct at 1031–32.
133 John F. Manning, The New Purposivism, 2011 S Ct Rev 113, 141–46 (discussing contemporary trends in statutory interpretation, which look first to a statute’s plain text
the original reason for the allotment acts: the termination of tribal land holdings altogether.

As stated in Part I and noted by the Ninth Circuit, the fifty-sixth Congress intended to provide allotted plots “no special protection” from condemnation actions by states. But the seventy-third Congress changed course entirely with the 1934 Indian Reorganization Act. By terminating the allotment policy but leaving already-allotted parcels frozen in their Allotment Era status, Congress brought confusion to the status of a state’s § 357 power. The fifty-sixth Congress clearly intended to terminate tribal landholdings, which would make a purposivist inquiry in 1901 rather easy. But Congress’s intent at the time would almost certainly be rejected today, and it was repudiated by Congress itself nearly seventy-five years ago. Section 357 remains good law, but Congress’s later attitudes and a general increase in societal and judicial respect for tribal self-determination muddy any inquiry into whether adherence to statutory purpose remains a wise course.

Not only has Congress changed course, but, as a normative matter, relying on the purpose of Congress in 1901 would only serve to reinforce a now-rejected regime of treatment of Native Americans. A view of statutory purpose informed by history necessarily requires rejecting any reading that relies on the vestiges of a dark history of explicit subjugation and deprivation of Native American land at the hands of the federal government. As discussed in Part I, throughout both the Forced Relocation Era and the Allotment Era, which brought about the passage of § 357, Congress’s intentions involved a bald desire to strip tribes of land in order to make room for other uses. The obvious repugnance of this purpose makes it an especially inappropriate basis for interpreting § 357.

Another method of interpretation is the so-called “Indian canon,” which provides that “statutes are to be construed liberally in favor of the Indians, with ambiguous provisions interpreted to

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but generally permit consideration of legislative history and purpose “in cases of statutory ambiguity”).

134 S California Edison Co, 685 F2d at 356.
their benefit.” Analogous in its application to the contract principle of contra proferentem, the motivation behind this canon is the history of systematic disadvantages that characterize Native American interactions with the federal government. When ambiguities arise, a court may resolve them in a tribe’s favor.

Interestingly, both parties in a § 357 dispute may invoke this canon: either side may appeal to the tribe’s “best interests.” In the cert petition filed in Barboan, the utility argued that the beneficiaries of power lines through Native American lands are often tribe members who would otherwise be without power. Because the utility had both tribal and nontribal customers, they argued, allowing a single holdout to shut down the project or extract large side payments is not only inefficient but ultimately harmful to the tribe. Whether the utility is correct about the application of this particular canon, however, should not weigh heavily on the analysis. For one, there is an emerging consensus that the best judge of the tribe’s interest is the tribe itself, and a paternalistic justification for condemnation when the tribe itself does not consent to the taking is dubious.

It is also not clear that the canon should apply to this statute at all. Courts and parties to these cases have debated and questioned the actual reach of this particular interpretive tool. The Supreme Court has stated that the canon applies to statutes “passed for the benefit of dependent Indian tribes.”

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137 See Conference of Western Attorneys General, American Indian Law Deskbook § 1:6 (May 2018 Update) (“Indian canons . . . derive from the disadvantage labored under by tribes in making treaties and agreements with the Executive Branch.”). These canons take into consideration the government’s trust relationship with tribes, and other considerations might include intentional deception by the government, language barriers, and special advantage-taking of legal technicalities.

138 PNM Petition at *29–32 (cited in note 97). See also Shakopee Mdewakanton Sioux Community v Hope, 16 F3d 262, 264–65 (8th Cir 1994) (interpreting a gaming statute in the tribe’s interests does not require accepting the tribe’s legal arguments or requested result).


140 Alaska Pacific Fisheries v United States, 248 US 78, 89 (1918).
clearly did not pass § 357 for the benefit of Native American tribes. The utility in Barboan requested a more permissive reading, calling it merely “abbreviated” and omitting the phrase “for the benefit of [ ] Indian tribes.” This reading arguably suggests that the canon might be applied to all statutes that govern tribes.

But it is not clear whether the fact that the statute may not have been passed for the benefit of affected tribes matters because, as stated above, one should presume that a tribe is well equipped to look out for its own interests and would consent to beneficial utility projects. While the utility in Barboan was able to cite a handful of cases in which a court applied the “Indian canon” and ruled against the tribe, presuming otherwise is highly paternalistic and especially inappropriate in a § 357 dispute, in which the tribe is able to exercise bargaining power during the necessarily prior and consent-based right-of-way process.

As the tribe is well equipped to represent its own interest and hold out against a taking if it deems that action necessary, a court overriding a tribe’s determination of its own best interests is especially out of place in the context of § 357. While there may be reasons to permit a condemnation to proceed anyway, as the court did in WBI Energy, those reasons should not be based on a nontribal determination of the tribe’s best interests, despite the utility’s arguments about the beneficiaries of its business operations.

The application of these canons of interpretation does not, therefore, entirely resolve the question whether § 357 permits a state to condemn any part of an allotment in which a tribe holds an undivided interest.

C. The Undivided Tribal Interest as a Blocking Interest

The WBI Energy court inferred that an individual interest in a jointly held allotment can be condemned because § 357 does not extend to the tribal interest. But this inference was misplaced for two reasons. First, the statute does not plainly give rise to that

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141 PNM Petition at *30 (cited in note 97).
142 See Blackfeet Tribe, 471 US at 766.
143 See PNM Petition at *31 (cited in note 97), citing Yellowfish v City of Stillwater, 691 F2d 926, 931 (10th Cir 1982), and Shakopee Mdewakanton Sioux Community, 16 F3d at 264.
144 See, for example, WBI Energy, 2017 WL 532281 at *2 (characterizing the project that sought to cross tribal land as “necessary”).
inference. As discussed in Part III.A, the plain text of the statute neither proves nor disproves the utilities’ proposition that § 357 opened all allotment territory to state condemnation. The statute merely establishes that allotments held entirely by individuals cannot claim a tribal immunity defense to condemnation. Second, if courts are to hold the tribal interest immune from condemnation under § 357, they have yet to articulate a workable partition-based solution that allows these interests to be divided from each other, and it would not be possible without divesting a tribe of an interest in property against its consent. Third, the potential gap in condemnation authority left by a narrower reading of § 357 can be filled by other schemes. A broad reading of § 357 runs the risk of ignoring the tribe’s important sovereignty interest against incursions by state governments. Considering these factors, this Comment concludes that the best reading of § 357 limits state condemnation power to allotments in which the tribe claims zero interest, particularly in light of statutory regimes that have explicitly recognized a tribe’s right to self-determination. This includes the ability to negotiate for and to provide social services and public works to a tribe’s members.

One principle informing this conclusion is the long history of tribal land deprivation that Part II describes. As scholars have chronicled, state and federal court actions have generally resulted in massive land losses for tribes, as government entities prioritized white settlement over tribal sovereignty. Any taking of Native American land by a state government requires a discussion of whether such a scheme would be in the interest of justice considering the history of tribal lands. If a particular power line or utility project were in the tribe’s interest, one should presume that a tribe would not surrender the benefits of that project merely to assert its own sovereignty.

As was the case in Barboan, utilities commonly argue that a narrow reading of state condemnation authority defeats the purpose of eminent domain and exposes utilities with costly existing

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145 See, for example, Leeds, 41 Tulsa L Rev at 52 (cited in note 43) (“For centuries, American Indians have seen their lands taken by federal and state governments without consent, and at times, without compensation.”), citing Tee-Hit-Ton Indians v United States, 348 US 272, 288–91 (1955) (holding that compensation is not available to the tribe when the United States does not recognize aboriginal title); Sioux Tribe of Indians v United States, 316 US 317, 331 (1942) (holding that the federal government does not owe compensation for taking lands that were set aside to Indians by executive order).
146 See Part I.
147 See note 139.
projects to massive waste, loss of capital, or liability for trespass. The utility will incur substantial costs when the tribe claims any interest. It therefore might seem inefficient to permit the tribe to veto a taking by a public utility or hold out for excessive payments using its position in the bilateral monopoly. This problem is amplified when, as was the case in Barboan, the tribe is able to shut down (or greatly inconvenience) a project using only a 0.14 percent undivided fractional interest in a single allotment. From a utility’s perspective, the current circuit law and its related inferences blocking condemnation create an “anticommons” problem, in which multiple interest-holders have veto power over the project but none alone can grant access. A condemning authority working on a utility project that requires crossing multiple plots can usually force a sale if negotiations fail. But in the current context of a parcel of land exempted by § 357, the utility must reroute, cease entirely, or negotiate with an interest-holder who might refuse for any reason at no cost. Allowing a tribe to acquire a small, fractional interest well after the Allotment Era and then proceed to shut down an existing project after the right-of-way expires seems ripe for manipulation. For example, in Nebraska Public Power, the tribal members who successfully immunized their plot from state condemnation transferred a future interest to the tribe while reserving for themselves only a life estate. The Eight Circuit thought this was sufficient to deny the state utility the power to condemn the parcel. The petition for certiorari in Barboan referred to this as manipulation in the form of creating tribal land “by recording a deed—rather than leaving that decision to Congress.”

But potential waste resulting from a single holdout to a utility project over tribal land after an adverse § 357 ruling is not a

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149 See, for example, Michael A. Heller, The Tragedy of the Anticommons: Property in the Transition from Marx to Markets, 111 Harv L Rev 621, 623–24, 673–79 (1998) (discussing the “tragedy of the anticommons,” a problem that emerges when multiple owners are “endowed with the right to exclude others from a scarce resource, and no one has an effective privilege of use”).

150 See generally, for example, Thomas J. Miceli and Kathleen Segerson, A Bargaining Model of Holdouts and Takings, 9 Am L & Econ Rev 160 (2007).

151 There is little doubt that western settlement depended on the construction of telegraph and electric lines over tribal land. When the right-of-ways expire and the parcels are immune from condemnation, utilities can be suddenly exposed to massive liability for trespass. See Barboan, 857 F3d at 1105.

152 See Nebraska Public Power, 719 F2d at 961–62.

153 PNM Petition at *28 (cited in note 97).
serious concern because § 357 is not the only avenue by which a utility can acquire the right to condemn allotted lands. Tribes themselves also have the power to condemn lands within their own territory for public use.154 Exercising sovereign authority within the boundaries of reservations, the tribal entity’s power to condemn is the proper filler to the gap left by § 357. While it would, on its own, be somewhat absurd and certainly inefficient to say that a miniscule tribal interest in a single allotment could stop or shutdown an entire utility, the tribes will generally continue to look out for their own interests, including access to power and water.155

When a utility serves tribal customers, or when the tribe sees an opportunity for productive negotiations, it will have the ability to both negotiate with the individual allotment-holders for a right-of-way and (if negotiations fail) seek a condemnation in conjunction with the tribal authority. In light of more recent developments in Native American law, scholars have begun to question any interpretation of tribal authority that deprives a tribe of the determination of its own best interests.156 Here too, one should be hesitant about a regime that excludes from the process a sovereign tribe with the ability to negotiate during multiple stages of the right-of-way and potential condemnation process.

Recognizing certain rights to tribal self-determination—the idea that a “nation freely governs itself”—as encompassing the ability to participate in negotiations with utility providers and other governments has received widespread regulatory and scholarly acceptance.157 Since at least 1975, the federal government has

154 See, for example, Leeds, 41 Tulsa L Rev at 69 (cited in note 43) (“Tribal codes and constitutions have been amended to provide for the power to acquire lands within their political and territorial boundaries without the consent of the individual landowners.”), citing, among others, Sisseton-Wahpeton Sioux Tribal codes § 47-01-01 (“[The] Tribe shall have authority . . . to condemn trust or restricted land . . . for public uses, including the elimination of fractional heirship interests.”), and Eastern Band of Cherokee Indians Code at § 40-1 (permitting condemnation by the tribe when its Council deems it “appropriate”).
155 See Hoeft, 14 Law & Ineq at 267 (cited in note 139) (advocating a “reanchoring” of the Indian canons to foreground tribes’ own interpretations of “their best interests”).
156 See, for example, id. See also Russel Lawrence Barsh, The Omen: Three Affiliated Tribes v. Moe and the Future of Tribal Self-Government, 5 Am Indian L Rev 1, 28–33 (1977) (discussing “benefit-burden” calculations that tribal governments make when providing certain services to their members and the nontribal persons who live inside and near reservations).
157 Geoffrey D. Strommer and Stephen D. Osborne, The History, Status, and Future of Tribal Self-Governance under the Indian Self-Determination and Education Assistance Act, 39 Am Indian L Rev 1, 3 (2014). See also id at 3 & nn 2–3, 16–18 (citing examples and defending the underlying rationale of tribal self-determination as a “human right”).
explicitly devolved certain powers to tribes that it “would otherwise be obliged to provide to Indians . . . includ[ing] healthcare, education, road construction, and social services.”

Today, the federal government’s empowerment of tribes to explicitly act on behalf of the general welfare of tribe members, including through the provision of useful social services and public works, provides another justification to safely presume the tribe will negotiate in good faith on behalf of its members’ interests in the receipt of those services.

D. The Unworkability of a Partition Solution

Despite some compelling economic efficiency arguments made by utilities that have lost § 357 condemnation actions, a nontribal interest in allotted plots should still be held immune from any condemnation under § 357 for multiple reasons. First, any partition action or access to the parcel against the tribe’s consent necessarily injures the tribe’s undivided interest, and to adjudicate even the tribe’s tiny fractional interest after it asserts ownership would be a violation of its “extremely compelling” interest in sovereign immunity. Second, immunity from condemnation is not necessarily as inefficient as the utilities suggest because tribes will likely look out for their own interests and not arbitrarily or spitefully withhold their consent when the project benefits its members. Third, tribal condemnation power supplies an additional safeguard for the interests of the tribe generally against the holdout problem created by a potential individual holder of an allotment who frustrates a utility’s attempt to condemn.

There simply is no way to partition an allotment with a tribal interest that does not fundamentally reduce the extent of the tribe’s sovereignty and rights with respect to that undivided parcel even if the deprivation occurs against a small and undivided interest. Any kind of partition similar to the WBI court’s order either gives the tribe a blocking interest (thus rendering the partition useless), entirely surrenders tribal control over the plot to the state’s desires, or results in a “permanent physical occupation” on land over which the tribe asserts ownership. This would clearly be a taking under § 357 against tribal interests even if the court holds that the interests have somehow been severed.

158 Id at 4.
159 Loretto v Teleprompter Manhattan CATV Corp, 458 US 420, 426 (1982).
A solution that advocates for partitioning an allotment does not address the economic inefficiencies inherent in a § 357 dispute, nor does it adequately take account of tribal sovereignty. For one, partitions generally must be initiated by someone with an interest in the plot, and a utility is not in that position; courts in this context would theoretically be required to initiate a partition sua sponte.\textsuperscript{160} Second, because generations of intestate succession have created a situation in which most allotted plots have dozens or hundreds of owners of undivided interests, there may be too many parties with which to negotiate and divide interests. Certain states have enacted solutions to this problem in the context of nontribal land, such as the Uniform Partition of Heirs Property Act.\textsuperscript{161} When many heirs have inherited undivided interests and cannot agree on a partition or consolidation solution, these statutes permit any cotenant other than the one seeking a partition to buy out the cotenant seeking a partition at a fair market value.\textsuperscript{162}

But this solution likely would not work in the context of a § 357 dispute. First, when a tribe is a cotenant in an allotted property, courts have been clear that it can assert its rights both as an interest holder and as a sovereign entitled to have its interest protected with extreme caution.\textsuperscript{163} Second, partitions and buyouts are likely to result in a further loss of tribal land if portions of plots can be forcibly bought out, especially outside of the trust relationship and restraints on alienation with respect to certain allotted plots created by federal law. Third, a partition in kind

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\textsuperscript{160} Courts have rarely engaged with this question whether they have the authority to issue partition orders sua sponte. A review of state court decisions indicates that the practice is not supported by any rule of procedure, and the practice is nearly universally disallowed. See, for example, \textit{Lysaght v Krekstein}, 2017 WL 588391, *1 (Pa Sup); \textit{Guo v Guo}, 137 AD3d 974, 975 (NY App 2016). Even in both of these cases, unlike the theoretical partition in the case of a partially tribal allotment, at least one party in \textit{Guo} and \textit{Lysaght} sought a judicial partition, and the issue was whether the court could issue such an order on its own motion. In both cases, appeals courts determined that the power to order a partition sua sponte does not exist.

\textsuperscript{161} See, for example, Uniform Partition of Heirs Property Act, Mont Code Ann § 70-29-401 et seq.

\textsuperscript{162} See Mont Code Ann § 70-29-411 (2013).

\textsuperscript{163} See generally, for example, \textit{Enable Oklahoma}, 2016 WL 4402061. As courts have stressed, deprivations of tribal sovereignty must be treated with extreme caution, and any partition action necessarily injures the tribal interest. See also, for example, \textit{Solem}, 465 US at 472 (“When both an Act and its legislative history fail to provide substantial and compelling evidence of a congressional intention to diminish Indian lands, we are bound by our traditional solicitude for the Indian tribes to rule that diminishment did not take place and that the old reservation boundaries survived.”) (emphasis added).
might still create an interest that breaks up tribal land (by restricting the tribe’s interest to a stretch of physical land proportionate to its previous undivided percentage interest) or still blocks the project (if the tribe retains a 1 percent interest, does it hold the edge of the plot and retain the ability to block the power line that intends to cross it?). Finally, the sovereign interest of the tribe is still important to consider: while the WBI court intended to hold the tribe’s interest separate from its order permitting the utility to cross and take the land for its project because § 357 could not reach the tribe, merely stating that an order does not apply to the tribe could not actually divide the land because the tribe held an undivided interest in the entire plot.

Thus, a partition solution would result in a loss of tribal landholdings and sovereign interest. While Congress could, of course, amend or replace the allotment system by statute, in the absence of that decision, courts should not interpret § 357 to provide a right to a nonconsensual partition of partially tribal allotments.

E. Defending the Sovereignty-Oriented Solution Even When the Tribe Is Not a Significant Beneficiary

There remains a significant objection that a tribe’s interest may not lead to productive bargaining when a project benefits the public writ large but not the tribe or its members. For example, when a power line crosses tribal land but does not serve any tribal customers, the tribe might enter negotiations as a holdout with little incentive to cede an easement or initiate a taking.

While this is a serious consideration, § 357 is not the only way to take tribal land when necessary; it is simply the only way for a state to unilaterally divest tribal property interests. Importantly, the federal government retains the power to diminish tribal land holdings.164 And unlike the states, the federal government is bound by its trust relationship with the tribes. The Supreme Court has held that the federal government owes a “duty of protection” to tribes under a “ward-guardian” principle.165 Courts require the executive branch to adhere to a “strict” fiduciary relationship with dependent tribes while remaining more deferential

164 See Bay Mills Indian Community, 134 S Ct at 1030.
to Congress’s plenary control over tribal land.\footnote{166}{See Reid Peyton Chambers, Judicial Enforcement of the Federal Trust Responsibility to Indians, 27 Stan L Rev 1213, 1221–22 (1975).} Applying these principles, courts have recognized Fifth Amendment takings claims by tribes against the federal government. In 1980, the Supreme Court held that an 1877 statute ceding portions of the Great Sioux Reservation to the United States effected a taking and affirmed an award of $105 million.\footnote{167}{See generally United States v Sioux Nation of Indians, 448 US 371 (1980). Applying what is known as the Fort Berthold test, the Court reasoned that when Congress acts against tribal land, it wears “two hats,” the first as a trustee with fiduciary responsibilities and the other as a sovereign exercising eminent domain power. Congress may wear either, but not both simultaneously. Id at 408–09, citing The Three Affiliated Tribes of the Fort Berthold Reservation v United States, 390 F2d 686, 691 (Ct Cl 1968).} In sum, the federal government is able to cede portions of tribal land to necessary utilities, bound by both its “ward-guardian” obligations and the Fifth Amendment’s just compensation requirements. Permitting utility projects that benefit large swaths of the public writ large is well within federal power.

Additionally, courts have been quite comfortable affording Native American law a more liberal standard of review. Creating a higher burden for state takings of partially tribal land is consistent with this principle, even in the absence of a flawless economic rationale. In the Pacific Northwest, for example, federal law guarantees to a small native population the right to take one-half of all harvestable salmon.\footnote{168}{See Washington v Washington State Commercial Passenger Fishing Vessel Association, 443 US 658, 684 (1979).} The BIA is also permitted to employ hiring practices that explicitly prefer Native Americans over other applicants.\footnote{169}{See Morton v Mancari, 417 US 535, 547 (1974).} Despite some scholarly concerns that legal preferences such as these might violate the Equal Protection or Due Process Clauses, no compelling case has been made to this effect.\footnote{170}{See David C. Williams, The Borders of the Equal Protection Clause: Indians as Peoples, 38 UCLA L Rev 759, 761–62 (1991).} Requiring states to show that the taking does not implicate a tribal property interest is consistent with the idea that the semisovereign status of tribes permits a special legal regime.

Narrowly interpreting § 357 to permit condemnations only when the tribal interest is zero still leaves the utility with three options to pursue its project when the tribe asserts an undivided fractional interest. First, it may negotiate with allottees through the normal consent-based right-of-way process. Second, when the project is in the interests of the tribe, the tribe itself may condemn
reservation land. Third, the utility may appeal to a federal interest. Because the federal government may take tribal land consistent with its trust obligations to tribes specifically, a coherent system for considering these options is already in place, so there is no need to expand state power to accomplish the same thing using § 357.

CONCLUSION

In a § 357 dispute, when a state utility attempts to exercise its condemnation authority against allotted parcels that contain fractional, undivided tribal interests, economic efficiencies may indeed point to permitting the condemnation at first glance. The utilities suggest that they need to keep online their existing projects that cross allotments, and their only way to do this is to condemn the allotments. The intent of the Congress that passed § 357 seems well aligned with this interpretation of the statute.

But subsequent history and principles of tribal sovereignty weigh heavily in favor of a more restrictive view of state condemnation authority. If a court were inclined to permit a taking, as one did in WBI Energy, such a decision would not comport with a proper conception of either efficiency or tribal sovereignty. To the extent the utility asserts—as it did in Barboan—that it is in the tribe’s interest for the court to establish an easement across its allotted land without its consent, this argument likely misapplies171 the “Indian canon” and, as a more concerning matter, requires courts to engage in paternalistic assessments of the tribe’s best interest that are counter to the tribe’s own assessment.

Therefore, a solution to the holdout problem asserted by the utilities must also be consistent with the extremely compelling interest in maintaining the principles of tribal sovereignty. If there is no entirely consistent way to reconcile various interpretive principles, such as plain text, purpose, traditional canons, and economic implications, courts should err on the side of protecting tribal interests.

This problem does not necessarily end at simple power lines. A rule of law that interprets § 357 as a broad restriction of state power to act against these partially tribal allotments would protect against unacceptable losses of sovereignty, especially considering the potential implications of an alternative rule. If existing power lines can stand based on the state condemnation authority

171 See notes 135–39 and accompanying text.
of § 357 alone, there would be little to stop a state from interfering with tribal interests in allotted lands for larger and more invasive projects. In *Pend Oreille*, in the Ninth Circuit, for example, the project was not a power line but a hydroelectric dam that trespassed on allotments by flooding the plots. One could imagine large projects extending over allotted territory, such as major highways or even more invasive power projects, swallowing up whole plots in which the tribal entity itself claims an interest. It makes little sense for a utility to prevail on the argument that blocking these types of invasions of tribal sovereignty is wrong because it is “inefficient” from their perspective.172

The most sensible solution is to leave the gap created by § 357 to be filled by actors other than the state, be that the tribe capable of looking out for its own best interests or the federal government bound by its ward-guardianship responsibilities. While such a project could not proceed without the tribe’s consent in most cases, this does not seem to be the doomsday scenario that the utilities predict because one should assume the tribe will not block a useful project out of spite or ignorance of the economics. Additionally, accepting the premise that takings are justified as a solution for holdouts,173 the tribal condemnation solution solves the “anticommons”174 problem of having multiple holders of the same allotted plots pursuing competing interests. This approach further respects the “extremely compelling”175 interest in tribal sovereignty, which history teaches courts should not lightly ignore. To the extent that not extending the state condemnation power to plots that contain any fractional tribal interest creates a holdout problem, this is not actually a problem because there are other avenues to constructing a useful utility over these parcels. The solution to that “problem” should not be unilateral state condemnation against any interest, tribal or nontribal, under § 357 unless the tribe asserts no interest in the plot.

172 Nevertheless, this is an essential component of the utility’s argument. See PNM Petition at *31–32 (cited in note 97).
173 See note 100 and accompanying text.
174 See note 149 and accompanying text.
175 *Enable Oklahoma* 2016 WL 4402061 at *5.
The Underlying Underwriter: An Analysis of the Spotify Direct Listing

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In April 2018, music streaming giant Spotify disrupted the traditional initial public offering model and became a publicly traded company through a novel process known as a direct listing. Eschewing standard Wall Street practice, Spotify did not raise new money through the offering and instead simply made its existing shares available for purchase by the public. Spotify worked throughout 2017 and 2018 alongside legal counsel and investment banks and in communication with the Securities and Exchange Commission to facilitate the unorthodox approach. Major technology companies are now adopting a similar approach.

In recognition of these developments, this Comment has two aims: to shed light on the statutory contours of a direct listing and to contribute to the legal understanding of underwriter liability. As this financial innovation unfolds, an important question remains: Who is liable as an “underwriter” in a direct listing for purposes of liability under Section 11 of the Securities Act? This Comment argues that the investment banks Spotify retained as financial advisors qualify as statutory underwriters notwithstanding language in the registration statement to the contrary. By walking through the precise statutory elements of a direct listing and by calling attention to latent liabilities in the process, this Comment seeks to set forth a path for future technology unicorns to follow the Spotify playlist.

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INTRODUCTION

On April 3, 2018, global music streaming company Spotify Technology S.A. (Spotify) went public through a direct listing of its ordinary shares on the New York Stock Exchange (NYSE). Rather than raise money by issuing new shares to the public through a traditional initial public offering (IPO), Spotify made its existing shares available for purchase on the public exchange through the seldom-utilized direct listing process. Spotify worked closely alongside legal counsel and investment banks and in communication with the Securities and Exchange Commission (SEC) throughout 2017 and early 2018 to facilitate the unorthodox listing. This Comment examines the statutory contours of the process and asks whether the investment banks that Spotify retained as “financial advisors” qualify as statutory underwriters notwithstanding Spotify’s claim to the contrary.

Direct listings have the chance to become a new tool in the equity capital markets toolkit. In a direct listing, a company makes its shares available for purchase on a national exchange. The company does not raise new money through the offering as it would in a traditional IPO. Rather, existing shareholders, such as employees and early-stage investors, can simply sell their shares to the general public upon listing. Direct listings allow a company to achieve many of the benefits of being public without incurring the costs associated with a traditional IPO. Shareholders can take advantage of the liquidity that a national exchange provides without first being subject to a lengthy lockup period. The company,
Meanwhile, can realize the financial flexibility that public companies typically enjoy without facing the steep fees common to the standard IPO process.

Many legal scholars and financial commentators have remarked on the novelty of the approach, the pecuniary and strategic benefits of the process, and the potential for other “unicorns” to follow Spotify’s lead. Indeed, workplace messaging company Slack has filed confidential materials with the SEC to conduct a direct listing in 2019, making it the first to adopt the model that Spotify pioneered. The NYSE amended its rules to provide a path for direct listings, and the Nasdaq has recently filed a proposal to clarify its direct listing procedures. Now, direct listings are not intended for all companies. The ideal candidate is a company without an immediate need for cash with a strong brand and an easy to understand business model. As more money flows into private markets, direct listings could become a viable path to liquidity for many unicorns. Indeed, major companies have taken the lead. Spotify went public at a valuation exceeding $26 billion; Slack was recently valued at $7 billion. As other major technology companies follow the Spotify playlist, it will be essential to understand the precise statutory contours of a direct listing and the latent liabilities that exist in the process.

1 “unicorn” is a company with greater than a $1 billion valuation based on a recent round of financing. For legal commentary on the Spotify direct listing, see generally, for example, John C. Coffee Jr, The Spotify Listing: Can an “Underwriter-less” IPO Attract Other Unicorns? (CLS Blue Sky Blog, Jan 16, 2018), archived at http://perma.cc/XV4K-ZV2P. See also generally, for example, Matt Levine, Spotify’s Non-IPO Really Is Novel (Bloomberg, Jan 4, 2018), archived at http://perma.cc/DF7Y-AUXV.

2 As of publication, Slack has not yet completed its direct listing. However, the company has filed a registration statement with the SEC. Slack Technologies, Inc., Form S-1 Registration Statement (Apr 26, 2019), archived at http://perma.cc/MV78-MZWY. See also Maureen Farrell, Slack Files to Go Public with Direct Listing (Wall St J, Feb 4, 2019), online at http://www.wsj.com/articles/slack-files-confidentially-to-go-public-with-direct-listing-11549301336 (visited Apr 29, 2019) (Perma archive unavailable).

3 For more on the NYSE rule change, see Part II.B.3. In February 2019, Nasdaq proposed changes to the SEC to clarify its direct listing process, presumably in an effort to stay competitive with the NYSE in the listing sphere. See Securities and Exchange Commission Release No 34-85156, 84 Fed Reg 5787 (Feb 22, 2019).


As this Comment explains, “going public” and “direct listing” are specific terms that carry certain legal ramifications for the parties involved. A theme that runs throughout the Comment—indeed, one that runs throughout much of securities regulation doctrine—is whether substance prevails over form. Are direct listings functionally equivalent to IPOs, and, therefore, do the same liability rules for material misstatements or omissions in offering materials apply? Or is there a key distinction between the two methods for going public that changes, or should change, where such liability falls?

In the wake of the stock market crash of 1929, the legal regime governing financial securities in the United States shifted from caveat emptor to caveat vendor. With the goal of protecting investors through mandatory disclosure, Congress passed two foundational statutes: the Securities Act of 1933 (the Securities Act) and the Exchange Act of 1934 (the Exchange Act). The Securities Act governs the initial distribution of securities, while the Exchange Act governs their subsequent trading. Section 11 of the Securities Act imposes strict liability on multiple parties for material misstatements or omissions in offering documents. An underwriter, or “any person who . . . participates” in a distribution of securities, is an enumerated defendant under the statute. The securities regime imposes liability on underwriters in public securities offerings to ensure complete and accurate disclosure of information about the issuer to the public. This Comment

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6 See, for example, Securities and Exchange Commission v M & A West, Inc, 538 F3d 1043, 1053 (9th Cir 2008) (“The Supreme Court has long instructed that securities law places emphasis on economic reality and disregards form for substance.”); Tcherepnin v Knight, 389 US 332, 336 (1967); Securities and Exchange Commission v W.J. Howey Co, 328 US 293, 298–300 (1946).
8 48 Stat 74, codified as amended at 15 USC § 77a et seq.
9 48 Stat 881, codified as amended at 15 USC § 78a et seq.
11 15 USC § 77k. For a thorough discussion of § 11 liability, see Part III.A.
12 15 USC §§ 77b(a)(11), 77k(a). For a thorough discussion of underwriters generally, see Part III.B.
13 Investment banks play an important role in promoting the securities to the public and are often referred to as “gatekeepers” or “reputational intermediaries.” For further discussion of this theory and its connection to direct listings, see Part IV.B.
asks whether the investment banks that Spotify retained as financial advisors qualify as statutory underwriters and are therefore subject to liability under § 11 of the Securities Act.

The question requires close attention given the prominent role that investment banks play in both traditional IPOs and direct listings. Imposing underwriter liability on investment banks in a direct listing will likely have the effect of increasing the cost of the process. However, direct listings will still be less expensive than the traditional IPO. This is because there is no underpricing or firm-commitment spread fee in a direct listing. While one of the supposed benefits of a direct listing is its lower cost, imposing underwriter liability on the financial advisors will not erase all of the efficiency gains that direct listings create and will likely have a positive effect on investor protection.

The question is also not entirely foreclosed. Rather, it is quite open to debate. In SEC filings, Spotify asserted that its direct listing did not involve any underwriters. However, as this Comment explains, the statutory definition of underwriter is broad, and courts interpret the term accordingly. Based on the plain text of the underwriter statute, legal precedent evaluating the underwriter status of third-party advisors, and the legislative history of the Securities Act, there is a strong argument that the investment banks that Spotify retained as financial advisors for its direct listing qualify as statutory underwriters. Academic scholarship exploring the breadth of the underwriter definition and the policy rationales for imposing liability on “gatekeepers” of information in a securities offering further support this claim. Moreover, direct listings have yet to be challenged in court.

This Comment proceeds in four parts. Part I describes the structure and characteristics of traditional IPOs to establish the baseline from which the Spotify direct listing departs. Part II discusses the history of direct listings and describes the steps Spotify took to accomplish its direct listing. Part III covers the statutory framework and relevant background law that governs the issuance of securities to the public, including the definition of “underwriter.” Part IV then examines whether the investment banks Spotify retained as financial advisors qualify as statutory underwriters by applying the relevant statutes and case law. This Comment argues that because the financial advisors participated

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14 For more discussion on the lack of underpricing in a direct listing, see Part II.A.
15 *Spotify Technology S.A.*, 2018 WL 1531993, *n 1 (“[T]he Financial Advisors are not acting as underwriters in connection with the Registration and Listing.”).
in a distribution of securities, they qualify as statutory underwriters and are therefore subject to § 11 liability. This Comment aims to clarify uncertainties surrounding the direct listing innovation and to propose a path forward for future listings with an eye toward practitioners, regulators, and courts alike.

I. How Initial Public Offerings Work

In a traditional IPO, a company raises money by selling new securities to the public through a national exchange. To understand why a company would seek an IPO, consider the following example. Company A is looking to raise $100 million. The company has completed several rounds of financing from venture capital firms through private markets and is ready to access a larger pool of public capital. Early investors are eager to realize a return on their investment, and employees are keen to diversify their holdings. To raise the money in the context of a public offering, the company can issue either or both of two types of securities: debt, typically in the form of bonds, or equity, typically in the form of common stock. Because of the nature of the business, a desire to establish a public market for its existing shareholders, or the need to de-lever its balance sheet, Company A decides to issue new common stock. The new shares will dilute the positions of the existing shareholders, but the increase in liquidity through the newly created public market is a worthwhile tradeoff. The company then works closely with lawyers, accountants, and investment banks over several months to register the securities with the SEC, market the securities through a “road show,” “build a book” of interested investors, and ultimately sell the securities to the public. When done for the first time, this process is called an IPO. Importantly, the investment banks involved in an IPO are liable as underwriters for purposes of § 11 of the Securities Act. This Comment argues that the similarity in roles for investment banks in an IPO and a direct listing supports a finding of underwriter status in the latter context.

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17 To de-lever is to pay down debt.

18 15 USC § 77k(a)(5).
A. The IPO Process

The registration, marketing, and sale procedure consists of three stages: the prefiling period, the waiting period, and the post-effective period. The prefiling period begins when an issuer, like Company A, engages in preliminary discussions with an investment bank about a potential offering. The conversations generally cover the strengths and weaknesses of the company, the desired size of the offering, and the type of security to be issued.

The key law governing the prefiling period is § 5 of the Securities Act. Section 5(c) prohibits any offer to buy or sell a security without a registration statement. The prohibition’s underlying purpose is to prevent parties from “conditioning the market,” or “jumping the gun,” without first providing full disclosure of information about the company and offering. Registration statements are long, detailed documents accompanied by a prospectus, and they must conform with SEC regulations. Notable sections include information about the offering, a description of the company, a listing of critical risk factors, and audited financial statements.

The waiting period begins once the issuer files the registration statement with the SEC and ends when the registration statement becomes effective. While SEC staff review the registration statement, the issuer works with investment banks over several months to conduct what is known as a “road show.” Road shows are the primary way an issuer generates interest in its offering. Often a company seeking to undergo an IPO has not made details about its business strategy, growth prospects, and financial metrics available to institutional investors, such as large pension funds, mutual funds, or hedge funds. During the road show, the company and its investment bank advisors travel across the country to promote the offering and “build a book” of interested
investors. In the context of a direct listing, road shows are not necessary because there is no bookbuilding process; the purpose of the direct listing is to sell the securities directly to the public. Nonetheless, Spotify conducted what it labeled an “Investor Day” to inform the public about the offering. The Investor Day is relevant to the underwriter analysis because it qualified as a statutory road show for purposes of 17 CFR § 433 and is discussed further in Part IV.

B. Traditional Underwriting

By the conclusion of the road show, the investment banks have built a book of interested investors who intend to purchase the securities in the offering. There are then two primary ways in which the sale to these investors occurs: a “firm commitment” underwriting or a “best efforts” underwriting.

In a firm commitment underwriting, the offering unfolds in two steps. First, the underwriter purchases the securities from the issuer at a discounted, fixed price. The underwriter then resells the securities to the interested buyers at a public offering price that the underwriter sets. In this scenario, the underwriter assumes the risk of setting the right public offering price. To account for this risk, the underwriter receives compensation in the form of a spread—the difference between the price the underwriter paid for the securities and the public offering price. The spread is often between 7 and 10 percent.

Best efforts underwritings are simpler but less common because of the uncertainty involved in the pricing. In a best efforts

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27 See note 170 and accompanying text.

28 These investors are typically institutional investors, including large pension funds, mutual funds, or hedge funds.

29 The third way is the seldom-used “standby” underwriting. See Loss, Seligman, and Paredes, 1 Securities Regulation at 97–126 (cited in note 19). See also Arnold S. Jacobs, 5 Disclosure and Remedies under the Securities Laws § 3:9 (Thomson Reuters 2018) (describing types of underwriting arrangements).

30 Loss, Seligman, and Paredes, 1 Securities Regulation at 108 (cited in note 19).
underwriting, the traditional underwriter does not purchase any securities from the issuer at a fixed price. Rather, the underwriter contractually agrees to use its best efforts to sell as many securities as possible at the market price. The underwriter then receives a flat commission as compensation instead of a spread.\footnote{See id at 110. Liability in the case of a best efforts underwriting is still unresolved. The Second Circuit has, on occasion, looked to the agency relationship between the issuer and underwriter to determine who is liable. See, for example, DeMarco v Edens, 390 F2d 836, 844–45 (2d Cir 1968) (holding that an issuer was not liable in a best efforts underwriting because the underwriter was not acting as an agent of the issuer). See also Ernest L. Folk III, Civil Liabilities under the Federal Securities Acts: The BarChris Case Part II—The Broader Implications, 55 Va L Rev 199, 205 (1969) (summarizing DeMarco).}

For purposes of underwriter liability pursuant to § 11, the type of underwriting has little impact.\footnote{Jacobs, 5 Disclosure and Remedies under the Securities Laws § 3:9 (cited in note 29).}

C. Aftermarket Features of an IPO

After the securities are distributed to the public, there are two important elements of IPOs that are not present in direct listings: price stabilization and lockup periods. When a company first comes into the public market, many investors know little about its prospects. To help mitigate volatility in the share price in the days after an IPO, underwriters often have what is known as an overallotment or greenshoe option. This provides the underwriter with the opportunity to buy back shares in an offering for the purpose of reducing the supply of stock on the market and stabilizing the price.\footnote{For a description of overallotment options, see James D. Cox, Robert W. Hillman, and Donald C. Langevoort, Securities Regulation: Cases and Materials 119–20 (Wolters Kluwer 8th ed 2017).}

The financial advisors in the Spotify direct listing did not have an overallotment option because there was no firm underwriting.\footnote{See Part II.B.}

The second common IPO feature is a lockup period.\footnote{See Cox, Hillman, and Langevoort, Securities Regulation: Cases and Materials at 120 (cited in note 33). See also generally Alon Brav and Paul A. Gompers, The Role of Lockups in Initial Public Offerings, 16 Rev Fin Stud 1 (2003).} In most IPOs, underwriters require that employees of the company and other early investors be restricted from selling their securities for what is typically a six-month period. Lockup periods are intended as an assurance to investors who purchase in an IPO that the remainder of the company’s shares will not flood the market and lower the price. Accordingly, the company’s existing shareholders
are prevented from selling in the time period immediately following the offering. Providing shareholders with the opportunity to sell without a lockup period is one of several important goals of direct listings. There was no lockup period in the Spotify direct listing.\textsuperscript{36}

\section*{II. How Direct Listings Work}

In principle, a direct listing is similar to an IPO in that both involve a company making its securities available for purchase on a national exchange. In each process, the issuer works with attorneys and investment banks to prepare and file a registration statement with the SEC. However, after filing, the processes diverge. In a direct listing, the road show can be abbreviated, and there is no bookbuilding, price stabilization, or lockup period. Thus, direct listings allow a company to gain the benefits of being a public company without the major costs associated with the process. This Part first discusses the brief history of direct listings. The Part then walks through the Spotify direct listing and explains why it is particularly noteworthy.

\subsection*{A. Direct Listings Generally}

A company’s motivations for going public drive the difference in methods used to achieve this end. One primary motivation for being a public company is to create a market for existing shareholders to sell their shares. When a company is privately held, there may not be a robust liquid market for its shares because of restrictions on the sale of privately held securities. Once a company has access to a public exchange, such as the NYSE, liquidity increases dramatically, which raises the value of the shares by increasing the number of potential buyers. Another benefit relates to the company’s future financing decisions. For example, a public company can issue new shares to raise additional funds quickly. A company can also conduct mergers and acquisitions by using its stock rather than cash or debt to make purchases. Moreover, a company can repurchase its shares through a buyback program. Indeed, in November 2018, Spotify announced a $1 billion share repurchase program of up to 10 million ordinary shares.\textsuperscript{37}

\textsuperscript{36} See Part II.B.

\textsuperscript{37} Spotify Technology S.A., Form 6-K (Nov 5, 2018), archived at http://perma.cc/492G-TEHC.
A direct listing allows a company to achieve each of these ends—market creation and financing flexibility—more efficiently than it could with an IPO. In this regard, direct listings are an efficiency story. First, a direct listing provides liquidity without the dilution that comes with a new securities offering. There is no need to issue new shares to create a market; the existing shares simply become the market, so existing shareholders are not diluted. Second, the expenses incurred are not as high. Underwriting fees are lower because there is no need to pay a spread to an investment bank for incurring the risk of holding the securities on their books. Nor does the company incur as significant road show expenses because the company does not build a book of investors; the buyers are the public, which could—but does not have to—include institutional investors. Lastly, existing shareholders are not subject to a lockup period. Rather, the issuer’s existing shareholders can simply sell their shares on a national exchange pursuant to the exchange’s rules.

The other major cost saving in a direct listing is the lack of underpricing. In a firm commitment IPO, underwriters purchase the securities from the issuer and resell them to the book of interested investors. In many IPOs, the share price “pops” on the first day, generating a return for the investors who purchased from the underwriter at the lower price. Between 2001 and 2016,

38 For a discussion of traditional IPO expenses, see Schneider, Manko, and Kant, 27 Vill L Rev at 29–33 (cited in note 16). Note that this source should be read for ordinal rather than nominal amounts due to inflation.
39 The only road show expenses Spotify incurred were presumably related to its online Investor Day.
40 In a conversation with TechCrunch, notable IPO expert Professor Jay Ritter stated this observation in clear terms. Arman Tabatabai, TechCrunch Conversations: Direct Listings (TechCrunch, Jan 19, 2019), archived at http://perma.cc/4T3W-6JST (“The big advantage of a direct listing is that it reduces the two big costs of an IPO—the direct cost of fees paid to investment bankers . . . and the indirect cost of selling shares at an offer price less than what the stock subsequently trades at.”).
over 96 percent of midsized IPOs featured a spread of exactly 7 percent.\textsuperscript{42} Spotify, while larger than the typical midsize IPO,\textsuperscript{43} was keen to avoid this expense in their direct listing.\textsuperscript{44}

Direct listings have historically been used in spin-offs of private subsidiaries of a public company, the emergence of a public company from Chapter 11 bankruptcy, and the listing of a public foreign company on a US exchange.\textsuperscript{45} However, no direct listings have occurred on the scale of Spotify's.

B. The Spotify Direct Listing

The Spotify direct listing was a novel and innovative event. There was little precedent for direct listings, especially for a company of Spotify's size.\textsuperscript{46} Before answering the question whether the investment banks that Spotify retained as financial advisors to help prepare the registration statement and conduct the listing qualify as statutory underwriters, it is important to understand each element of the direct listing. Spotify first filed a registration statement with the SEC.\textsuperscript{47} The NYSE then amended its rules around listing requirements to permit direct listings.\textsuperscript{48} Spotify

\textsuperscript{42} See Jackson, \textit{The Middle-Market IPO Tax} (cited in note 41).
\textsuperscript{43} The Spotify valuation has been compared to the size of Snap Inc at the time of its IPO. See, for example, Maureen Farrell, \textit{Spotify Disrupted the Music World, Now It's Doing the Same to Wall Street} (Wall St J, Jan 15, 2018), online at http://www.wsj.com/articles/spotify-disrupted-the-music-world-now-its-doing-the-same-to-wall-street-1516024778 (visited Jan 19, 2019) (Perma archive unavailable).
\textsuperscript{44} See Barry McCarthy, \textit{IPOs Are Too Expensive and Cumbersome} (Spotify, Aug 8, 2018), archived at http://perma.cc/E6KZ-SDRF.
\textsuperscript{46} See Levine, \textit{Spotify’s Non-IPO Really Is Novel} (cited in note 1); Farrell, Osipovich, and Steele, \textit{Spotify’s Splashy Debut Pressures Banks} (cited in note 5).
\textsuperscript{47} Spotify Technology S.A., \textit{Amendment No. 3 to Form F-1 Registration Statement} (Mar 23, 2018), archived at http://perma.cc/ES4F-D9YW.
then received a no-action letter from the SEC concerning communication in the days leading up to the offering and ultimately listed its securities on the NYSE.

1. The company and role of the financial advisors.

Spotify is a Luxembourg limited liability company based in Sweden and founded in 2006. The company offers the world’s largest music streaming subscription service and generated €4.09 billion in revenue in 2017. As of December 2017, the platform consisted of 157 million monthly active users, including 71 million premium subscribers.

In early 2017, Spotify began the process of becoming a public company. Spotify had several goals it wished to accomplish through the direct listing. First, the company wanted to offer greater liquidity to its existing shareholders, including the opportunity to sell over a national exchange. Second, the company wanted to provide equal access to all buyers and sellers of its stock with no lockup period. Lastly, Spotify wanted to enable price discovery through a transparent, market-driven process rather than through a firm commitment underwriting.

To undergo the listing, Spotify entered into engagement letters with three investment banks: Goldman Sachs, Morgan Stanley, and Allen & Company (the financial advisors). In particular, the financial advisors provided “advice and assistance to [Spotify] with respect to [Spotify]’s (i) defining of objectives with respect to the Registration and Listing, (ii) drafting of the

49 Spofify, 2018 WL 1531993 at *2–4 (stating that the Division of Trading and Markets will not recommend that the SEC take enforcement action in connection with the Spotify direct listing pursuant to Regulation M of the Exchange Act).
50 Spotify, Amendment No. 3 to Form F-1 at *2 (cited in note 47). This was approximately $4.90 billion as of December 2017.
51 Id at *1.
52 See Part II.B.3 for discussion of the contemporaneous NYSE rule changes that also made the direct listing possible.
53 See Jaffe, Rodgers, and Gutierrez, Spotify Case Study at *1–3 (cited in note 45).
55 Spotify, Amendment No. 3 to Form F-1 at *186 (cited in note 47). Morgan Stanley, Goldman Sachs, and Allen & Company are also the three investment banks that are linked to the potential Slack direct listing. Farrell, Slack Files to Go Public with Direct Listing (cited in note 2). According to the Thomson Reuters 2017 League Tables, Morgan Stanley, Goldman Sachs, and Allen & Company were each top-rated US IPO underwriters. Global Equity Capital Markets Review: Managing Underwriters Full Year 2017 *5 (Thomson Reuters), archived at http://perma.cc/9A44-7LLW.
Form F-1 and (iii) drafting of public communications and investor presentations in connection with the Registration and Listing.\footnote{Id.}{56}

Spotify incurred nearly $46 million in expenses related to the direct listing.\footnote{See Spotify, Amendment No. 3 to Form F-1 at *187 (cited in note 47).}{57} This amount included fees paid to the SEC, auditors, attorneys, and, notably, the financial advisors. In particular, the financial advisors’ fee was $35 million.\footnote{See id.}{58} According to a J.P. Morgan Capital Markets report, an equivalent fee for a firm commitment underwriting for a company with a similar valuation to Spotify would be between $80 and $120 million.\footnote{Corporate Finance Advisory Trending Topics: A 1H 2018 Compendium *14 (J.P. Morgan, Apr 16, 2018), archived at http://perma.cc/X3L2-UW3T. Commentators also have compared the Spotify direct listing to the traditional IPO that messaging company Snap undertook in 2018 at a similar valuation. Snap paid $100 million in underwriter fees for its public offering. See, for example, Maureen Farrell, \textit{Spotify Disrupted the Music World} (cited in note 43).}{59} Thus, Spotify was able to go public at roughly one-third of the cost of a similar IPO because of the lack of a firm commitment spread fee.

In multiple SEC filings, Spotify stated that the financial advisors were not “acting as underwriters” in connection with the direct listing.\footnote{See, for example, Spotify, 2018 WL 1531993 at *6 n.1.}{60} As Part III.B explains, underwriters are parties who participate in a distribution of securities. Two activities that contribute to underwriter status include marketing the company’s securities to investors during a road show and conducting sales of such securities. In the Spotify direct listing, Spotify emphasized that the financial advisors were not “engaged to participate in investor meetings or to otherwise facilitate or coordinate price discover [sic] activities or sales of [ ] ordinary shares.”\footnote{Spotify, Amendment No. 3 to Form F-1 at *186 (cited in note 47).}{61} This language was presumably an intentional effort to distinguish the duties of the financial advisors from those of traditional underwriters. However, the financial advisors were retained to draft the registration statement and investor materials for a one-time “Investor Day” online presentation to the public. In March 2017, Spotify held a live presentation streamed over the internet to educate investors on the company and investment opportunity, which it called its Investor Day.\footnote{Investor Day—March 2018 (cited in note 26). For coverage of the Investor Day, see generally Maureen Farrell, et al, Live Analysis: Spotify’s IPO Investor Day (Wall St J, Mar 15, 2018), online at http://www.wsj.com/livecoverage/spotify-ipo (visited Feb 12, 2019) (Perma archive unavailable).}{62} The Investor Day lasted more
than two hours, which was nearly double the time of a traditional IPO road show meeting, and included presentations from the full executive team rather than just the chief executive officer and chief financial officer.63 Approximately ten thousand unique viewers streamed the presentation.64

Moreover, the SEC neither affirmed nor rejected Spotify’s underwriter assertion in its no-action letter. Rather, the SEC’s Division of Trading and Markets recommended that the agency would not take any action against Spotify for this arrangement.65 Thus, the question remains: Do the financial advisors qualify as statutory underwriters?

2. Registration statement.

To achieve its goal of providing liquidity to existing shareholders while complying with securities law, Spotify registered some of its securities with the SEC under a Form F-1 resale shelf registration statement.66 Spotify submitted its first confidential draft in December 2017, and the SEC ultimately declared its registration statement effective on March 23, 2018.67 Upon registration, Spotify had 178,112,840 ordinary shares outstanding.68 Of these ordinary shares, Spotify registered 55,731,480 shares—or approximately 31 percent—under the registration statement.69 To understand which shareholders were eligible to participate in the direct listing and why Spotify registered only 31 percent of its shares, it is helpful to sort Spotify’s shareholders into three groups.

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63 See Jaffe, Rodgers, and Gutierrez, Spotify Case Study at *5 (cited in note 45).
64 Id. at *3 n 5.
65 Spotify, 2018 WL 1531993 at *4 (“Accordingly, based on the facts and representations that you have made in the Request Letter, but without necessarily concurring in your analysis, the Division will not recommend that the Commission take enforcement action.”) (emphasis added).
66 Spotify used the Form F-1 rather than the traditional Form S-1 because it is a foreign issuer. The company also could not file the traditional resale shelf registration statement, a Form F-3, because it had not been subject to reporting requirements for at least twelve months. See generally Spotify, Amendment No. 3 to Form F-1 (cited in note 47). See also Jaffe, Rodgers, and Gutierrez, Spotify Case Study at *3 n 7 (cited in note 45). For further discussion of SEC registration requirements, see Part III.A.
68 Spotify, Amendment No. 3 to Form F-1 at *49, 150, 173 (cited in note 47).
69 Spotify, Prospectus (cited in note 67).
The first group of shareholders consisted only of Chinese social media company Tencent, which owned approximately 9 percent of Spotify’s ordinary shares. Tencent was subject to an earlier lockup agreement unrelated to the direct listing and thus was not eligible to participate in the listing.

The second group consisted of nonemployees that had held shares for at least one year. This group held approximately 60 percent of Spotify’s ordinary shares and were eligible to resell to the public at any time without registration under SEC Rule 144. Thus, these shareholders, if they chose to sell their shares during the listing, did not need to do so under the registration statement’s terms.

The third group—the remaining 31 percent—consisted of (i) employees and (ii) nonemployees that had held their shares for less than one year. These shareholders had no other direct option for public resale and were thus the primary intended beneficiaries of the direct listing. By registering these remaining shares, Spotify allowed its shareholders to resell immediately in the direct listing, which likely increased the value of the stock by fostering the development of a public market.

3. NYSE rule changes.

In June 2017, the NYSE proposed three changes to its listing requirement rules that would enable a company to undergo a direct listing on the exchange. While the proposal did not explicitly

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70 Tencent held 16,152,440 ordinary shares. Id at *150.
71 Id at *8, 49.
72 17 CFR § 230.144. Rule 144 is a safe harbor that allows holders of restricted securities to resell such securities to the public without registration subject to certain timing, manner of sale, volume, and notice constraints. Under Rule 144(b)(1), nonaffiliates of an issuer who have held for at least one year are permitted to resell without complying with the Rule 144 requirements. 17 CFR § 230.144(b)(1). Rule 144(a)(1) defines “affiliate” as “a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer.” 17 CFR § 230.144(a)(1). For a detailed discussion of Rule 144 and its resale requirements, see Loss, Seligman, and Paredes, 1 Securities Regulation at 576–87 (cited in note 19). Spotify expected that 106,228,920—or approximately 60 percent of its 178,112,840 ordinary shares—were held by nonaffiliates and eligible for public resale without registration under Rule 144. See Spotify, Prospectus at 173 (cited in note 67).
73 Nevertheless, they certainly benefited from the listing. Without access to the NYSE, there was no market for public resale.
74 This group included the remaining 55,731,480 shares.
mention Spotify, it was widely understood to contemplate the Spotify direct listing.\footnote{See, for example, Alexander Osipovich and Maureen Farrell, “Spotify Rule” Would Help New York Stock Exchange Woo Unicorns (Wall St J, May 26, 2017), online at http://www.wsj.com/articles/spotify-rule-would-help-new-york-stock-exchange-woo-unicorns-1495791000 (visited Feb 12, 2019) (Perma archive unavailable) (referring to the NYSE rule change as “the Spotify rule”).} Prior to the changes, the NYSE could list companies that were not registered with the SEC—like Spotify—on a case-by-case basis if the company had (i) a $100 million valuation and (ii) several months of sustained trading history in private markets.\footnote{See Jaffe, Rodgers, and Gutierrez, Spotify Case Study at *6–7 (cited in note 45).} The proposed changes included (i) removing the private market trading requirement if the company could provide a valuation from an independent third party of at least $250 million, (ii) requiring the company to hire an independent financial advisor to work with a designated market maker (DMM) to determine the opening day price, and (iii) eliminating the need for the company to file a Securities Act registration statement in connection with the listing. In February 2018, the SEC approved a revised proposal that included only the first two proposed changes, effectively clearing the path for the Spotify direct listing.\footnote{83 Fed Reg at 5654 (cited in note 48).}

The first change eliminated the private markets trading history requirement if the company can provide a valuation by an independent valuation agent of at least $250 million.\footnote{See generally 83 Fed Reg 5650 (cited in note 48).} While Spotify had some private trading history, it was not enough to satisfy the requirement.\footnote{Spotify, Amendment No. 3 to Form F-1 at 185 (cited in note 47).}\footnote{80} The SEC concluded that by increasing the valuation threshold and implementing additional independence requirements, the amended rules will support the “maintenance of fair and orderly markets thereby protecting investors and the public interest.”\footnote{81} Spotify retained Morgan Stanley, one of its financial advisors, to act as its independent valuation agent in connection with the listing.\footnote{Spotify, Amendment No. 3 to Form F-1 at 185 (cited in note 47). Note that the precise valuation was not disclosed. If a court were to find that Morgan Stanley acted as a...
The second change instituted a requirement that a company seeking to undergo a direct listing retain both a financial advisor and a DMM to work together to determine the opening day price based on prelisting buy and sell orders. DMMs are trading specialists who execute the opening trades of stocks on national exchanges. The financial advisor, meanwhile, is intended to utilize its knowledge of the company and market to consult with the DMM to set the opening price. The financial advisor is meant to “have an understanding of the status of ownership of outstanding shares in the company and would have been working with the issuer to identify a market for the securities upon listing.” The financial advisor will then “provide input to the DMM regarding expectations of where such a new listing should be priced, based on pre-listing selling and buying interest and other factors that would not be available to the DMM through other sources.”

In its release approving the NYSE proposal, the SEC noted a direct parallel between financial advisors in a direct listing and underwriters in an IPO: the DMM requirement to consult with a financial advisor “is based in part on Nasdaq Rule 4120(c)(9), which requires that a new listing on Nasdaq that is not an IPO

statutory underwriter in connection with the listing for its role as a financial advisor, its status as an independent valuation agent would potentially be implicated because the amended version of § 102.01B of the NYSE Listed Company Manual requires that the independent valuation agent not have “provided any . . . underwriting services to the company . . . in connection with the proposed listing.” For more discussion, see notes 89–91 and accompanying text.

83 Fed Reg at 5650 (cited in note 48). Spotify retained Citadel Securities as the DMM and Morgan Stanley as the financial advisor to the DMM. Notably, Spotify also retained Morgan Stanley to serve as one of the three financial advisors to advise on the offering, including drafting the registration statement and Investor Day materials. Unfortunately (for purposes of clarity), the roles are different, but the names are the same. Alexander Osipovich, Spotify Picks Citadel Securities to Handle NYSE Debut (Wall St J, Mar 7, 2018), online at http://www.wsj.com/articles/spotify-picks-citadel-securities-to-handle-debut-at-nyse-1520439264 (visited Jan 19, 2019) (Perma archive unavailable); Spotify, Amendment No. 3 to Form F-1 at 185 (cited in note 47).


85 Fed Reg at 5652 (cited in note 48).

86 Id. The NYSE noted that the DMM would not be “bound by the input” of the financial advisors. Id at 5652 n 35.
have a financial advisor willing to perform the functions performed by an underwriter in connection with pricing an IPO."  

This statement is particularly relevant because it further suggests that the financial advisor who supports the DMM performs the same functions as an underwriter in a traditional IPO. In approving the proposal, the SEC concluded that the DMM and financial advisor requirement is “reasonably designed to protect investors and the public interest and promote just and equitable principles of trade for the opening of securities listed under the new standards.”

The NYSE contemplated a third change—eliminating the need for a Securities Act registration statement—but ultimately did not include it in its final proposal. However, this amendment would have had significant implications on underwriter liability. The initial proposal would have permitted a direct listing without a Securities Act registration statement. Had this change been adopted, it would have greatly expedited the listing process. It also would have raised a serious question about whether Securities Act liability falls on the relevant parties due to the lack of a registration statement. However, the NYSE ultimately removed this proposed amendment from its final proposal. Presumably, this proposal revision was the result of a compromise between the SEC and NYSE in the interest of disclosure and liability.

Two further points are worth addressing concerning the rule changes and how they relate to underwriter liability. First, the amended rules require that the independent valuation agent has not provided “investment banking services,” including “acting as an underwriter,” in connection with the listing. Importantly, this requirement is based on a legal conclusion about underwriter liability.

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88 83 Fed Reg at 5654 (cited in note 48).
89 Id at 5651 & n 11 (noting that the Exchange removed the proposed change that would have allowed a company to list without a Securities Act registration).
90 82 Fed Reg at 28201 (cited in note 75).
91 In particular, the SEC noted the NYSE rule changes must “be designed to promote just and equitable principles of trade . . . and, in general, to protect investors” and that a direct listing without a Securities Act registration “may raise a number of unique considerations, including with respect to the role of various distribution participants.” Securities and Exchange Commission Release No 34-81640, 82 Fed Reg 44229, 44231 (Sept 21, 2017).
92 83 Fed Reg at 5652 n 25 (cited in note 49). There is an inherent contradiction here between not “acting as an underwriter” but also being willing to “perform the functions performed by an underwriter” per the Nasdaq guidelines upon which the NYSE rule is based. See note 87 and accompanying text.
status. “Underwriter” is a legal term defined under the Securities Act, and fulfilling the NYSE listing requirement should not be interpreted to mean that a financial advisor has not otherwise fulfilled the requirements to qualify as a statutory underwriter for purposes of § 11 liability. As Part III discusses, courts have looked at similar independent valuation agents and found them to be underwriters. Second, with respect to determining the opening price, the registration statement states that the price would be based in part on Morgan Stanley’s “understanding of the ownership of [Spotify’s] outstanding ordinary shares and pre-listing buying and selling interest in [Spotify’s] ordinary shares that it becomes aware of from potential investors and holders.” This point is addressed further in Part IV, but the reliance on Morgan Stanley’s acute awareness of the market and understanding of potential investors provides a strong justification for holding the bank liable as an underwriter. If Morgan Stanley is collecting interest from public investors and relaying such information to the DMM, who then accepts bids to set an opening price, then perhaps a court may be willing to step the two pieces together and find the process is, in substance, bookbuilding even though in form it is not.

4. SEC no-action letter.

Spotify also sought guidance on the direct listing from the SEC in the form of a no-action letter. In particular, Spotify inquired about the application of an Exchange Act rule—Regulation M—that limits issuer communications in the time period around a securities offering to prevent market manipulation. Due to the nontraditional nature of the Spotify direct listing, it was unclear

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93 15 USC § 77b(a)(11).
94 See notes 145–51 and accompanying text.
95 Spotify, Amendment No. 3 to Form F-1 at 185 (cited in note 47).
96 See notes 193–95 and accompanying text.
97 SEC staff write no-action letters in response to requests by companies seeking guidance on a particular securities matter. When approved affirmatively, the letter will state that the relevant division will not recommend enforcement given the facts presented. See generally Thomas P. Lemke, The SEC No-Action Letter Process, 42 Bus Law 1019 (1986).
98 See Spotify, 2018 WL 1531993 at *6–12 (requesting clarification on the applicability of Regulation M of the Exchange Act). Regulation M is designed to prevent market manipulation by prohibiting issuers, selling security-holders, and other distribution participants from certain communication activities during a distribution. See 17 CFR §§ 242.100–05. In a traditional IPO setting, Regulation M is assumed to apply. However, in a direct listing, there is no pricing period, so it was unclear whether a Regulation M restricted period applied, and if so, for how long.
whether the prophylactic measures of the rule applied, which would restrict Spotify’s ability to communicate with investors in the period immediately before and after the listing date.

In its no-action letter, the Division of Trading and Markets stated that it would not recommend enforcement against Spotify, the financial advisors, or the shareholders if the parties refrained from communication within five days of the opening through the second day after the listing.99 Critically, the letter does not concede that the listing constituted a distribution for Securities Act purposes, nor does it address the underwriter status of the financial advisors. Rather, the letter focuses solely on communications around the listing date and is otherwise limited in scope.

III. RELEVANT SECURITIES LAW FOR UNDERWRITER LIABILITY

The Securities Act and Exchange Act aim to protect investors through a mandatory disclosure regime. To serve this aim, Congress established the SEC to oversee the substantial increase in regulation of a wide range of market participants.100 The SEC has two competing policy objectives: requiring disclosure for the sake of protecting investors and fostering capital formation without imposing overly burdensome costs on companies seeking to raise money from investors.101 As disclosure demands increase, the compliance cost to companies looking for investors increases as well. This Part discusses the sections of the Securities Act relevant to the Spotify direct listing: specifically, § 11, which imposes significant liability on parties involved in a securities offering, and § 2(a)(11), which defines the term “underwriter.”102

A. Section 11 Liability

The purpose of the Securities Act is to protect investors by requiring complete and accurate disclosure from companies issuing securities. To ensure compliance with the disclosure requirements by all parties involved in an offering, the SEC provides purchasers of securities issued under a registration statement with

99 Spotify, 2018 WL 1531993 at *2.
101 See, for example, 15 USC § 77b(b) (“Whenever . . . the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.”).
102 15 USC §§ 77b(a)(11), 77k.
an express private right of action for material misstatements or omissions in the registration statement. The policy goal is deterrence rather than just compensation. In particular, § 11 of the Securities Act provides:

In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue.

To bring a successful § 11 claim, a plaintiff must first point to a material misstatement or omission in a registration statement. A plaintiff need not show that she relied on the material misstatement when purchasing the security; instead, reliance is presumed under the “fraud-on-the-market” theory. A plaintiff also need not have purchased the security in the actual offering to have standing.

Rather, a plaintiff must “trace” the security to the registration statement to have standing. The tracing requirement is easily met in a traditional IPO because all shares issued are sold pursuant to the registration statement. In direct listings, however, plaintiffs may have a much harder time with the tracing analysis. Due to the way brokers hold securities for purchasers, it can be difficult to track which specific share one owns. In a

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103 15 USC § 77k.
104 See Cox, Hillman, and Langevoort, Securities Regulation at 488 (cited in note 33). See also Laventhal, Krekstein, Horwath & Horwath v Horwitch, 637 F2d 672, 676 (9th Cir 1980) (“In extending liability to underwriters and those who prepared misleading statements, the purpose of the Act is regulatory rather than compensatory.”).
105 15 USC § 77k(a) (emphases added).
106 For the seminal case on reliance and fraud-on-the-market, see Basic v Levinson, 485 US 224, 241–49 (1988) (holding that fraud-on-the-market operates as a rebuttable presumption of reliance when stock prices reflect all material information about the company). For an example of a defendant successfully rebutting the Basic presumption, see International Brotherhood of Electrical Workers Local 98 Pension Fund v Best Buy Co, 818 F3d 775, 782–83 (8th Cir 2016).
107 See Hertzberg v Dignity Partners, Inc, 191 F3d 1076, 1080 (9th Cir 1999).
108 Id at 1080 n 4.
109 See Cox, Hillman, and Langevoort, Securities Regulation at 490 (cited in note 33).
direct listing, some shares are sold under the registration statement while others are not.\textsuperscript{110} Moreover, courts have rejected statistical analyses purporting to prove tracing in favor of an actual tracing requirement, which requires that a plaintiff show her share was purchased pursuant to a registration statement.\textsuperscript{111} As discussed in Part II.B, Spotify registered only 31 percent of its shares under the registration statement.\textsuperscript{112} This could create a challenging hurdle for a plaintiff to overcome given the lack of a record behind share ownership. Nonetheless, the risk of § 11 liability should still serve the SEC’s deterrence goal of preventing misleading offer documents.

Congress expressly enumerated five parties subject to § 11 liability: issuers; officers and directors; accountants and other “experts;” and underwriters.\textsuperscript{113} Issuers are strictly liable for any material misstatements or omissions in a registration statement. The other potential defendants are able to assert what is known as a “due diligence” defense,\textsuperscript{114} which can be invoked by parties who did not have knowledge of the misstatement and conducted a sufficiently detailed level of investigation. The required level of investigation varies depending on the role of the defendant and the type of information at issue. For example, underwriters have a “general liability for what appears in [the] document.”\textsuperscript{115} For an underwriter’s due diligence defense to succeed, the underwriter must have conducted a “reasonable investigation” and have had a “reasonable ground” to believe in the accuracy of the registration statement.\textsuperscript{116}

\textsuperscript{110} See Part II.B.2.

\textsuperscript{111} See, for example, \textit{Krim v pcOrder.com}, 402 F3d 489, 502 (5th Cir 2005).

\textsuperscript{112} See text accompanying note 69.

\textsuperscript{113} 15 USC § 77k(a)(1)–(5). For discussion of “expertized” portions of a registration statement, which are beyond the scope of this Comment, see Louis Loss, Joel Seligman, and Troy Paredes, \textit{2 Fundamentals of Securities Regulation} 1605–09 (Wolters Kluwer 6th ed 2011).


\textsuperscript{115} Folk, 55 Va L Rev at 52 (cited in note 114). Defenses for the other parties are beyond the scope of this Comment.

\textsuperscript{116} See BarChris, 283 F Supp at 697 (“[T]he phrase ‘reasonable investigation’ must be construed to require more effort on the part of the underwriters than the mere accurate reporting in the prospectus of ‘data[ ] presented’ to them by the company. . . . [T]he underwriters must make some reasonable attempt to verify the data submitted to them.”). For
Assuming the claim survives, the potential scope of § 11 liability is important for the parties to consider. It is worth noting first that these types of claims are common. Between 2009 and 2017, 19.5 percent of IPOs faced a core federal securities class action filing.\footnote{Securities Class Action Filings—2018 Year in Review *25 (Cornerstone Research, 2018), archived at http://perma.cc/UV3R-ZDYV. The study defines “core filings” as federal securities class actions excluding merger and acquisition-related filings. Id at *39–40.} Statutory damages are equal to the difference between the public offering price of the securities and the price at the time of sale or the suit.\footnote{15 USC § 77k(e).} According to one study, the median estimated statutory damages amount for Securities Act claims between 2008 and 2017 was $83.3 million.\footnote{Laarni T. Bulan, Ellen M. Ryan, and Laura E. Simmons, Securities Class Action Settlements—2017 Review and Analysis *9 (Cornerstone Research, 2018), archived at http://perma.cc/RNW6-ZR7M. The median settlement amount for such suits was $4.5 million. Id.} Moreover, 84 percent of settled cases had an underwriter named as a defendant.\footnote{Id at *10.} For plaintiffs who filed claims under the Exchange Act as well, the median estimated statutory damages amount over the same time period was $315.5 million.\footnote{Id at *9. The median settlement amount for such suits was $12.8 million. Id.}

B. Section 2(a)(11) Underwriter Definition

The investment banks that Spotify retained as financial advisors played a critical role in the direct listing process.\footnote{See Part II.B.1.} Because of the key role that underwriters play in the offering process, underwriters are one of the enumerated defendants under § 11. Courts interpret the underwriter definition broadly to include “all persons who might operate as conduits for securities being placed into the hands of the investing public.”\footnote{Securities and Exchange Commission v Lybrand, 200 F Supp 2d 384, 393 (SDNY 2002), quoting Thomas L. Hazen, The Law of Securities Regulation 431 (West 4th ed 2002). See also, for example, Securities and Exchange Commission v Platform Wireless International 489 US 375, 386–87 (1985).} Underwriters come in

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\footnote{Securities Class Action Filings—2018 Year in Review *25 (Cornerstone Research, 2018), archived at http://perma.cc/UV3R-ZDYV. The study defines “core filings” as federal securities class actions excluding merger and acquisition-related filings. Id at *39–40.}

\footnote{15 USC § 77k(e).}

\footnote{Laarni T. Bulan, Ellen M. Ryan, and Laura E. Simmons, Securities Class Action Settlements—2017 Review and Analysis *9 (Cornerstone Research, 2018), archived at http://perma.cc/RNW6-ZR7M. The median settlement amount for such suits was $4.5 million. Id.}

\footnote{Id at *10.}

\footnote{Id at *9. The median settlement amount for such suits was $12.8 million. Id. Rule 10b-5 of the Exchange Act provides an implied private remedy for fraudulent misstatements or omissions in connection with the purchase or sale of any security. Cox, Hillman, and Langevoort, Securities Regulation at 698–99 (cited in note 33); 17 CFR § 240.10b-5. Rule 10b-5 damages are cumulative with § 11 claims. See Herman & MacLean v Huddleston, 459 US 375, 386–87 (1983).}

\footnote{See Part II.B.1.}

two forms: traditional underwriters and statutory underwriters. Traditional underwriters are generally considered to be investment banks that engage in a firm commitment underwriting on behalf of an issuer. Pursuant to the statutory definition, statutory underwriters meanwhile include any party that is necessary to a distribution of securities.

Section 2(a)(11) defines “underwriter” as follows:

[A]ny person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking.

As the definition makes clear, the underwriter definition turns on the relationship between the relevant party and the offering. Any person who performs one of the enumerated functions in the definition in connection with an offering becomes a statutory underwriter.

The plain language of § 2(a)(11) thus establishes three types of statutory underwriters: (1) any person who purchases from an issuer “with a view to” the distribution of a security; (2) any person who offers or sells for an issuer “in connection with” the distribution of a security; and (3) any person who “participates” in any such undertaking. This Section addresses each type of statutory underwriter in turn. The latter two types are particularly relevant to the Spotify direct listing.

1. Persons who have purchased with a view to distribution.

This type of statutory underwriter is typically a traditional investment bank engaged in a firm commitment underwriting. Under such arrangements, the bank works with the issuer to prepare the registration statement, conducts the road show, and then

Corp, 617 F3d 1072, 1086 (9th Cir 2010) (“The definition of ‘underwriter’ in the Securities Act is expansive.”).

124 See Loss, Seligman, and Paredes, 1 Securities Regulation at 97–126 (cited in note 19).
125 15 USC § 77b(a)(11).
126 See Loss, Seligman, and Paredes, 1 Securities Regulation at 458 (cited in note 19) (“The term underwriter is defined not with reference to the particular person’s general business but on the basis of his or her relationship to the particular offering.”).
127 15 USC § 77b(a)(11).
128 See Loss, Seligman, and Paredes, 1 Securities Regulation at 100–09 (cited in note 19) (discussing firm commitment underwriting).
purchases the securities from the issuer for resale to the book of institutional investors. In the Spotify direct listing, the investment banks had a role in the first two parts of the process but did not actually purchase any Spotify securities in the offering. Thus, this definition of underwriter does not apply.

2. Persons offering to sell or selling for an issuer.

This type of statutory underwriter includes any person who solicits an exchange of securities on behalf of an issuer. This is commonly seen in “best efforts” underwritings, in which an investment bank is compensated not by the spread but rather by a commission. This relationship shares many similarities to the arrangement between Spotify and its financial advisors. To qualify as underwriters pursuant to this part of the definition, the financial advisors must have played a necessary role in the distribution of the Spotify ordinary shares.

The leading case on this type of underwriter is one in which the court looked to substance over form and attached underwriter status notwithstanding the lack of a contractual relationship between the party and the issuer. In Securities and Exchange Commission v Chinese Consolidated Benevolent Association, the Second Circuit considered whether a charitable association that promoted the sale of Chinese government war bonds qualified as an underwriter when it offered to sell the Chinese securities to American investors. In particular, the association marketed the securities to members of Chinese communities in New York, New Jersey, and Connecticut through meetings and newspaper advertisements. The association then exchanged funds that it collected for the securities and distributed them to its members. The association had no contractual relationship with

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129 For a full discussion of “selling for an issuer” and relevant case law, see id at 461–63.
130 See Edward F. Greene, Determining the Responsibilities of Underwriters Distributing Securities within an Integrated Disclosure System, 56 Notre Dame L Rev 755, 762 n 35 (1981) (“Although a person distributing securities on a best efforts basis technically is not underwriting the issue, he is subsumed within the definition of ‘underwriter’ set forth in § 2(11).”). For a discussion of best efforts underwriting, see Part I.B.
131 120 F2d 738 (2d Cir 1941).
132 Id at 740–41.
133 Id at 739.
134 Id.
the Chinese government and received no compensation for its actions.\textsuperscript{135} However, the court determined that the association qualified as an underwriter because the language of the statute should be read “as covering continual solicitations . . . which normally would result in a distribution of [securities].”\textsuperscript{136} The court continued to state that the definition includes any person who “engaged in steps necessary to the distribution of securities.”\textsuperscript{137} Many courts continue to follow the Chinese Consolidated rule today, which makes the definition relevant to consider in the direct listing context.\textsuperscript{138}

3. Persons participating in any such undertaking.

This type of statutory underwriter turns on the proper interpretation of “participates” and “any such undertaking.”\textsuperscript{139} Courts have taken several approaches to defining these terms. Some courts look to whether the public relies on a party’s expertise when purchasing the securities. Others consider whether the party’s actions were necessary to the distribution, similar to the Chinese Consolidated approach. More broadly, some ask whether the party’s actions were simply distribution related. This Comment addresses each interpretation in turn to consider the role of the Spotify financial advisors.

First, several courts focus on whether the public relies on the expertise of the party in evaluating the registration statement. According to this approach, if the public relies on the party’s expertise, then that party may be considered to have participated in a distribution and qualify as an underwriter. In \textit{McFarland v Memorex Corp},\textsuperscript{140} the court considered whether institutional investors that exercised registration rights in a securities offering

\begin{footnotes}
\item[135] Chinese Consolidated, 120 F2d at 739.
\item[136] Id at 741.
\item[137] Id.
\item[139] 15 USC § 77b(a)(11). For a full discussion of “participation in an underwriting” and a collection of relevant case law, see Loss, Seligman, and Paredes, 1 \textit{Securities Regulation} at 471–74 (cited in note 19).
\end{footnotes}
“participated” in a distribution and thereby became statutory underwriters. The court concluded that institutional investors were not underwriters because they did not have control over the registration statement and the public did not rely on their expertise when making investment decisions. The court observed that “underwriters are subjected to liability because they hold themselves out as professionals who are able to evaluate the financial condition of the issuer.” Thus, this case demonstrates the importance of considering the role the financial advisors had in drafting the registration statement when analyzing underwriter status in the Spotify direct listing.

Second, other courts consider whether the person’s role was “necessary to the distribution.” This is an expansion of the Chinese Consolidated approach. In Harden v Raffensperger, Hughes & Co, the Seventh Circuit considered whether a qualified independent underwriter was subject to § 11 liability as a statutory underwriter. Firstmark Corporation, a financial services company, issued debt securities through a subsidiary. According to industry rules, Firstmark was required to retain a “qualified independent underwriter” to perform due diligence on the registration statement and recommend a minimum yield for the offering. The court rejected the defendant’s argument that it was not an underwriter solely because it did not purchase the

141 Id at 644.
142 Id at 646.
143 Id. See also In re Activision Securities Litigation, 621 F Supp 415, 424 (ND Cal 1985) (“[U]nderwriters who participate in the preparation of the registration statement are liable [under § 11].”). For further discussion of McFarland and Activision, see Jennifer O’Hare, Institutional Investors, Registration Rights, and the Specter of Liability under Section 11 of the Securities Act of 1933, 1996 Wis L Rev 217, 239–45.
144 See Part IV.B.
145 See, for example, Kern, 425 F3d at 152–53 (holding a corporation who “engaged in steps necessary to the distribution” to be a statutory underwriter), quoting Chinese Consolidated, 120 F2d at 741 See also, for example, Securities and Exchange Commission v Universal Major Industries Corp, 546 F2d 1044, 1046–47 (2d Cir 1976) (holding that an attorney who wrote letters in connection with transfers of unregistered stock that expressed his opinion that such transfers were legal violated § 5 of the Securities Act). But see Securities and Exchange Commission v North American Research and Development Corp, 424 F2d 63, 71–72 (2d Cir 1970) (observing that “joining in the common effort” to sell unregistered shares subjects one to “the injunctive and other powers of the SEC and the federal courts”).
146 65 F3d 1392 (7th Cir 1995).
147 Id at 1394.
148 Id at 1394–95. A minimum yield on a bond offering is similar to a minimum price on an equity offering.
issuer's securities. Instead, the court held that the third party Firstmark retained had “participated” in the distribution—and was therefore a statutory underwriter—because its actions were “necessary to the distribution.” This case has important implications for the underwriter status of the financial advisors in the Spotify direct listing.

In contrast to other circuits, the Second Circuit takes a narrower approach and looks to whether the party engaged in distribution-related activities. In In re Lehman Brothers Mortgage-Backed Securities Litigation, the Second Circuit concluded that credit rating agencies involved in structuring mortgage-backed securities did not “participate” in a distribution because their activities were not “distribution-related.” The plaintiffs averred that the rating agencies qualified as underwriters because their actions were a “necessary predicate to the securities’ distribution.” The court, in rejecting the plaintiffs’ argument, distinguished between entities “who provide services that facilitate a securities offering” and those who “participate in the statutorily specified distribution-related activities.” The court interpreted § 2(a)(11) to mean that the underwriter definition encompasses only activities that are “related to the actual distribution of securities.” The rating agencies merely facilitated the participation of others in the offering; they did not participate in the offering themselves and were therefore not statutory underwriters. Even under this narrow reading of the statute, this Comment argues that Spotify’s financial advisors may qualify as statutory underwriters.

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149 Id at 1400.
150 Harden, 65 F3d at 1400–01, quoting Securities and Exchange Commission v Holschuh, 694 F2d 130, 139 n 13 (7th Cir 1982). The Ninth Circuit takes a similarly broad approach. See generally, for example, Platform Wireless, 617 F3d at 1086 (interpreting the underwriter definition to include “[a]ny intermediary between the issuer and the investor that is an essential cog in the distribution process”) (citation omitted).
151 See Part IV.A.2.
152 650 F3d 167 (2d Cir 2011).
153 Id at 176, 182.
154 Id at 175. In addition to passively evaluating the credit risk of each pool of mortgage-backed securities, the rating agencies allegedly aided in the structuring and securitization process. Id at 172–73.
155 Id at 176.
156 Lehman Brothers, 650 F3d at 176. In reaching its conclusion, the court looked to In re Refco, Inc Securities Litigation, 2008 WL 3843343, *4 (SDNY 2008) (“While the definition of ‘underwriter’ is indeed broad and is to be interpreted broadly, it must be read in relation to the underwriting function that the definition is intended to capture.”).
IV. THE UNDERWRITER STATUS OF THE FINANCIAL ADVISORS

The underwriter designation carries significant liability under § 11 of the Securities Act. As a consequence, a court finding underwriter status for the financial advisors in the Spotify direct listing would potentially increase the costs associated with a direct listing. Yet as this Part demonstrates, such liability would not be fatal to the direct listing innovation. This Part draws from precedent, legislative history, and academic scholarship to argue that these advisors were statutory underwriters who “participated” in a distribution of Spotify’s ordinary shares to the public and are liable under § 11 of the Securities Act.

As Part III describes, there are three types of statutory underwriters under § 2(a)(11). The latter two—persons who offer securities for sale for an issuer and persons who participate in a distribution—require careful consideration in the context of the Spotify direct listing. The financial advisors were explicitly retained to define the objectives of the registration statement, draft the registration statement, and draft public communications and investor presentations. While the financial advisors did not conduct a firm commitment underwriting nor provide price stabilization, their extensive involvement in the process is still sufficient to warrant underwriter status. The total cost of a direct listing will still necessarily be less than a traditional IPO because investment banks will not be taking a spread fee or aftermarket pricing risk. Moreover, the increased specter of liability will ensure investor protection and align with SEC policy goals.

A. Legal Precedent Supports Underwriter Status

As Part III.B describes, courts have interpreted the plain language of § 2(a)(11) differently. This Part aims to demonstrate that the financial advisors in the Spotify direct listing likely qualify as statutory underwriters under either the “offer” or “participate” parts of the underwriter definition. The Comment applies the Chinese Consolidated analysis to the former and the Harden and Lehman Brothers analyses to the latter to support finding underwriter status.

1. The financial advisors likely offered securities for sale under a *Chinese Consolidated* analysis.

Under § 2(a)(11), the underwriter definition includes any person who “offers . . . for an issuer in connection with[ ] the distribution of any security.”\(^{158}\) The relevant inquiry is thus whether the financial advisors solicited sales of the Spotify securities in the direct listing. The controlling case for this type of underwriter is *Chinese Consolidated*.\(^{159}\) In *Chinese Consolidated*, the charitable association involved in the offering had no contractual relationship with the Chinese government nor received “any compensation from any source.”\(^{160}\) However, the court determined that the association became an underwriter when it solicited offers to buy the Chinese government bonds because the association engaged in “continual” behavior that “culminated in a distribution.”\(^{161}\) The association held meetings, distributed flyers through the mail, and transferred the funds and securities between the Bank of China and the purchasers.\(^{162}\)

The question then becomes whether the financial advisors engaged in an analogous type of continual behavior. On an initial read, the answer may appear to be no. The financial advisors did not hold meetings or accept monies or securities on behalf of a purchaser or issuer. However, the financial advisors’ role in the investor education raises an interesting question. In March 2017, Spotify held a live presentation streamed over the internet to educate investors on the company and investment opportunity, which it called its Investor Day.\(^{163}\) The Investor Day lasted more than two hours, which was nearly double the time of a traditional IPO road show meeting, and included presentations from the full executive team rather than just the chief executive officer and chief financial officer.\(^{164}\) Approximately ten thousand unique viewers watched the presentation live.\(^{165}\) The dissent in *Chinese Consolidated* raises the possibility that under the majority’s reading of § 2(a)(11), “a single solicitation of an offer to buy would be

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159 See notes 131–38 and accompanying text.
160 *Chinese Consolidated*, 120 F2d at 739.
161 Id at 740–41.
162 Id at 739.
164 See Jaffe, Rodgers, and Gutierrez, *Spotify Case Study* at *5 (cited in note 45).
165 See id at *3 n 5.
equally within the language [of the statute].”

Was the Investor Day sufficient to attach underwriter status?

Based on the significant role of the financial advisors in preparing the presentation materials and the expansive nature of the presentation, the Investor Day is likely sufficient. Spotify disclosed that one of the services to be performed by the financial advisors included the “drafting of public communications and investor presentations in connection with the Registration and Listing.” This almost certainly included the Investor Day materials. Spotify was careful, though, to state that this role was limited to drafting, not active participation. However, this distinction seems tenuous and may draw close scrutiny from a court. First, Spotify stated to the SEC that the Investor Day qualified as a road show for purposes of the Securities Act. Second, there is evidence suggesting that the Investor Day was not a singular event either, making it even more consistent with a road show. Given the emphasis courts place on substance over form in this context, a factual inquiry may be required to determine the extent of the financial advisors’ involvement in the Spotify direct listing or in any subsequent direct listings. The aim of the Securities Act is to make complete and accurate informative materials available for investors, and this objective can be satisfied if the drafters of such materials—regardless of whether they have a role in the actual presentation of the material—are held liable for any misstatements or omissions.

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166 Chinese Consolidated, 120 F2d at 742 (Swan dissenting).
167 Spotify, 2018 WL 1531993 at *9. See also text accompanying note 56.
168 See Jaffe, Rodgers, and Gutierrez, Spotify Case Study at *5 (cited in note 45).
169 Spotify, 2018 WL 1531993 at *9 (“Notably, the Advisory Engagement Letters . . . expressly provide that the Financial Advisors will not further assist . . . [Spotify] in the planning of, or actively participate in, investor meetings.”).
170 Id at *8 (“The Investor Day presentation will be treated by . . . [Spotify] as a ‘road show’ for purposes of Section 6(e)(1) of the Securities Act.”).
171 In its letter, Spotify reserved that it “may engage in potential additional investor education activities . . . including possible follow-up Investor Days and individual meetings with investors.” Id. Indeed, Spotify posted four additional decks on its website. Investor Day—March 2018 (cited in note 26).
2. The financial advisors likely participated in a distribution under either a *Harden* or *Lehman Brothers* interpretation of § 2(a)(11).

Under § 2(a)(11), the underwriter definition also (perhaps more expansively) includes any person who participates in a distribution of securities. The question to consider is thus whether the financial advisors participated in the distribution of Spotify securities. However, as Part III describes, courts are divided over the proper interpretation of the statute. Indeed, there is a burgeoning circuit split on the matter between the Seventh and Second Circuits. This Comment argues that the financial advisors nonetheless qualify as statutory underwriters under either regime.

The relevant provision of § 2(a)(11) defines an underwriter as any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking.¹⁷²

The Seventh Circuit has interpreted the statute to read that “participates” means to engage in actions “necessary to the distribution.”¹⁷³ The key issue in *Harden* was whether a third party who performed due diligence on a registration statement and recommended a minimum yield on a bond offering qualified as a statutory underwriter. In the court’s view, these actions were “necessary to the distribution” and therefore sufficient to conclude that the independent third party qualified as an underwriter.¹⁷⁴

The Second Circuit, meanwhile, has adopted a narrower reading. Rather than consider whether the actions were necessary to a distribution, the *Lehman Brothers* court considered whether the party itself engaged in a distribution.¹⁷⁵ The court concluded that credit rating agencies involved in structuring mortgage-backed securities did not “participate” in a distribution because their activities were not “distribution-related.”¹⁷⁶

¹⁷² 15 USC § 77b(a)(11) (emphasis added).
¹⁷³ *Harden*, 65 F3d at 1400–01, quoting *Holschuh*, 694 F2d at 139 n 13. For further discussion on the breadth of the “participates in an underwriting” language, see Cox, Hillman, and Langevoort, *Securities Regulation* at 345–46 (cited in note 33).
¹⁷⁴ *Harden*, 65 F3d at 1400–01.
¹⁷⁵ *Lehman Brothers*, 650 F3d at 182.
¹⁷⁶ Id at 176.
court distinguished the facts from *Harden* by separating those “who provide services that facilitate a securities offering” from those who “participate in the statutorily specified distribution-related activities.”177 Because the rating agencies merely facilitated the participation of others in the offering, as opposed to directly engaging in the purchase or sale of the securities, they did not qualify as statutory underwriters.

Under either the *Harden* or *Lehman Brothers* approaches, the financial advisors are likely statutory underwriters. Under the *Harden* rule, the financial advisors in the Spotify direct listing would likely qualify as statutory underwriters because their activities were necessary to the public listing. Without the financial advisors, Spotify’s shareholders would have been unable to sell their shares on the NYSE. Like the third party in *Harden*, the financial advisors played a critical part in preparing the registration statement. The registration statement is the vehicle through which the SEC enforces its disclosure regime and accordingly holds the drafting parties liable.

The strongest argument against a finding of liability for the financial advisors under *Harden* is the fact that the third party in *Harden* assumed underwriter liability.178 However, we do not know whether the investment banks in the Spotify listing assumed or expressly waived liability. Assumption nonetheless seems secondary to the purpose for imposing liability: to ensure complete and accurate disclosure. The financial advisors were involved in multiple steps of the offering. First, they helped draft the registration statement. Second, they prepared the investor material. Third, one advisor also provided an independent valuation and worked with the DMM to determine the opening price.179 The multiple touchpoints in the process weigh in favor of holding parties liable for any material misstatements or omissions.

The argument for a finding of liability also likely succeeds under a *Lehman Brothers* interpretation. The financial advisors were much closer to the actual sale of securities in the Spotify direct listing than the credit rating agencies were in *Lehman Brothers*. In *Lehman Brothers*, the court emphasized that the credit rating agency defendants merely facilitated the distribution by others. While perhaps necessary to the ultimate sale of

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177 Id.
178 *Harden*, 65 F.3d at 1402–03.
179 This Advisor was Morgan Stanley. Spotify, Amendment No. 3 to Form F-1 at 46, 185 (cited in note 47).
the mortgage-backed securities, the evaluation of credit risk was not inherent to the sale because the Second Circuit saw, in formalist terms, the process of creating the security as distinct from the process of selling it. In discussing the relevant precedent, the court emphasized that its analysis was “consistent with” Kern’s language about “essential” roles in a distribution.\textsuperscript{180} Here, the financial advisors both prepared the full registration statement under which the securities were registered and drafted the investor education materials. Presumably, the registration statement could not have been prepared without investment banking support because companies rely on bankers’ expertise in marketing securities to the public.\textsuperscript{181} This behavior would fall under the “statutorily specified distribution-related activities” requirement of the \textit{Lehman Brothers} court.\textsuperscript{182} Moreover, Spotify acknowledged that the price determination would be based, in part, on Morgan Stanley’s understanding of Spotify’s ownership and prelisting buying interest.\textsuperscript{183} The registration statement and pricing analysis have a much more direct role in “distribution activities” than, say, helping to amend the NYSE rules that later facilitated the distribution. Therefore, because the financial advisors were necessary to the distribution and because they were much closer to the actual sale of securities than credit rating agencies, underwriter liability should attach.

Importantly, the reading of § 2(a)(11) that this Comment proposes is not so broad as to cover the nonbank entities involved in the process. Rather, the definition remains properly confined to those who participate in the statutorily defined distribution activities. This Comment is not calling for general advisor liability but instead for modestly ensuring that the safeguards in the registration process continue to exist.

B. Underwriter Status Is Consistent with Congressional Intent and Achieves the SEC Policy Goal of Investor Protection

Based on the foregoing analysis, the financial advisors are likely liable as underwriters in the Spotify direct listing. Although this may appear at first blush as if it would have a negative impact on the future viability of direct listings, this Comment posits

\textsuperscript{180} \textit{Lehman Brothers}, 650 F3d at 177–78 & 178 n 7.
\textsuperscript{181} See Part IV.B.
\textsuperscript{182} See \textit{Lehman Brothers}, 650 F3d at 176.
\textsuperscript{183} See text accompanying notes 95–96.
otherwise. From a policy perspective, holding financial advisors in a direct listing liable as underwriters can benefit the investing public while still capturing the efficiency benefits of a direct listing. The twin aims of the Securities Act are to protect investors through disclosure while fostering capital formation.\textsuperscript{184} If one accepts the premise that public companies are a net positive for the US economy,\textsuperscript{185} and if one accepts that direct listings are an efficient way of creating public companies by lowering the cost and increasing the speed at which companies can go public,\textsuperscript{186} then one must be careful to not lose the benefits of direct listings by imposing additional liability on the process.

It is important to keep in mind that the risk of material misstatement or omissions in a registration statement is no lower in a direct listing than it is in a traditional IPO.\textsuperscript{187} After all, Spotify used the same form used in IPOs.\textsuperscript{188} Why should the liability rules be any different with respect to preparing information for the same filing form? The incentives are slightly different. In a traditional IPO, the underwriter is compensated in large part based on the spread between the offer price and sale price to the public, so there exists an incentive to cause the price to be as high as possible. In the direct listing, there is no premarket pricing, but the reputation of the investment banks and issuer are still important factors to consider. Moreover, there is no reason why § 11 liability would not attach to the issuer, Spotify.\textsuperscript{189} Additionally, the investment banks retain their BarChris due diligence defense. This Comment posits that the marginal increase in cost from imposing liability on underwriters does not offset the gains

\textsuperscript{184} Regulation of Securities, S Rep No 47, 73d Cong, 1st Sess 1 (1933) (“The purpose of this bill is to protect the investing public and honest business. The basic policy is that of informing the investor of the facts concerning securities to be offered for sale in interstate and foreign commerce and providing protection against fraud and misrepresentation.”).

\textsuperscript{185} See generally Frank Partnoy, The Death of the IPO (The Atlantic, Nov 2018), archived at http://perma.cc/M6T6-R7DW (discussing the economic growth a robust public market creates); David Weild IV and Edward Kim, A Wake-Up Call for America (Grant Thornton LLP, Nov 2009) (discussing the decline in IPOs and its negative impact on jobs); Ted Kaufman, Kaufman Calls Decline in IPOs “Choke Point” to Job Creation, Economic Recovery (University of Delaware Library, Dec 16, 2009), archived at http://perma.cc/RK7V-ES5D.

\textsuperscript{186} See Part II.A.

\textsuperscript{187} This Comment does not allege that there are any material misstatements or omissions in the Spotify registration statement.

\textsuperscript{188} The Spotify registration statement contained a “Plan of Distribution” section rather than an “Underwriting” section. See Spotify, Amendment No 3 to Form F-1 at 185 (cited in note 47).

\textsuperscript{189} See 15 USC § 77k(a)(1).
direct listings create. By potentially increasing the quality of information disclosed, such a threat could make direct listings even more attractive going forward by making the product safer for investors.

Since 1997, the number of companies listed on US exchanges has declined by more than 50 percent. Professor Frank Partnoy has suggested some potential reasons for this trend, including the high costs of going public and the steady deregulation of private markets. As private investments become less regulated, more money has flown to private markets. Direct listings have the ability to reduce the cost of going public directly by eliminating the direct underwriting spread fee. It also provides the liquidity solution without dilution or a lockup period. But does a direct listing make it easier for companies to take advantage of unsophisticated investors? Underwriter liability can ensure this does not become the case.

The first argument for underwriter status follows from the role that the registration statement serves in an offering. It is the primary document on which investors rely when considering an investment. In the House report accompanying the Securities Act, Congress explicitly stated its intent to impose § 11 liability on those who are “responsible for” the disclosure in registration statements. Indeed, Congress sought to ensure that persons “who sponsor the investment of other people’s money [are] held up to the high standards of trusteeship.” Because the financial advisors were explicitly retained to prepare the registration statement in the Spotify direct listing, liability is justified given Congress’s clear statement of intent.

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190 For an explanation attributing this decline to growing incentives for small firms to sell to a larger organization, see Xiaohui Gao, Jay R. Ritter, and Zhongyan Zhu, Where Have All the IPOs Gone?, 46 J Fin and Qualitative Analysis 1663, 1690 (2013) (“fewer firms are going public and staying independent because greater value is created in a sale to a strategic buyer in the same or a related industry.”).

191 Private assets under management were under $1 trillion in 2000 but surpassed $5 trillion in 2017. Partnoy, The Death of the IPO (cited in note 185); Eaglesham and Jones, The Fuel Powering Corporate America (cited in note 4).

192 Commissioner Jackson calls these fees a “middle-market tax” that can deter small and midsize companies from going public. Jackson, The Middle-Market IPO Tax (cited in note 41). See also notes 41–44 and accompanying text.

193 Securities in Interstate Commerce, HR Rep No 85, 73d Cong, 1st Sess 5 (1933) (“[The] essential characteristic [underlying § 11 liability] consists of a requirement that all those responsible for statements upon the face of which the public is solicited to invest its money shall be held to standards like those imposed by law upon a fiduciary.”) (emphasis added).

194 Id at 3.
As Professor Jennifer O’Hare points out, and cases such as *Chinese Consolidated* support, control over a registration statement can result from a party’s involvement in a distribution absent any formal contractual obligation. In her article, O’Hare argues that underwriter liability should not attach to institutional investors who exercise registration rights in an offering because such investors are not responsible for and do not have contractual control over the contents of a registration statement. Applying O’Hare’s analysis to the Spotify direct listing supports finding underwriter status for the financial advisors. They clearly played a significant contractual role in drafting the registration statement and Investor Day materials. While the financial advisors did not provide capital as they would have done in a traditional underwriting, their expertise and opinions likely shaped how Spotify marketed its business to the public, which further supports finding underwriter status.

A second, related argument in favor of underwriter liability follows from the “gatekeeper” theory pioneered by Professors Ronald Gilson and Reinier Kraakman. Gilson and Kraakman refer to traditional underwriters as “reputational intermediaries” that the public trusts when evaluating investment opportunities, particularly innovative ones. First-time issuers, such as Spotify, face a series of costs when going to the market, including a lack of capital to invest in a reputation, a lack of time to build a

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195 O’Hare, 1996 Wis L Rev at 254 (cited in note 143); *Chinese Consolidated*, 120 F2d at 740–41.
198 Gilson and Kraakman, 70 Va L Rev at 618 (cited in note 197):

If distribution and risk sharing do not adequately account for the investment banker’s function, some additional factor must be at work. Our analysis suggests that investment bankers play a third role, that of an information and reputational intermediary, which is particularly important in the context of new issues and other innovations.

(emphasis added).
reputation, and a “lingering suspicion” from prospective buyers. Because investment banks are repeat players in the capital markets industry and therefore do not face the same bonding costs as first time issuers, investment banks can lower the cost of the offering by “rent[ing]” their reputation to the issuer. Professor Michael Dooley connects this point to liability and registration statements:

[T]he underwriter’s self-interest in avoiding liability and preserving its own reputation may go a long way toward ensuring the accuracy of the registration statement and prospectus. The managing underwriter occupies a position with respect to the issuer which is both semi-adverse and not without clout, because withdrawal of the [underwriter] may effectively eliminate the chances of a successful offering.

This role is only amplified in cases of innovations, such as Spotify’s direct listing. In the registration statement, Spotify expressly names the financial advisors. Putting these names out into the world signals to investors that large financial institutions with strong reputations have kicked the tires on Spotify’s financials. While the banks did not participate in a traditional road show or build a book of potential investors, they still helped prepare the financial statements on which the public is presumed to rely for § 11 liability purposes. There is little doubt that the financial advisors’ role, however defined, provided some level of comfort to investors around the offering.

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199 Id at 619–20. One of the reasons Spotify chose to do a direct listing was because it had a “well-known brand, global scale, a relatively easily understood business model, and a transparent company culture,” Jaffe, Rodgers, and Gutierrez, Spotify Case Study at *2 (cited in note 45). Presumably this helped to reduce the need to do a firm commitment underwriting. Nonetheless, the financial advisors likely helped lower the remaining investor education bonding costs by drafting the registration statement and Investor Day materials.

200 Gilson and Kraakman, 70 Va L Rev at 620 (cited in note 197) (“In essence, the investment banker rents the issuer its reputation. The investment banker represents to the market . . . that it has evaluated the issuer’s product and good faith and that it is prepared to stake its reputation on the value of the innovation.”).

201 Dooley, 58 Va L Rev at 786 (cited in note 116) (citations omitted).

202 Spotify, Amendment No. 3 to Form F-1 at 186 (cited in note 47). While Spotify makes clear that the financial advisors were not acting as underwriters and does not feature Morgan Stanley, Goldman Sachs, and Allen & Company prominently on the cover page, the banks’ substantial role in the process likely had some positive impact on prospective investors.

203 For discussion of this theory in the context of the Spotify direct listing, see Maureen Farrell, Private Trades in Spotify Shares to Play Key Role in Upcoming Debut (Wall St J, Feb 19, 2018), online at http://www.wsj.com/articles/private-trades-in-spotify
also point out that a “sizable percentage” of typical underwriting compensation goes to participants who do not actually participate in the selling of securities, suggesting there are other purposes the underwriters serve.\textsuperscript{204}

The consequences of underwriter liability in a direct listing are the increased costs of going public. This could make direct listings less attractive, which matters on the margin if one considers them to be a more efficient way of going public. Even so, direct listings will still be cheaper than a traditional IPO. The largest component of an underwriters’ fee is the spread that it realizes when it resells the securities in a firm commitment offering. Because that process is necessarily lacking in a direct listing, this new product will be cheaper.\textsuperscript{205} However, courts should not be willing to sacrifice investor protection for efficiency. If direct listings serve the purpose of getting securities into the hands of common investors more quickly and through fewer intermediaries, then ensuring accuracy becomes even more essential. Moreover, imposing liability on underwriters will not destroy the efficiency gains because of (i) tracing challenges when there are both registered and unregistered securities and (ii) the due diligence defense. Thus, while litigation costs may increase, there are sufficient hurdles in place to prevent overdeterrence.

CONCLUSION

The Spotify direct listing represents a potentially significant shift in securities capital markets. There are many established

\textsuperscript{204} Gilson and Kraakman, 70 Va L Rev at 617 (cited in note 197). Another question that presents itself is whether this direct listing was just a “backdoor IPO.” Only 31 percent of the shares were not eligible to be sold to the public. The other 60 percent of the Spotify shares, excluding the 9 percent subject to a lockup agreement, already were eligible to be sold without registration. Yet there was no public market into which those shares could be sold. The direct listing created a market, presumably at a lower cost than a traditional IPO. The SEC has expressed concern about these types of “too clever by half” maneuvers. See generally, for example, Erik P.M. Vermeulen, High-Tech Companies and the Decision to “Go Public”: Are Backdoor Listings (Still) an Alternative to “Front-Door” Initial Public Offerings?, 4 Penn St J L & Intl Aff 421 (2015).

\textsuperscript{205} Indeed, one commentator has remarked on the potential for direct listings to drive down underwriting fees significantly. See Matt Levine, Bankers Can’t Feel Great Helping Slack Go Public (Bloomberg, Feb 5, 2019), online at http://www.bloomberg.com/opinion/articles/2019-02-05/bankers-can-t-feel-great-helping-slash-go-public (visited Feb 12, 2019) (Perma archive unavailable).
technology companies that have had tremendous success in raising capital in private markets and are now looking to go public. Will others follow the path? Or will the specter of § 11 liability keep unicorns away? Maybe not. Slack has already filed a registration statement with the SEC in pursuit of a direct listing for Spring 2019. Slack is also reportedly using the same three investment banks that Spotify retained as financial advisors—parties that this Comment asserts qualify as underwriters for purposes of § 11. Are there underlying underwriters in the Slack process? To borrow language from the late Professor Louis Loss, § 11 liability is not likely to become the “bête noire” of direct listings, and clarity around the specter of such liability will lower uncertainty for future unicorns, reduce verification costs for prospective investors, and ultimately provide higher returns to shareholders.

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206 See Loss, Seligman, and Paredes, 2 Securities Regulation at 1599 (cited in note 113).