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In this message, I’d like highlight our Section’s role in trying to change public policy. One way to affect policy is through sponsoring resolutions in the ABA’s House of Delegates. The members of the House (including our highly respected delegates Judy Kaleta and Tom Susman) labor long and hard to make the right decision about literally dozens of different proposals brought before them.

We’ve sponsored a resolution urging Congress to reauthorize and adequately fund the Administrative Conference of the United States. Congress unwisely defunded ACUS in 1995. This action saved the princely sum of $1.8 million per year, while heedlessly tossing aside a precious resource for law reform. Congress recently reauthorized ACUS, but it has not yet appropriated funds to get it up and running again.

We also sponsored a resolution on disclosure of grass-roots lobbying that has yet to bear fruit.

At the next meeting of the House, we’re proposing a resolution calling on the states to create independent redistricting commissions to shift the line-drawing process away from state legislatures. Twelve states already have such commissions. Trevor Potter and Gerry Hebert are responsible for this important, timely, and controversial resolution.

We’re working on a proposal for a model ordinance to create fair procedures in local land use planning disputes. This will replace a law written by Herbert Hoover in 1926! The Interstate Compacts Committee — headed by Bill Morrow, Jeff Littwak, and Kent Bishop — is putting the finishing touches on recommendations for an Interstate Compact APA. We’re also working with other sections to improve their resolutions, as we did with a resolution from the Standing Committee on Immigration about excessive fees for humanitarian applications. Lenni Benson led the Council discussion.

Another way we can affect public policy is by sending blanket authority letters to Congress or to agencies, taking positions that are consistent with ABA policy. We’ve sent a letter urging Congress not to defund enforcement of Executive Order 13422 concerning guidance documents such as interpretive rules and policy statements. The Order urges agencies to involve the public before for adopting significant guidance documents and subjects such documents to OIRA scrutiny. Paul Noe took the initiative on this letter.

We’ve also worked on a letter to Congress, opposing pending legislation that would allow the International Trade Commission to hire non-ALJs. Robin Arzt did the heavy lifting.

Another policy initiative we’re working on is the improvement of e-rulemaking and of regulations.gov. Cynthia Farina has assembled a powerhouse committee to study the issues in depth and make suggestions for improvement. Meanwhile, we’re preparing a letter to the new President — whoever he or she may be — about administrative law priorities. Chair-elect Russ Frisby heads up the POTUS project.

We in the Administrative Law Section are policy people. We care about what Government does and we want to make it better. We don’t always agree about the public interest, of course, but we can often compromise our differences. If you’d like to comment on these policy initiatives or propose new ones, please let me know. My email address is asimow@law.ucla.edu.

The Section values the input of all its members. Make your opinion count. Contact us at knightk@staff.abanet.org. Also, please let us know how we can help you get more involved with Section activities.

Visit the Section’s Website at www.abanet.org/adminlaw and click on ONLINE CLE for access to Section programs at WestLegalEdcenter.
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Clark Byse was a legend. He taught at four of America's best law schools, most prominently Harvard Law School, in a teaching career that spanned sixty years. He was president of the American Association of University Professors and a strong voice for academic freedom. He was a guiding force in the Administrative Conference of the United States and for many years an active participant in the work of the Administrative Law and Regulatory Practice Section of the American Bar Association as well. He wrote classic law review articles and was co-author of a leading casebook on Administrative Law. All of these accomplishments contributed to his fame. All deserve note on his passing.

But what most set Clark apart — what fueled his prowess as a teacher and his prominence in the profession, what endeared him to so many, so deeply, for so long — were personal qualities. Those are part and parcel of the legacy Clark leaves behind.

Clark was widely rumored to have been the model for Professor Kingsfield — a rumor that tickled Clark, though he insisted that Lon Fuller, not he, provided the real-life inspiration for that character. He was, indeed, known from his first class at the University of Iowa in 1939 to his last class at Boston University in 2000 (and through years at the University of Pennsylvania and Harvard in between) as one of the masters of the “Socratic method,” a tough task-master who insisted that students learn the material and be able to respond promptly and cogently to questions about it. His no-nonsense style is remembered by generations of students who felt grateful to have been pushed hard to think and speak clearly and precisely by someone who himself settled for nothing less.

Yet the students understood full well that underneath the tough exterior beat a heart of pure mush, one that had some room for everyone and a great deal of it for those he could help most, a warm heart that animated a man who cared deeply about friends, family, students, and colleagues. Students knew that Clark pushed them out of genuine interest in their success, and they saw that in many other ways. He was always reaching out to them, inviting them for lunches, serving as an advisor and mentor. And he did the same for junior colleagues — and kept doing that when they became senior to almost everyone else.

I had the good fortune to have Clark as a colleague for seventeen years, ten of them while I served as Dean at Boston University. I saw first-hand his devotion to the classroom, his connection to his students, his mastery of the craft of teaching, and his generosity with colleagues. I profited from his kindness and advice, including his encouragement to me and to Colin Diver to produce our own Administrative Law casebook on a somewhat different model from the one he labored over for so many years with Walter Gellhorn, and then with Peter Strauss. Few people would be so generous with time and counsel. Few would invest the attention he did on mentoring students, too, taking time to help many gain teaching jobs, writing references, calling on faculty members who might provide a placement.

Clark did that and more, finding time for students interested in teaching or in clerkships or in practice and for colleagues interested in Administrative Law or Contracts or Federal Courts or any other subject that engaged his energy and insight.

Clark had a way of dealing with people that understated his own accomplishments, even while demonstrating his perception of the central problem at hand, just as he had a way of making people feel cared about regardless of their position in the profession. Peter Strauss, a former Chairman of the Administrative Law Section and long Clark’s co-author on the casebook Walter Gellhorn launched in 1940, in his forthcoming tribute in the Harvard Law Review, has this to say about his collaborator:

I was privileged to work with Clark on two editions of the Administrative Law teaching materials he had long co-authored with my Columbia mentor Walter Gellhorn. What a sharp and kindly eye Clark brought to the work of his new junior colleague! Making me also a guest in his home and sharing the concerns of his life during the weeks we were preparing new editions for publication, in the years before Elizabeth so wonderfully found him and returned the joy to it. In his editing, too, what students would take away was always at the fore. “How do you expect this to work in class?” “What are the central issues students need to confront, and how can we sharpen what’s here to make that happen?” Putting the materials in ways that would capture their interest and advance their understanding was the watchword, and not exploiting a captive audience for his own scholarship; students could hardly know (unless paying attention to what they were learning) what a shaper of the field he, in particular, had been.

When Clark, late in life, re-found Elizabeth — a woman he had known five decades before they re-connected in a manner that would make anyone a believer in fate — he found a romance and excitement that animated him, that lightened his step, that gave him the glow of a teenager in love. That glow spread to those around them during the last decade of his full life. While the love and connection they shared was very special, Elizabeth knew that Clark’s heart warmed others as well, just as his mind illuminated dark corners of the arcane fields that fascinated him.

All of us who knew Clark Byse have lost a friend. And the profession has lost a wonderful example of what is best in teachers, scholars, and mentors. His work will live on — and his many kindnesses will as well.

Ronald A. Cass is Dean Emeritus of Boston University School of Law and a former Chairman of the Section on Administrative Law and Regulatory Practice. He is Chairman of the Center for the Rule of Law and President of Cass & Associates, PC.
Hedge Funds, “Decoupling,” and Regulation

By Henry T. C. Hu1 and Bernard Black2

At the core of the governance of the publicly held corporation is the shareholder vote. That governance, at almost all companies, is based on a proportional relationship between voting power and economic ownership: one share—one vote. This coupling of voting power and economic interest serves several goals. The power to oversee company managers is placed in the hands of those who have an incentive to exercise the power to increase firm value. The more shares owned, the greater the incentive and thus the greater the number of votes. The coupling of votes and shares makes possible the market for corporate control. Beyond the instrumental role of voting, the concept of shareholder-as-owner-and-as-voter is a core ideological basis for managerial exercise of authority over property they do not own.

The derivatives revolution and other capital markets developments now allow the large-scale, low-cost decoupling of shareholder voting rights from shareholder economic interests. We analyze this decoupling and its corporate governance implications in The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership, 79 S. CAL. L. REV. 811-908 (2006), and related articles. This note provides a very brief overview of decoupling strategies and the need for disclosure reforms.

Decoupling can come in a variety of forms. We will focus here on two types, which we call “empty voting” and “hidden (morphable) ownership.”

Empty voting occurs when an investor holds more votes than economic ownership. The shares have thus been emptied partly or fully of a corresponding economic interest. In an extreme case, an investor can hold votes with no economic interest, or potentially a negative economic interest in the company. Someone with a negative economic interest has an incentive to vote to cause the company to make bad decisions, not good ones.

Hidden (morphable) ownership occurs when investors have undisclosed economic ownership that exceeds their apparent voting rights. The ownership is hidden, because current disclosure rules cover principally voting ownership, not economic ownership. It is “morphable” because the hidden owner often has de facto access to voting rights, when needed. For example, the familiar 5% and over disclosure requirements under Schedule 13D apply only to voting ownership. A shareholder might, for instance, hold a 9.9% economic stake in a company without any public disclosure, yet be able to obtain the corresponding voting rights at any time.

Empty voting can be accomplished in a number of ways. Here are two examples. The first involves a hedge fund called Perry Corp. In late 2004, Perry owned seven million shares of King Pharmaceuticals. Mylan Laboratories agreed to buy King. King’s shares jumped, but Mylan’s shares dropped sharply. To try to help Mylan obtain the needed shareholder approval, Perry bought 9.9% of Mylan, thereby becoming Mylan’s biggest shareholder. However, Perry fully hedged its market risk on the Mylan shares through short positions in equity swaps (equity swaps are derivative contracts which are basically side bets on the performance of a company’s shares) and other means, thereby ending up with 9.9% voting ownership but zero economic ownership. Including its position in King, Perry’s overall economic interest in Mylan was negative. The more Mylan (over)paid for King, the more Perry would stand to benefit.

Another example involves “record date capture,” through share borrowing. Borrowed shares convey votes without economic ownership (which remains with the share lender). For example, a shareholder who wants to support a shareholder proposal or elect insurgent directors can enhance his voting power by borrowing shares just before the record date for a shareholder vote, and then return the shares immediately afterwards. One example of this “record date capture” strategy occurred in the U.K. in 2002. Laxey Partners, a hedge fund, held about 1% of the shares of British Land. At the annual general meeting, Laxey voted over 9% of British Land’s shares to support a proposal to dismember British Land. Just before the record date, Laxey borrowed almost 42 million shares. Laxey perceived itself as calling weak management into account. British Land’s chairman didn’t see matters the same way, characterizing Laxey’s “rent-a-vote” strategy as an abuse of the voting system.

We offer many more examples of empty voting and hidden (morphable) ownership in our research. For our current, but ever-expanding list, see Equity And Debt Decoupling And Empty Voting II: Importance And Extensions (working paper 2007), at http://ssrn.com/abstract=1030721.

What should be done? Current disclosure rules do not reach most decoupling strategies. And state corporate law on vote buying is unlikely to reach empty voting.

The first need is for better disclosure. U.S. securities rules currently include five discrete, highly complex, and often internally inconsistent sets of ownership disclosure rules. These rules cover, respectively: (1) active 5% shareholders (Schedule 13D); (2) passive 5% investors...
equity swaps and other OTC derivatives disclosure is required. Positions involving which positions must be disclosed once trigger an obligation to disclose and determining which ownership positions funds. Different rules often apply in exchange Act of 1934); and (5) mutual insiders (Section 16(b) of the Securities U.S. equity securities (Form 13F); (4) investors holding over $100 million in (Schedule 13G); (3) all institutional ownership positions holding or call (800) 285-2221.

We have proposed a set of “integrated ownership disclosure” rules, which would largely replace these five sets of rules with one consistent set, while also providing improved disclosure of empty voting and hidden (morphable) ownership. Our proposal would extend existing 16(b) and mutual fund disclosures to cover current 13D, 13F, and 13G filers, cover both economic and voting ownership, require symmetric disclosures of long and short positions, and add reporting of share lending and borrowing positions, and of actual instances of significant empty voting. These proposed rules would not only result in better information but — because they are simpler than the current patchwork — may be less burdensome overall.

An assessment of what responses beyond disclosure rules are appropriate must reflect the fact that not all vote buying is bad. Some vote buying could enhance shareholder oversight of management in certain circumstances. Moreover, empty voting and hidden ownership depend on the derivatives, share borrowing, and short-selling markets, all of which — derivatives, share borrowing, and short-selling markets — have valuable social roles. For instance, short sellers can help make stock prices more efficient.

We develop several families of strategies which collectively could do much to address empty voting. One family focuses directly on voting rights. The key question there is: under which circumstances should the voting rights of an empty voter be limited or denied altogether? We would bar negative economic owners from voting, require derivatives dealers and banks, who are often zero economic owners, to pass votes on to true economic owners when feasible, and allow corporations limited power to amend their charters to address other instances of empty voting. A variety of technical reforms to the mechanics of shareholder voting — the voting architecture — would limit opportunities for record date capture, improve the ability of economic owners to vote, and improve the ability of share lenders to recall and vote shares if they want to. A third family of strategies addresses supply and demand for share lending and other transactions which facilitate empty voting.

Existing legal and economic theories of the public corporation presume a link between voting rights and economic ownership that can no longer be relied on. Financial innovation and hedge funds now allow large scale, low cost decoupling of economic and voting rights. Empty voting and hidden (morphable) ownership are worldwide phenomena. Disclosure reform, in our judgment, is the first step. It is already occurring in a number of other countries. The U.S. needs to follow.
Hedge Fund Activism: The Case For Non-Intervention

By Marcel Kahan and Edward Rock¹

Hedge funds have become critical players in both corporate governance and corporate control. They seem to be everywhere. Recently hedge funds have pressured McDonald’s to spin-off major assets in an IPO; asked Time-Warner and Tiffany to change its business strategy; urged Alcoa to drop its efforts to acquire Alcan and Mirant to drop its efforts to acquire NRG; pushed Target Corp. to take steps to “correct” the market’s undervaluation of its shares; demanded that Angelica, Glenayre Technologies, eSpeed and PDLC BioPharma take steps to sell themselves; urged Kraft Food to sell assets and buy back shares; threatened or commenced proxy contests over H.J. Heinz, Motorola, WCI, and H&R Block; installed new management at Take-Two Interactive Software; made a bid to acquire Lear; opposed acquisitions by Novartis of the remaining 58% stake in Chiron, by Sears Holdings of the 46% minority interest in Sears Canada, by Micron of Lexar Media, by Great Plains Energy of Aquila and by a group of private equity firms of VNU. Even though most hedge funds are not activist — J.P. Morgan recently estimated that only about $50 billion in hedge fund assets are available for shareholder activism — the ones that have captured the attention. Martin Lipton, the renowned advisor to corporate boards, lists “attacks by activist hedge funds” as the number one key issue for directors and the Wall Street Journal calls hedge funds the “new leader” on the “list of bogeymen haunting the corporate boardroom.”

Public and private pension funds, union funds and mutual funds — the traditional institutional investors — all engage in shareholder activism. Every year, there are dozens of shareholder proposals relating to various aspects of the corporate governance rules, such as poison pills, confidential voting, and majority voting for directors, and often targeting multiple companies with similar proposals. In addition, since the mid-1990s, institutions have increasingly initiated private negotiations to get boards to make governance changes voluntarily, resorting to formal proposals only when boards failed to do so.

Hedge fund activism differs from activism by traditional institutions by focusing on specific companies, by investing substantial resources, and by pursuing their goals publicly. Although activist hedge funds control only a small fraction of the capital available to traditional institutions, their activism has become much more threatening to management.

How have hedge funds emerged as the prime movers and shakers? Part of the answer may be that traditional institutions face regulatory barriers, political constraints, or conflicts of interest that make activism less profitable than it is for hedge funds. Most significantly, regulatory constraints impede the ability of mutual funds to charge the steep performance-based fees — typically 20% of profits — earned by hedge fund managers. And although public pension funds can employ professional managers compensated by performance-based fees, it is a risky strategy for trustees. Pay packages in the $100 million dollar range (not unusual for hedge fund managers) and some of the more aggressive activist strategies employed by hedge funds predictably attract public criticism.

But regulatory and political constraints are only part of the story. The different styles of activism emerge because hedge funds and traditional institutions pursue fundamentally different business models. Activist hedge funds accumulate stakes in portfolio companies in order to engage in activism. For them, activism is an integral part of a pro-active profit-making strategy. Traditional institutions, when they become activist, are typically reactive: Fund managers note that portfolio companies are underperforming, or that their governance regime is deficient, or that someone else has offered a shareholder proposal, and then (sometimes) take steps to correct the problem. The business model of many mutual and pension funds is based not on activism but on diversification, low management expenses, and trading strategies that can be applied to the fund’s large number of portfolio companies.

Although hedge funds hold great promise as active shareholders, their intense involvement in corporate governance and control also raises some concerns. Hedge funds are set up to make money for their investors without regard to whether the strategies they follow benefit shareholders generally. There have been instances in which hedge funds have faced direct conflicts with other shareholders in their activism. Perhaps the most notorious example involved Perry Corp. which acquired “empty votes” in Mylan Laboratories — it bought shares (and thus votes) in Mylan and then hedged its economic exposure — in order to vote these shares.

¹ Professor of Law, New York University School of Law, and Professor of Law, University of Pennsylvania Law School, respectively. An earlier version of this article first appeared in the ISS Corporate Governance Bulletin. A more thorough analysis of the issues raised was published in the University of Pennsylvania Law Review and can be found at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=919881.
in favor of the proposed merger with King Pharmaceutical in which Perry held a large economic stake. But such instances of direct conflict are rare and, importantly, we have not found any evidence of hedge funds and corporate managers making side deals in which the firm pays the hedge fund to go away, such as greenmail.

The most serious concern about hedge fund activism is that hedge funds may exacerbate an already serious problem of “short termism” in the executive suite. Whether hedge funds sacrifice valuable long-term projects in favor of short-term gains is not always easy to tell. Consider Deutsche Boerse’s (DB) failed attempt to acquire the London Stock Exchange. DB’s CEO wanted to acquire the LSE and convinced the board that doing so was a good idea. Hedge funds who had acquired large stakes in DB disagreed. They maintained that the plan to acquire the LSE represented wasteful managerial empire building and that DB’s cash hoard should instead be distributed to shareholders. Now, if the investment in acquiring the LSE was a valuable long-term project, then the involvement of the hedge funds had the effect of pushing the company towards the lower value outcome, an outcome worse for long-term shareholders than acquiring the LSE. If the hedge funds were right that the investment was simply a bad investment driven by delusions of grandeur, their opposition benefited both short-term and long-term shareholders. At the time, the hedge funds’ success in derailing the proposal was hailed as a great victory for shareholders. The vigorous competition for the LSE in recent months may suggest otherwise. It is worth remembering that hedge funds bet against Eddie Lampert when he took Kmart out of bankruptcy in May 2003 at $15 per share, stock that within a year and a half was worth more than $100 per share.

Is short-termism a real problem? If markets accurately value companies that pursue long-term projects — if they are “efficient” in this respect — then the interests of investors with short-term trading horizons will not conflict with those of investors with long-term trading horizons. Many managers, directors, private equity funds, and investment bankers are convinced that the markets are myopic and undervalue long-term projects. Others believe that the short-term/long-term distinction is a foil for a managerial failure to deliver results, and the empirical evidence on the extent and magnitude of myopia is sketchy at best.

But even assuming that markets are sometimes myopic, the case for legal intervention designed to curb hedge fund activism is not strong. For one, it is unclear to what extent hedge funds activism is driven by excessive short-termism. Is it always the case, when a hedge fund gets involved, that it is pursuing strategies with a short-term payoff over strategies with a more valuable long-term payoff? Or is the short-term payoff preferred by hedge funds sometimes the more valuable one?

...hedge funds are generally not powerful enough to exercise control over the targets of their activism.

And how often is hedge-fund activism motivated by altogether different concerns, such a bad management, an ill-advised strategy, or an insufficient price in an acquisition?

Moreover, hedge funds are generally not powerful enough to exercise control over the targets of their activism. In order to prevail, they must gain the support of others: corporate management, independent directors, traditional institutional investors with large stakes, and other large shareholders. Over time, the degree of support that hedge funds receive will likely depend on whether long-term shareholders benefit.

But most fundamentally, our skepticism about legal intervention rests on our view that companies (and the market more generally) will take what we have called “adaptive devices” to deal with the potential negative effects of hedge fund short-termism. To see the shape of some of these devices, one need look no further than the “Hedge Fund Attack Response Checklist” mailed by Martin Lipton to the clients of his firm. In this widely circulated memo, Lipton recommends that companies prepare in advance for hedge fund activism by: periodic updates of the board of directors; review of dividend policy; improved financial public relations; consistency in one’s strategic message; proactively addressing reasons for any shortfall in peer company benchmarks; regular, close contact with major institutional investors; a review of basic strategy with the board; and so on. These are terrific ideas, not just to deal with activist hedge funds, but in general. If companies follow Lipton’s advice, hedge funds will already have made significant positive contributions to the management of U.S. companies.

Whether desirable or not, the activities of hedge funds have exposed fundamental weaknesses in our corporate law voting technology. As we are exploring in a new paper, The Hanging Chads of Corporate Voting (available at SSRN: http://ssrn.com/abstract=1007065) the existing corporate election machinery may not produce results in a close contest that are even as reliable as Florida’s punch card ballots were in 2000. When you combine multiple layers of custodial ownership with widespread short selling in a world in which thousands of annual meetings are held between March and June of every year and in which hedge funds contest more of these corporate votes than ever before, it turns out that the system may not be able to answer the most basic question of all: who won?

How will the current credit crunch affect hedge fund activism? There are signs that it may, at least temporarily, chill it. At least one activist fund (Pirate Capital) has frozen withdrawals after an 80 percent decline in assets. In addition, with fewer private equity buyouts, activist funds’ ability to make substantial gains by triggering a sale is reduced. Finally, it is now harder for firms to finance stock buybacks or special dividends through borrowing. But only time will tell. Stay tuned!
A Self-Regulation Proposal for the Hedge Fund Industry

By J.W. Verret

In 2003, The Securities Exchange Commission instituted a regulation requiring certain hedge funds, previously unregulated, to register as Investment Advisers. That regulation would have meant that funds would have become subject to an intense compliance inspection program. The SEC’s stated goals in instituting this proposal were to minimize instances of fraud perpetrated by hedge funds. Though all market players are subject to existing anti-fraud rules, the SEC’s enforcement capability only comes into play after the fraud is discovered (if at all) and once the damage to that fund’s investors, and possibly other financial institutions (think of market timing at mutual funds) has already been done. In addition, investments in hedge funds by public pensions expose pension beneficiaries to that risk as well. In sum, part of the SEC’s interest was in fraud prevention and information gathering.

Critics of hedge fund registration, such as former Fed Chairman Greenspan, urged that over-regulating hedge funds could mean stifling the liquidity that these funds bring to the securities markets. Other critics argued that hedge funds may have simply moved offshore to avoid the regulation. Finally, some asked why the SEC should be in the business of protecting the sophisticated investors in these funds, which had to be multi-millionaires or financial institutions in order for the regulatory exemption for hedge funds to apply. In the summer of 2006, the District of Columbia Court of Appeals invalidated the 2004 registration provision in Goldstein v. SEC. Since that time, the House Committee on Financial Services, Chaired by Rep. Barney Frank, has held hearings into hedge fund regulation. The Administration has announced its intention not to support a further regulatory effort. Though the branches of government are currently are odds, this issue is not likely to go away, especially if Congress and the Executive branch are controlled by the same party after the ’08 elections.

In the last ten years, nearly 2 trillion investment dollars have flowed into an industry that found itself at the center of a mutual fund fraud investigation in 2004 and now has a starring role in the subprime lending crisis. Anticipating future regulatory efforts, this article intends to design a regulatory scheme that is more effective and less costly than the SEC’s invalidated registration requirement. Self-Regulation is a prominent theme in our capital markets. The NASD and NYSE, now merged to form the FINRA, have long regulated member firms and broker dealers. The Federal Reserve is effectively a quasi Self-Regulatory Organization (“SRO”), with member banks nominating the Regional Presidents. One wonders why the idea of self-regulation in the hedge fund industry has not been previously explored as a viable compromise between the existing extreme views on this topic. Bureaucratic regulators are notoriously slow to innovate their approach, especially when compared to the pace of change in the financial markets. But self-regulators are closer to the front lines. In addition, self-regulatory entities are more sensitive to compliance costs. In choosing between equally effective regimes, bureaucratic regulators may, however, have incentives other than cost in mind.

Economic competition theory also supports self-regulation, as an SRO creates internal competition among market players which results in decision outcomes that are more preferential than if the group were not forced into collective action. For instance, consider the classic example of the prisoner’s dilemma (Two suspects are asked to confess to a crime. If neither confesses, they both walk free. If they both confess, they each get ten years. If only one confesses, he gets a year and the other prisoner gets 25. The result will invariably be that they both confess. Each of their optimal strategies is to confess, in light of the other’s expected optimal strategy, even though if they could agree then they would both walk. But, even in light of an agreement not to confess, each would expect that the other would cheat and so would minimize their exposure.) In much the same way, firms would seek to take capital investments from competitors by voting within the SRO for regulations that enhance transparency of a fund’s fiduciary compliance, out of an interest in taking capital flows from competitors who may not. The result is an equilibrium of compliance that would exceed the level of transparency that would exist without the collective action, thus giving more sharpness and binding effect to any best practices that may exist in the industry and providing a more cost effective enforcement avenue for those best practices.

Looking from a broader overview, hedge funds as an asset class also compete inter-industry for capital with other asset classes, such as private equity, so the entire fund industry would also have an incentive to promote greater accountability with respect to inter-industry competition for capital. This externality to regulation may not be internalized by individual funds, or by the SEC, but an SRO would more readily appreciate that advantage to enhanced transparency. The sector has not been able to promulgate binding rules thus far because the groups suffer from a collective action problem. The advantage to each fund of transparency rules does not make up for the cost of being the first mover in collective action. But with the SEC requiring membership the SRO can then begin...
to function along the lines of the theory. One way the SEC could encourage membership in the SRO would be to allow an exemption or safe-harbor to any future registration requirement to firms that submit to regulation by the SRO body. It could also initiate official Staff Guidance, in the form of official opinions or no-action letters, to give regulatory and enforcement authority to disclosure decisions made in accordance with SRO rules, in similar relationship to the SEC’s official recognition of GAAP.

As an aside, there is also a very good argument that any future Congressional or SEC regulatory action in the hedge fund sector should also recognize exemptions and more effectively coordinate with the CFTC (Commodities Futures Trading Commission). If a hedge fund trades in commodities such that it is required to register with the NFA (National Futures Association, another SRO overseen by the CFTC), the SEC should recognize an exemption from SEC registration. Though the CFTC requested such an exemption for the previous registration effort, that request was denied in the final rule release. Mutual recognition and coordination is a hallmark of banking regulation, one from which the SEC could take valuable lessons should it continue to regulate in this area. In addition, more effective coordination with the UK Financial Services Authority, as well as more effective relief for hedge funds registered with the FSA, would also be advisable in future rulemaking.

In order for self-regulation to work, however, the system must be designed to prevent regulatory capture by the member firms, and this will require gentle oversight from the SEC. The SEC’s oversight role would play out in four ways. It would design the SRO’s charter to define the rulemaking process. One prescription the SEC should include in that charter would be that the SRO rulemaking function should be separate from the SRO enforcement function, and that enforcement personnel should be independent of regulated firms. The SEC would also need to approve any amendments to the SRO charter. Then, it would vet nominees to the rulemaking body to ensure that a diverse group of firms were represented based on fund strategy as well as fund size, ensuring that one fund or one fund class did not dominate the process to promulgate rules to their advantage.

One caveat to my approach: systemic risk, or risk that excessive leverage will ripple out into the market, involves the kind of economic externalities that a self-regulatory regime may be ill equipped to handle. The Federal Reserve’s margin rules and the NASD’s broker lending rules are more appropriate approaches for that related concern. Thus, the issues surrounding the subprime fiasco, to the extent they derive from abuse of leverage, are more properly issues for those regulatory venues.

Congressional interest in hedge fund regulation continues to fester. In response, the hedge fund sector has stepped up its lobbying function to respond. Some members of Congress have hinted at their desire to expressly grant the SEC the authority to require hedge fund registration as a response to the Goldstein decision. It would be to a fund manager’s advantage to channel government interest into a self-regulatory mechanism as a more cost-effective and nimble alternative. In the event that the eventual SRO design is subject to light oversight by the SEC, a self-regulatory alternative to outright registration would be in investors’ and beneficiaries’ best interest as well.

From the ABA Section of Administrative Law and Regulatory Practice and the ABA Government and Public Sector Lawyers Division


By Jeffrey S. Lubbers

This fourth edition brings the essential Guide to Federal Agency Rulemaking, formerly published by the Administrative Conference of the United States (ACUS), completely up to date. A concise but thorough resource, the Guide provides a time-saving reference for the latest case law, and the most recent legislation affecting rulemaking. This manual provides agency rulemakers, participants in rulemaking and judicial review, and private practitioners with valuable insights into how federal rules are made, with an integrated view of the procedural requirements. The new edition of A Guide to Federal Agency Rulemaking, written by Jeffrey S. Lubbers, former ACUS Research Director, retains the basic format of the previous editions while building upon the strong foundation established by ACUS in the previous editions. This fourth edition of The Guide, contains an index, and is organized into five parts: Part I is an overview of federal agency rulemaking and describes the major institutional “players” and historical development of rulemaking. Part II describes the statutory structure of rulemaking, including the relevant sections of the Administrative Procedure Act (APA). Part III contains a step-by-step description of the informal rulemaking process, from the preliminary considerations to the final rule, including a discussion of e-rulemaking. Part IV discusses judicial review of rulemaking with an expanded decision of the Chevron caselaw. Part V Appendices include key rulemaking documents. This is an indispensable guide for anyone developing or drafting federal agency rules. Order your copy today.

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Friday, February 8, 2008

9:00am – 10:30am
California Initiatives to Mitigate Climate Change

In the face of federal inaction, a growing number of states individually and collectively are launching efforts to control carbon emissions within their own boundaries. As in so many other areas, no state has moved as broadly and dramatically as California. Assembly Bill 32, enacted in fall 2006, has committed the state to a comprehensive, multi-decade program of greenhouse gas (GHG) reductions from all “significant” stationary sources. The California Air Resources Board (CARB) is currently conducting an extensive stakeholder process in preparation for issuing implementing rules. On the mobile source front, the Clean Air Act (CAA) authorizes California, with EPA approval, to set auto emission standards that differ from federal standards, and the state has used this opportunity to establish GHG standards for cars. The state’s preemption waiver request has been pending before EPA for an unusually long time, but auto companies have not waited to challenge the auto standards as being preempted under the CAA and federal energy legislation. Our panelists will address both California programs, the challenges and opportunities they create for the private sector, and the legal issues involved in the auto standards disputes.

Panelists:
Mary Nichols, Chair, California Air Resources Board, Sacramento, CA;
Peter Hsiao, Partner, Morrison & Foerster LLP, Los Angeles, CA;
Marjorie Lewis, Partner, Gibson, Dunn & Crutcher LLP, Los Angeles, CA
Moderator:
Cynthia Drew, Professor, University of Miami School of Law, Coral Gables, FL

10:45am – 12:15pm
An Inside View of the Stoneridge Case — Investor Protection or Frivolous Litigation?

Argued before the Supreme Court on October 9, 2007, the case of Stoneridge Investment Partners v. Scientific-Atlanta is viewed by many securities law experts as a potential watershed that may significantly expand investor rights. The Supreme Court will determine whether investors who were deceived by public companies can sue other actors who participated in the fraudulent schemes. At issue is the meaning of Sec. 10(b) of the Securities Exchange Act of 1934 and the coordinating Securities and Exchange Commission regulation, Rule 10b-5. The Act bars market actors from using any “manipulative or deceptive device or contrivance … in connection with the purchase or sale of any security….” The Rule prohibits the use of any “device scheme or artifice to defraud,” any “untrue statement of a material fact [or omission of fact],” and any “act practice, or course of business which operates or would operate as a fraud or deceit upon any person,” in connection with the sale or purchase of stock. The plaintiffs in Stoneridge have argued that the law permits it to sue actors who participate in a fraudulent scheme, not as aiders or abettors, but as “primary violators” who are ultimately tied to market movements. The defendants have countered that the law reaches only those who make deceptive communications to shareholders or engage in fraudulent trading on the market. Although the SEC asked the Solicitor General to file a brief supporting the investors’ theory, he ultimately filed a brief essentially asking the Court to reject scheme liability. In contrast, several members of Congress have filed materials urging the Court to adopt a more consumer-friendly approach.

Panelists:
Robert R. Gasaway, Partner, Kirkland & Ellis LLP, Washington, DC;
Stanley M. Grossman, Partner, Pomerantz Haudek, New York, NY, Attorney for the Plaintiff; Thomas Karr, Assistant General Counsel, SEC, Washington, DC
Moderator:
Abigail Arms, Partner, Shearman & Sterling LLP, Washington, DC, former SEC Associate Director – Legal
10:45am – 12:15pm  
Causes and Possible Remedies for the Current Subprime Lending Crisis  
A recent LA Times report says 1 out of every 88 homes in California is in foreclosure. Some of the roots of the current subprime lending crisis are evident with hindsight. In recent years there has been much debate about the role of federal versus state regulation in the area of consumer protection in mortgage and other consumer lending products. This panel addresses state and federal regulatory and legal developments that may have had a part in feeding the problem once it started, and possible remedies.

Rebecca H. Gordon, Associate, Perkins Coie, Washington, D.C.  
Moderator:  
William V. Luneburg, Professor, University of Pittsburgh School of Law, Pittsburgh, PA

1:45pm – 3:15pm  
Lobbying Under the Honest Leadership and Open Government Act of 2007  
There have been important recent developments in Washington as well as in California with regard to lobbying regulation, including, most recently, the enactment of the Honest Leadership and Open Government Act of 2007. Indeed, potential criminal liability figures prominently in the new arsenal of sanctions applicable to prohibited activities — and the complexities of the law are such that an attorney may be lobbying when he or she does not realize it. This program will review some of the changes in the law, focusing on the distinctive approaches at the federal and state levels. Other than lobbying disclosure, the discussion will cover gift and travel rules, including use of campaign funds to finance travel. Attention to state law will include some coverage of the rules of selected California municipalities, including Los Angeles, San Francisco, and San Diego.

Panelists:  
Charles H. Bell, Jr., Partner, Bell, McAndrews & Hiltachk, LLP, Sacramento; Thomas M. Susman, Partner, Ropes & Gray, Washington, D.C.;

3:30pm – 5:00pm  
Lawyers on TV — the Good, the Bad, and the Ugly — And the People Who Script Them That Way  
People learn most of what they know (or think they know) about law and lawyers from popular culture, particularly television. As a result, lawyers should be thinking about the messages transmitted by pop culture. Dramatic series focusing on the legal process have been popular for many years. Law & Order, LA Law, The Practice, JAG, Close to Home, Judging Amy, and Ally McBeal were all quite successful (and of course Perry Mason and The Defenders in years past). Boston Legal and Shark currently enjoy excellent ratings but portray lawyers in a negative light. This panel of screenwriters (and legal consultants) for a number of these series will discuss the representation of lawyers on television and provide insights into the inner-workings of hit television shows about law and lawyers. This program is cosponsored by the Health Law Section, the Criminal Justice Section, the Government and Public Sector Lawyers Division, the Individual Rights and Responsibilities Section, and the Standing Committee on Legal Aid and Indigent Defendants. The panelists are: Bill Fordes, writer for Law & Order and Close to Home, Gary Glassberg, writer for Shark, Craig Turk, writer for Boston Legal, and Chuck Rosenberg, legal adviser to David Kelley. A reception will follow the program.

Moderator:  
Michael Asimow, Professor, UCLA Law School

5:00pm – 7:00pm  
Section Reception — The Beverly Hilton Hotel

7:00pm – 9:30pm — Group Dinners

9:30pm – 10:30pm — Chair’s Hospitality Suite  
The Beverly Hilton Hotel

Saturday, February 9, 2008  
7:30am — Publications Committee Meeting

8:00am — Women in Administrative Law Networking Breakfast

8:00am — Section Council Breakfast

9:00am – Noon — Section Council Meeting

12:15pm — Golf Outing

6:30pm – 9:30pm  
Section Reception and Dinner at the UCLA Faculty Club  
Keynote Speaker: The Honorable Kenneth W. Starr, Dean, Pepperdine University School of Law

10:00pm — Chair’s Hospitality Suite  
The Beverly Hilton

Sunday, February 10, 2008  
8:00am — Section Council Breakfast

9:00am – Noon — Section Council Meeting

Winter, 2008  
Administrative and Regulatory Law News
2008 Gellhorn-Sargentich Law Student Essay Competition

TOPIC
Discuss a problem or issue relating to presidential control of agency rulemaking.

ELIGIBILITY
The competition is open to currently enrolled students of ABA accredited law schools who are also members of the ABA Section of Administrative Law and Regulatory Practice. The essay must be the student's original, unpublished work. The paper may be prepared to satisfy a course requirement or for other academic credit. However, the essay must be the work of the submitting student without substantial editorial input from others. Co-authored papers are ineligible. Only one essay may be submitted per entrant.

FORMAT
Essays must not exceed 12 pages, including title, citations, and any footnotes. The text of the essay must be double-spaced, with twelve-point font and one-inch margins. Entries should reflect the style of Administrative & Regulatory Law News articles rather than law review style. Entrants are encouraged to review past copies of the News available at http://www.abanet.org/adminlaw/ prior to drafting their submissions. Citations must be embedded in text or in footnote form; essays with endnotes will be disqualified. Cites must conform with the 18th Edition of The Bluebook: Uniform System of Citation.

ENTRY PROCEDURE
Each submission must include a SEPARATE COVER PAGE with the entrant’s name, law school, year of study, mailing and email address, and phone number. The contestant’s name and other identifying markings, such as school name, MAY NOT appear on any copy of the submitted essay.

Submit a digital copy in Word format to Jenny Abreu, Section Coordinator, at abreuj@staff.abanet.org. Entries must be received by 7 p.m. EDT on March 31, 2008.

Section of Administrative Law and Regulatory Practice staff will assign a random number to each entry and record this number on all copies of each essay submitted. Neither the contestant’s identity nor his/her academic institution will be known to the selection committee.

By submitting an entry in this contest, the entrant grants the ABA and the ABA Section of Administrative Law and Regulatory Practice permission to edit and publish the entry in the Administrative & Regulatory Law News. Please direct any questions about the contest to the Section Staff Director at knightk@staff.abanet.org.

JUDGING
Entries will be judged based on the following criteria:
- Creativity and clarity of the proposal or thesis
- Organization
- Quality of the analysis and research
- Grammar, syntax and form
The entries will be judged anonymously by the Fellows of the ABA Section of Administrative Law and Regulatory Practice.

PRIZE
The winner will receive a $500 cash prize and round-trip airfare and accommodations to attend the Section’s Fall Conference in Washington, DC. At the discretion of the editorial board, the winning entry will be selected for publication in Administrative and Regulatory Law News.

Go to www.abanet.org/adminlaw/awardsprogram/2008essays/writings.html for details.
By Robin Kundis Craig*

This Supreme Court News column serves as a preview of the Court’s 2007–2008 term. While the Court has granted certiorari to few cases that directly raise core administrative law issues such as deference and the role of the federal Administrative Procedure Act, several nevertheless present issues that should interest administrative law practitioners. In particular, the Court has accepted several cases that should explore issues about the proper roles of federal and state authority in the regulatory context.

On October 10, 2007, the Supreme Court heard oral argument in Ex parte Medellin, 223 S.W.3d 315 (Tex. Crim. App. 2006), cert. granted sub nom Medellin v. Texas, 127 S. Ct. 2129 (April 30, 2007), a case that raises both separation of powers and federalism concerns. Medellin, a Mexican national, was convicted and sentenced to death for gang raping and murdering two girls in Houston. He sought habeas corpus relief on the grounds that his rights under the Vienna Convention had been violated. As his petitions were working their way to the U.S. Supreme Court the first time, the International Court of Justice decided the Avena case in favor of Mexico and against the United States on essentially the same issues that Medellin raised. On February 25, 2005, President Bush issued a presidential order determining that the United States would comply with this judgment by giving the Mexican nationals involved review and reconsideration in the state courts. This order prompted the Supreme Court to remand Medellin’s case back to the Texas courts, and in the Texas Court of Criminal Appeals, Medellin claimed that the Avena decision and the presidential order preempted Texas’ habeas law, which would otherwise consider Medellin’s petition procedurally defaulted. The Texas court disagreed, holding that the Avena decision was not binding federal law and that the presidential order violated separation of powers principles because the President had impermissibly intruded on the role of the judiciary. The U.S. Supreme Court granted certiorari to address two questions: (1) Did the President properly act within his foreign affairs authority in ordering the states comply with the United States’ treaty obligations; and (2) are state courts bound to give effect to the Avena decision?

During the week of October 29, the Supreme Court heard oral argument in two cases raising statutory interpretation issues. In Klein v. Co. Futures v. Board of Trade of the City of New York, 464 F.3d 255 (2d Cir. 2006), cert. granted, 127 S. Ct. 2431 (May 21, 2007), both the Southern District of New York and the Second Circuit dismissed Klein’s suit for lack of standing under the Commodity Exchange Act, 7 U.S.C. § 22, 25. Klein is a futures commission merchant who went out of business after miscalculating the margin requirements for First West Trading, Inc., Klein’s customer, because the principal of First West allegedly manipulated the settlement prices of P-Tech Futures and Options. Both the district court and the Second Circuit held that the Act’s cause of action extends only to purchasers and sellers of such futures and options, and Klein was neither.

The meaning of exemptions in the Federal Torts Claims Act (FTCA) was the subject of oral argument in Ali v. Federal Bureau of Prisons, 27 Fed. Appx. 778 (11th Cir. 2006), cert. granted, 127 S. Ct. 2875 (May 29, 2007). When prisoner Ali was transferred from a federal prison in Georgia to one in Kentucky, several of his religious and personal items went missing. The Northern District of Georgia dismissed Ali’s resulting FTCA claim for lack of subject matter jurisdiction, holding that the FTCA did not waive the United States’ sovereign immunity from the suit. 28 U.S.C. § 1346(b)(1) waives the United States’ sovereign immunity for damages resulting from acts by federal employees acting within the scope of their employment. However, Section 2680(c) exempts from this waiver “[a]ny claim arising in respect of the assessment or collection of any tax or customs duty or the detention of any goods, merchandise, or other property by any officer of customs or excise or any other law enforcement officer.” The district court found, and the Eleventh Circuit affirmed, that Bureau of Prisons officials fell within this exemption. In particular, the Eleventh Circuit noted that the Supreme Court has read this exemption broadly but engaged in no substantial statutory analysis. The Supreme Court granted certiorari to resolve a 6-4 split among the federal Courts of Appeals.

The federalism aspects of state tax law took center stage during the week of November 5, 2007. Oral argument in CSX Transportation v. Georgia State Board of Equalization, 471 F.3d 1281 (11th Cir. 2006), cert. granted, 127 S. Ct. 2879 (May 29, 2007), focused on the ability of railroads under the Railroad Revitalization and Regulatory Reform Act to challenge state property valuation methodologies. CSX Transportation had challenged Georgia’s proposed valuation of CSX’s real property for tax purposes. The Northern District of Georgia, however, found for Georgia, and the Eleventh Circuit affirmed. The Court of Appeals held that the Act did not explicitly state that the railroad could challenge the state’s methodology and that allowing the railroad to do so would impermissibly burden the states in the exercise of their traditional state powers.

In contrast, Davis v. Department of Revenue of Kentucky, 197 S.W.3d 557 (Ky. Ct. App. 2006), review denied Aug. 17, 2006, cert. granted, 127 S. Ct. 2451 (May 21, 2007) involves a dormant Commerce Clause challenge to Kentucky’s scheme for taxing interest income on state and municipal bonds. Specifically, Kentucky tax law exempts interest income from Kentucky-based bonds but taxes interest income from bonds from other states. The Kentucky Circuit Court granted the Department

* Attorneys’ Title Insurance Fund Professor of Law, Florida State University College of Law, Tallahassee, FL.
of Revue’s motion for summary judgment, but the Kentucky Court of Appeals reversed, finding that the bond taxation system facially discriminated against interstate commerce in violation of the Commerce Clause of the U.S. Constitution.

During that same week, on November 6, 2007, the Supreme Court also heard argument in a Fifth Amendment takings case arising out of federal agency site remediation. In John R. Sand & Gravel Co. v. United States, 457 F.3d 1345 (Fed. Cir. 2006), cert. granted, 127 S. Ct. 2877 (May 29, 2007), a sand and gravel company had a 50-year lease to mine sand and gravel on a 158-acre property that abutted a landfill. In the 1980s and 1990s, the federal Environmental Protection Agency (EPA) supervised a clean-up and remediation of the landfill pursuant to the federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA, aka Superfund), which required the fencing off of large portions of John R. Sand & Gravel Company’s leased site. The company sued, seeking compensation for a physical taking of the property. The Court of Federal Claims found for the United States, and the Federal Circuit affirmed, holding that the company’s taking claim was time-barred by the applicable six-year statute of limitations.

Federal preemption cases came to the fore at the end of November and early December. On November 28, 2007, the Supreme Court heard argument in New Hampshire Motor Transport Association v. Rowe, 448 F.3d 66 (1st Cir. 2006), cert. granted 127 S. Ct. 3037 (June 25, 2007), regarding the relationship between the Maine Tobacco Delivery Law and the Federal Aviation Administration Authorization Act of 1994. After the Maine District Court granted summary judgment in full to the Motor Transport Association, the First Circuit affirmed in part and reversed in part after taking a closer look at the relationship between the two laws. First, the Court of Appeals found that the trade association had representational standing to challenge the Maine law. Second, the First Circuit found that the federal statute preempted provisions of the Maine law that: (a) prescribed methods of delivering packages containing tobacco products, because the Maine requirements could interfere with federal package-delivery deadlines; and (b) deemed carriers to have constructive knowledge of the tobacco contents of any package labeled as containing tobacco, because the desire to avoid being charged with such knowledge would force the carriers to change their uniform package processing requirements. Finally, however, the First Circuit held that the federal statute did not preempt Maine’s ban on knowing delivery of contraband tobacco products to children. The Supreme Court granted certiorari on two issues, both of which examine the federal government’s ability to preempt states’ historic public health police powers.

The following week, the Supreme Court heard argument in Riegel v. Medtronic, Inc., 451 F.3d 104 (2d Cir. 2006), cert. granted, 127 S. Ct. 3000 (June 25, 2007), which involves the preemptive force of the express preemption provision of Medical Devices Amendments to the federal Food, Drug, and Cosmetic Act. Specifically, the Northern District of New York held that the Amendments preempt the plaintiff’s strict liability, breach of implied warranty, and negligent design, testing, inspection, distribution, labeling, marketing, sale, and manufacture claims against the manufacturer of the balloon catheter used in his angioplasty; only breach of express warranty and negligent manufacture claims were allowed regarding a device that had received pre-market approval from the Food and Drug Administration. The Second Circuit affirmed.

The Supreme Court will carry this preemption theme into 2008. Specifically, on January 9, 2008, it will hear oral argument in the consolidated cases of Crawford v. Marion County Election Board and Indiana Democratic Party v. Rokita, 472 F.3d 949 (7th Cir. 2007), cert. granted, 128 S. Ct. 33 (Sept. 25, 2007). In these cases, the plaintiffs challenged an Indiana law that requires voters to show a photo ID before being allowed to vote, alleging that the Indiana law violated the Constitution and the Voting Rights Act. The Southern District of Indiana granted summary judgment for the State of Indiana. The Seventh Circuit affirmed, holding that, although the political party plaintiffs had standing, the state requirement was not an undue burden on the right to vote in violation of federal law.

On the same day that it granted certiorari in the Indiana election law cases, the Supreme Court also agreed to hear Desiano v. Warner-Lambert Co., 467 F.3d 85 (2d Cir. 2006), cert. granted 128 S. Ct. 31 (Sept. 25, 2007). In this case, a claim for damages arising from use of the diabetes drug Rezulin, the Second Circuit held that the federal Food, Drug, and Cosmetic Act did not preempt a Michigan law excepting drug manufacturers from immunity to products liability claims if the manufacturer had misrepresented or withheld material information from the federal Food and Drug Administration during the drug approval process. Writing for the Second Circuit, Judge Calabresi also emphasized the states’ traditional and inherent police power to protect public health and safety.

Due process as well as federalism concerns are likely to be topics of discussion when the Supreme Court hears Pediatric Specialty Care, Inc. v. Arkansas Department of Human Services, 443 F.3d 1005 (8th Cir. 2006), cert. granted, 127 S. Ct. 3000 (June 25, 2007). The plaintiffs in this case brought a claim pursuant to 42 U.S.C. § 1983, alleging that proposed cutbacks in the state’s budget would violate their federal rights to early and periodic screening, diagnosis, and treatment services pursuant to federal Medicaid law. The Eastern District of Arkansas initially entered summary judgment for their plaintiffs on their procedural and substantive Due Process claims, but on remand from the Eighth Circuit, it granted the defendants’ motions for summary judgment regarding the issue of the Arkansas officials’ qualified immunity. On appeal from this remand, the Eighth Circuit continued on page 20
News from the Circuits

By William S. Jordan III*

5th Circuit: Standing for States but no Deference for Interior Under IGRA

In response to a Supreme Court ruling that states may not enforce anti-gambling laws against Indian tribes without congressional authorization, Congress in 1988 passed the Indian Gaming Regulatory Act, which gave states a role in regulating so-called Class III gaming by Indian tribes. Under the IGRA, a tribe and a state may enter into a voluntary compact governing such gaming activities. If the tribe and state cannot agree after a period of negotiation, the IGRA provides that the tribe may sue the state in federal court and seek a determination that the state did not negotiate in good faith. If the court makes such a finding, the court may order negotiation, then mediation. If the state rejects the court-appointed mediator’s ultimate proposal, the Secretary may prescribe regulations governing the gambling at issue.

Seminole Tribe of Florida v. Florida, 517 U.S. 44 (1996), disrupted the congressional scheme by holding under the 11th Amendment that states are immune from suit in this situation. Thus, a state could seemingly prohibit Class III gaming by Indian tribes by simply asserting sovereign immunity. The fact that Congress did not expect the state to choose whether to participate in undefined, administratively-prescribed procedures. Intriguingly, he suggested that the net result may be that there are now no constraints on Class III Indian gaming in Texas.

Judge Dennis dissented, arguing that a judicial decision can create a statutory gap for Chevron purposes. Since the Supreme Court theoretically recognizes law, rather than making it, he asserted that the ambiguity existed upon enactment of the statute, such that a judicial decision like Seminole Tribe can leave the agency with an “open policy space.”

9th Circuit: “Hard Look” Alive and Well as CAFE Standards Fall

Under the Energy Policy and Conservation Act of 1975 (EPCA), the National Highway Traffic Safety Administration has long set an “average fuel economy standard” for automobiles. The agency challenged both standing and ripeness on the ground that Texas would suffer no injury until the Secretary actually prescribed gaming procedures at some point in the future. As to standing, the court held that the injury complained of was “being compelled to participate in an invalid administrative process” (invalid because it was not authorized in the absence of a judicial finding of bad faith negotiation by Texas). Perhaps the most interesting aspect of the standing analysis is the court’s failure, in the wake of Massachusetts v. EPA, to give any attention to Texas’ status as a sovereign state.

The court treated Texas as if it were the same as the corporate parties found to have standing in Thomas v. Union Carbide Agric.

* C. Blake McDowell Professor of Law, The University of Akron School of Law; Council Member; Chair Judicial Review Committee; and Contributing Editor.
In an analysis highly reminiscent of State Farm, the court held that the agency’s cost-benefit analysis was arbitrary and capricious because it failed to monetize the benefits of reductions in greenhouse gases.

In acknowledging that the statute did not prohibit marginal cost-benefit analysis, the court signaled a rough road ahead for the agency by emphasizing that knowledge of climate change and the need for energy conservation had changed significantly since agency victories two decades before. In an analysis highly reminiscent of State Farm, the court held that the agency’s cost-benefit analysis was arbitrary and capricious because it failed to monetize the benefits of reductions in greenhouse gases. In light of the consistency of estimates from various sources, including the National Academy of Sciences (on whose work the agency otherwise relied), the court rejected NHTSA’s conclusion that estimates of such benefits were too “wideranging” to be useful. NHTSA’s argument suffered from the fact that it had monetized other uncertain benefits despite wide ranges in the estimates. NHTSA failed to show how consideration of carbon capture and sequestration, which it addressed in its explanation of the rule, were relevant to the discussion, and it provided no basis for a claim that it accounted for the adverse safety impacts of lighter vehicles, that would cancel any benefits of greenhouse gas reductions. On the other hand, the court upheld NHTSA’s refusal to require weight reduction of some vehicles as a means of improving fuel economy.

As to NHTSA’s rejection of a backstop standard, the court held that the agency had failed to consider the statutory goal of energy conservation. The court also held that the agency had failed to justify its decision not to close a loophole that allows certain SUVs to avoid the CAFE standards, and that it had failed to justify excluding heavier vehicles from the standard despite both statutory authority and evidence showing these vehicles could be controlled.

It is possible that this decision will be a pyrrhic victory for environmentalists if it delays implementation of somewhat more stringent fuel economy standards. Since the court did not explicitly vacate the standards it remains to be seen whether they will remain in effect. Finally, Judge Siler dissented as to the failure to adopt a backstop standard, asserting (as Justice Rehnquist had done in State Farm) that the agency had adequately explained itself as to that particular issue — suggesting that arbitrariness is all too often in the eye of the beholder.

**D.C. Circuit: Flawed Cost-Benefit-Analysis Held Harmless Error**

In City of Portland, Ore. v. EPA, --- E3d ----, 2007 WL 3254333 (D.C. Cir. 2007), the cities of Portland, Oregon, and New York challenged the cost-benefit-analysis (CBA) in a rulemaking under the Safe Drinking Water Act, only to be told that a flawed CBA would constitute harmless error under the applicable statutory provision. EPA had adopted certain requirements to treat drinking water for Cryptosporidium pursuant to a statutory requirement to achieve a contaminant level as close to zero as “feasible with the use of the best technology, treatment techniques and other means which the Administrator finds ... are available (taking cost into consideration).” As a general proposition, the Administrator may set a less stringent drinking water standard based upon a CBA, but the SWDA prohibits the Administrator from weakening a Cryptosporidium standard otherwise determined to be feasible. Thus, any flaw in the CBA would be harmless error because it could not affect the outcome of the rulemaking proceeding. While the outcome seems correct because the statute specifically prohibits such a use of a CBA, it is highly unusual for a court to hold that it does not matter whether an agency’s explanation is flawed.

**10th Circuit: En banc — No Environmental Intervention if Government has Identical Objective**

No doubt it came as a surprise to the Southern Utah Wilderness Alliance and other environmental groups (collectively “SUWA”) to learn that their interests were adequately represented by the Bush Administration. In San Juan County, Utah...
v. U.S., 503 F.3d 1163 (10th Cir. 2007), San Juan County sued the National Park Service to quiet title to a right-of-way in Canyonlands National Park. The Southern Utah Wilderness Alliance applied to intervene in opposition to the County under Fed. R. Civ. P. 24(a) (intervention as of right) and 24(b) (permissive intervention). After a divided panel granted intervention as of right, a majority of the en banc court found that standing was not needed in order to intervene, sovereign immunity was not an obstacle, SUWA could not intervene as of right because the Park Service adequately represented its interests, and that the District Court had not abused its discretion in denying permissive intervention. Several judges, however, would have denied intervention for lack of the necessary interest or based upon sovereign immunity. The dissenters would have granted permissive intervention. In the process, the court produced 54 pages in five opinions developing these issues at great length.

According to the majority, a prospective intervenor need not demonstrate standing as long as the original party on their side has sufficient standing to establish a case or controversy. Similarly, the majority found the SUWA's environmental interest in the land to be such that SUWA had the necessary “interest” to intervene, as required by Fed. R. Civ. P. 24. Several judges disagreed on both counts, arguing that intervenors must be able to qualify as full parties because they fully participate in and influence the litigation. These judges emphasized that the County had raised only a narrow claim about title to the property, and that any agency environmental responsibilities as to property it owned were irrelevant to the question of title.

The judges also battled over sovereign immunity, the majority finding essentially that the addition of the intervenors on the side of the United States could not expand what “what the government must consider a variety of interests, as to property it owned were irrelevant to the question of title.” The dissenters emphasized that the intervention threshold is significantly to the factual record, the dissenters concluded it should be permitted to intervene. One dissenter, Judge Lucerno, wrote a separate opinion in which he sought to “extract[] and synthesize[]” some of the key holdings. In so doing, however, he characterized SUWA’s role as “that of an amicus,” which would minimize its ability to affect the litigation.

The majority also held that the District court’s denial of permissive intervention had not been an abuse of discretion. The dissents emphasized that the intervention threshold is very low, that the interests of the parties must be “identical” to deny intervention, and that even when interests are identical, an agency may not adequately represent a private party. Here, for example, resolution of the quiet title action would require detailed consideration of the history of use of the right-of-way, which SUWA alleged the National Park Service had not adequately pursued. Since SUWA could contribute significantly to the factual record, the dissenters concluded it should be permitted to intervene. One dissenter, Judge Lucerno, wrote a separate opinion in which he sought to “extract[] and synthesize[]” some of the key holdings. In so doing, however, he characterized SUWA’s role as “that of an amicus,” which would minimize its ability to affect the litigation.

9th Circuit: Substantive Due Process Applies to Non-Taking Claim

In Crown Point Development, Inc. v. City of Sun Valley, --- F.3d ----, 2007 WL 3197049 (9th Cir. 2007), a developer challenged a permit denial on the ground that the denial was arbitrary and irrational, and thus a violation of substantive due process. Relying upon Armendariz v. Penman, 75 F.3d 1311 (9th Cir. 1996) (en banc), the District Court dismissed the complaint on the ground that “the Fifth Amendment’s Takings Clause subsumes or ‘preempts’ substantive due process claims.” Armendariz was based on Supreme Court precedents indicating that § 1983 claims “must be analyzed under the more specific” constitutional guarantees, “rather than under the more subjective standard of substantive due process.” Armendariz’ application of this principle to land use decisions depended on the proposition, derived from Agins v. City of Tiburon and Nollan v. California Coastal Comm’n, among others, that a land use restriction that does not “substantially advance legitimate state interests” constitutes a taking.

After Armendariz, however, the U.S. Supreme Court in Lingle v. Chevron U.S.A. Inc., rejected the argument that a Hawaii price control regime constituted a taking because it did not substantially advance state interests. Rather, a taking claim must be decided under Penn Central and other traditional taking doctrines. Lingle thus removed a “failure substantially to advance state interests” claim from the purview of the Taking Clause, but it did not address the distinct question of whether such a claim could be pressed as a violation of substantive due process. In Crown Point Development, the 9th Circuit took the next step of explicitly recognizing a substantive due process challenge to land use regulation. Thus, if the alleged conduct is not actually covered by the Taking Clause, it may be the basis for a distinct constitutional challenge to a land use regulation or permit denial.

Winter, 2008

Administrative and Regulatory Law News
2007 Administrative Law Conference Recap

By Michael Herz

The Section’s annual fall conference continues to go from strength to strength. The October 2007 event was characterized by much of what gives the Section its special character and makes membership so rewarding — a diverse group of administrative lawyers from government, private practice, and the academy, wrestling with important questions, sharing information and insight, and enjoying each other’s company mightily in the process.

For the second year in a row, the event was held at the National Press Club. The venue was excellent in almost every way — the location is convenient, fascinating photos cover the walls to distract those who need a break from administrative law, the staff is efficient, people like it. But as attendance grows, the Press Club may simply have become too small. This year the number of participants exceeded 800; a small portion of these were listening in by telephone, but most were present in the flesh (as those forced to sit in the hall at a couple of sessions can unfortunately attest).

These 800 lawyers were offered twenty-one separate programs of distinctly high quality. One prominent focus of the conference was recent developments in administrative law. As in the past, most of Friday morning was given over to the annual “developments panel,” held in a packed ballroom. In addition, Thursday’s panels included reviews of recent developments in antitrust and in education law as well as recent major changes in the two largest government benefits programs — the new regime in which applicants for veterans’ benefits are allowed to pay an attorney more than $10 and the appeals process for coverage denials under the new Medicare drug benefit. President Bush’s 2007 revisions to Executive Order 12866 were reviewed, critiqued, and defended (without consensus). Another panel brought light, to the extent possible, to the Supreme Court’s somewhat contradictory cases on availability of judicial review of agency inaction. And, in the single most hot-off-the-presses presentation, EPA Assistant Administrator for Enforcement Grant Nakayama offered a frank insider’s account of the settlement in the longstanding American Electric Power “new source review” litigation, which had been settled only weeks before the conference.

While the foregoing panels covered recent developments in familiar areas, several others made one realize that in some ways this is not your father’s administrative law. The “two T’s” of the modern world — technology and terrorism — were evident at several panels. These included a lively discussion of the government’s increasing reliance on private contractors (e.g., Blackwater) to carry out traditional governmental functions; a review of agency responses to possible terrorist threats to the safety of the nation’s food supply; an overview of the federal docket management system and e-rulemaking; and a presen-
organized and moderated the panel on Medicare appeals. The Honorable Timothy Dyk of the United States Court of Appeals for the Federal Circuit contributed his insights to the panel on intellectual property. Judge Robert A. Katzmann, U.S. Court of Appeals for the Second Circuit, an important voice on the pathologies of immigration litigation, appeared on the panel addressing standards of review in immigration cases. Finally, attendees had a rare treat on Friday afternoon when D.C. Circuit Judges Stephen Williams and Merrick Garland spoke informally about deference to administrative agencies. In a wide-ranging, illuminating, and entertaining discussion moderated by Professor Richard Murphy, the two judges spoke candidly (though shy of shockingly) about the realities of sitting in judgment of federal agencies.

The Article III hobnobbing peaked on Friday evening with a reception and dinner at the French embassy on Reservoir Road, a truly dazzling venue. This year’s dinner honored the D.C. Circuit, and we were privileged to have with us Judges Randolph, Garland, Brown, Kavanaugh, and Edwards (illness kept Judge Williams away). The actual proceedings began with the induction of Eleanor Kinney (affectionately and admiringly introduced by Ron Levin) as a Section Fellow, and the induction of Judge A. Raymond Randolph (affectionately and admiringly introduced by Judge Garland), as a Senior Section Fellow. Michael Asimow offered a tribute to the work of the court, invoking Justice Scalia’s apt analogy: “As a practical matter, the D.C. Circuit is something of a resident manager, and the Supreme Court an absentee landlord” in administrative law. Judge Randolph returned to the podium and offered remarks on behalf of the Circuit.

The Conference was an extremely informative, interesting, and enjoyable affair — a series of highlights. Those who were unable to attend can find podcasts of all the sessions on the ABA website. For the dinner, the reception, and the hallway conversations, you’ll just have to come next year.

Vice Dean, Professor of Law, and Director, Floersheimer Center for Constitutional Democracy at the Benjamin N. Cardozo School of Law at Yeshiva University. Section posts include: current Section Council Member; co-editor of A Guide to Judicial and Political Review of Federal Agencies; vice-chair of the Section’s Blackletter Statement on U.S. Administrative Law project; former co-chair of the Rulemaking Committee; and co-chair of the 2007 Conference.
The Devil’s in the Detailers

By William S. Morrow, Jr.

The Council of the District of Columbia has voted preliminary approval of legislation establishing a licensing regime for the marketing of prescription medication in the District. The measure passed 7 to 6 and must survive final approval after the first of the year to become law. The bill, dubbed the SafeRx Act of 2007, would also prohibit prescription data mining without advance physician approval.

Known as “detailers,” pharmaceutical marketing representatives would be required to register with the DC Board of Pharmacy before engaging in the “practice of pharmaceutical detailing,” defined as “the practice by a representative of a pharmaceutical manufacturer [including subsidiaries and affiliates] or labeler of contacting or engaging a licensed health professional located in the District of Columbia, or an employee or representative of a licensed health professional located in the District, for purposes of selling, educating or in any way providing information on a pharmaceutical [regulated by the Federal Food and Drug Administration].”

Detailers would be required to “fully disclose all related clinical trials and scientific evidence pertaining to the pharmaceutical which is the subject of the contact” and refrain from providing information “regarding an off-label use of pharmaceuticals unless such information is accompanied by a statement that the off-label use has not been approved by the federal Food and Drug Administration.”

Fines up to $10,000 and license fees ($250 per person) would be deposited in a “Pharmaceutical Education Fund” that would be used to finance an “outreach and education program” for providing to licensed prescribers information on the “therapeutic and cost-effective utilization of prescription drugs,” including information “about drug marketing that is intended to circumvent competition from generic or other therapeutically equivalent alternatives or other evidence based treatment options.”

The Act also would make it “unlawful to use, sell, transfer, license or exchange for value, any prescription information that identifies the patient or the prescriber for any commercial purpose, unless consent for such use is affirmatively provided by the prescriber in a manner set forth by the Department of Health prior to the use of the information.” Certain exceptions are provided, including one for: “The use, sale, transfer or exchange for value of prescription drug information by zip code, geographic region, or medical specialty for commercial purposes so long as the prescription information does not identify the patient or the prescriber.”

If SafeRx passes a final vote, the District would join a growing list of states and local governments opposed to perceived excesses in the marketing of prescription drugs and critical of an FDA seen as overly permissive. This is quite a change from the 60s and 70s, and even the 80s, when the FDA was widely criticized as a stodgy bureaucracy needlessly standing between those stricken with life threatening diseases, especially cancer, and a sophisticated global pharmaceutical industry ready, willing and able to bring forth “miracle” drugs that carried the hope if not the promise of cure. Big Brother at its worst. Now it seems we have entered the looking glass. The FDA is seen by many today as enabling commercial excess by an industry under enormous profit-seeking pressure to explore opportunities in secondary markets as primary markets become saturated. Many argue that the FDA is no longer a millstone around the neck of the industry but just the opposite -- its captive. States and other local governments sharing this view have taken the lead in reinining back the abuses they perceive.

The outlook for their success, however, remains in doubt. The Third Circuit recently held in Pennsylvania Employees Benefit Trust Fund v. Zeneca, Inc., 499 F.3d 239 (3rd Cir. Aug. 17, 2007), that FDA regulations preempt false drug advertising claims based on state consumer protection laws. That decision may be an indication of where all of this is ultimately headed. Stay tuned.

Supreme Court News

continued from page 14

The Supreme Court held that the plaintiffs could enforce their Medicaid rights through a Section 1983 action, but that the Arkansas Department of Human Services was entitled to Eleventh Amendment immunity and its officials were entitled to qualified immunity.

Finally, on September 25, 2007, the Supreme Court granted certiorari in two somewhat unusual agency deference cases, both involving the Federal Energy Regulatory Commission (FERC). Morgan Stanley Capital Group, Inc. v. Public Utility District No. 1 of Snohomish County, Washington and Calpine Energy Services, L.P. v. Public Utility District No. 1 of Snohomish County, Washington, 471 F.3d 1053 (9th Cir. 2006), cert. granted, 128 S. Ct. 30 (Sept. 25, 2007). The Ninth Circuit found that FERC was entitled to only limited deference when it set wholesale electricity rates in contracts and remanded the contracts at issue to the agency because FERC did not properly assess the public interest in evaluating them. Unsurprisingly, FERC claims that it was entitled to a greater degree of deference from the federal courts.
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Legislation, Regulation and Litigation

By James T. O’Reilly

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