# TEXAS TECH LAW REVIEW

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## COMMENTS



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# TEXAS TECH LAW REVIEW

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## CONTENTS

### Comments

# ROLLIN' ON DOWN THE RAIL: CAN TEXAS LEAD THE NATION IN DEVELOPING EFFICIENT HIGH-SPEED RAIL THIS TIME AROUND?

## Comment

*Kyle R. Baum**

## I. THE THREAT OF MORE CONGESTION

The Texas Department of Transportation's (TxDOT) core mission is to "provide safe and efficient movement of people and goods, enhance economic viability and improve the quality of life for the people that travel in the state of Texas by maintaining existing roadways and collaborating with private and local entities to plan, design, build and maintain expanded transportation infrastructure."[1] TxDOT depicts eight modes of travel on its website: planes, bikes, trucks, railroads, cars, boats, buses, and motorcycles.[2] With over eighty million miles of roads in Texas, however, mobility options without a car are almost nonexistent for most people in the state.[3]

In 1994, the United States Department of Transportation suggested the following:

> Without any measure to curb future travel demands, additional capacity is required to alleviate congestion. However, due to the scarcity and cost of right-of-ways, high construction costs, and environmental considerations, it is becoming increasingly difficult to increase the lane-miles of infrastructure in many urban areas. Thus, to address the needs of severely congested corridors, other improvements and initiatives must be implemented in conjunction with, *or in place of*, roadway expansion.[4]

To add to this problem of traffic congestion, the Texas government expects the population to increase from current levels of around twenty-five million to over forty million by 2050.[5] Without additional infrastructure to handle this anticipated growth, congestion will lead to not only increased delays but also economic loss.[6] Simply building more highways and widening existing roads will do nothing to reduce traffic and, in fact, will actually increase traffic congestion in the future.[7]

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1. *Texas Department of Transportation Forum: Hosts*, TEX. DEP'T OF TRANSP., http://www.dot.state.tx.us/tff/Hosts.htm (last visited Oct. 1, 2012).

2. TEX. DEP'T OF TRANSP., http://www.dot.state.tx.us/ (last visited Sept. 29, 2012).

3. *See District/County Statistics*, TEX. DEP'T OF TRANSP., http://www.dot.state.tx.us/apps/discos/default.htm (last visited Sept. 29, 2012) (click hyperlink to view pdf). As of August 31, 2009, there were 80,066,953 miles of road in the state of Texas. *Id.*

4. MARC H. BURNS, HIGH-SPEED RAIL IN THE REAR-VIEW MIRROR: A FINAL REPORT OF THE TEXAS HIGH-SPEED RAIL AUTHORITY 43 (1995) (emphasis added) (citing U.S. DEP'T OF TRANSP., TRANSPORTATION STATISTICS ANNUAL REPORT 89 (1994)).

5. *See Population Projections*, 2000-2060 TEX. WATER DEV. BD., http://www.twdb.state.tx.us/waterplanning/data/projections/2012/Population/1StatePopulation.pdf (last visited Sept. 29, 2011).

6. BURNS, *supra* note 4, at 42-43. In the Dallas–Fort Worth area alone, the economic costs of traffic congestion are estimated at $7.6 billion by 2010. *Id.* at 43. Sitting in traffic can consume up to five years of a person's life according to one estimate. *Id.*

7. ANDRES DUANY, ELIZABETH PLATER-ZYBERK & JEFF SPECK, SUBURBAN NATION: THE RISE OF SPRAWL AND THE DECLINE OF THE AMERICAN DREAM 88 (2000).

The Texas Triangle, a region roughly bounded by the area between San Antonio, Houston, and Dallas–Fort Worth, is where over seventy percent of Texans will call home by 2020.[8] Outside of vehicles, mobility within this corridor is primarily made up of passengers traveling by airplane, which accounts for about one-fourth of airport capacity within the region's urban centers.[9] Transportation by both car and airplane is extremely dependent on oil, and the transportation sector as a whole is the country's largest user of petroleum products.[10] This reliance on oil, in turn, creates smog and air pollution that affects everyone living within these regions, creating negative consequences for individual health and additional health care costs.[11]

Public transportation for middle- and long-distance travel is especially important to help solve many of the issues that increased population will bring about in Texas.[12] "Group travel saves energy and is both economical and more sustainable."[13] After spending billions of dollars on road construction, all that the government has managed to accomplish is increasing the amount of time people spend in their vehicles on a daily basis.[14] Without considering the long-term effects, Americans, and Texans specifically, choose cars for most of their travel because of the way the government subsidizes their use and because of limited alternatives.[15] The trucking industry is also heavily subsidized to make it a more economically favorable option without taking into account the real effects.[16] It is misguided and expensive to continue insisting on building roads instead of rails because one lane of track can move as many people as fifteen lanes of highway.[17]

The purpose of this Comment is to examine a viable alternative to more roads and congestion, specifically the options offered by high-speed rail in developing more advanced, sustainable transportation to move people between cities and regions. First, Part II looks at the history of two former passenger rail systems that helped define the cities of Dallas and Austin in the early twentieth century until the rise of the automobile. Part III then discusses the role of government in developing highways, both at the national and state

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8. *See* BURNS, *supra* note 4, at 37.

9. *Id.* at 43 (discussing economic and safety concerns of airport congestion and delays).

10. *See id.* at 45-46. Texas ranks second nationally for fuel use, consuming 8.5 billion gallons per year for highway travel, according to the Federal Highway Administration. *Id.*

11. *See id.* (discussing health care expenditures and premature deaths due to air pollution).

12. *See* Mark McCarthy, *Transportation and* Health, *in* SOCIAL DETERMINANTS OF HEALTH 141 (Michael Marmot & Richard G. Wilkinson eds., 2006).

13. *Id.* Investing in public transportation ensures a strong alternative to car travel. *Id.*

14. DUANY, PLATER-ZYBERK & SPECK, *supra* note 7, at 91.

15. *See id.* at 94. "[G]overnment subsidies for highways and parking alone amount to between 8 and 10 percent of our gross national product, the equivalent of a fuel tax of approximately $3.50 per gallon. If this tax were to account for 'soft' costs such as pollution cleanup and emergency medical treatment, it would be as high as $9.00 per gallon." *Id.*

16. *Id.* at 95. Compared to transporting the same amount by rail, trucks use fifteen times the fuel. *Id*. at 95-96.

17. *Id.* at 96; JAMES H. KUNSTLER, HOME FROM NOWHERE: REMAKING OUR EVERYDAY WORLD FOR THE 21ST CENTURY, 67, 99 (1998)).

levels. It goes on to examine the lobbying efforts behind this trend, the subsidization that encourages driving, and finally the effect on our cities. Next, Part IV takes a look at the first attempt by Texas to develop a high-speed rail system in the 1980s and the 2005 evaluation of the state's rail networks under the Texas Rail System Plan. Part V assesses recent legislation focusing on passenger rail networks at both the federal and state level. The new Texas Rail Plan, released in November of 2010, is scrutinized as it relates to intercity and high-speed passenger rail systems in Part VI. Part VII studies examples of high-speed rail systems in development in Florida, looking to become the first state with a high-speed rail line, and Great Britain, a nation playing catch-up with its European neighbors in regards to high-speed rail connectivity. Ultimately, this Comment offers ideas on how Texas can successfully develop high-speed rail this time around and lead the nation in connecting its people, cities, and regional economies through a more sustainable form of transportation.

## II. HISTORY OF TEXAS'S PASSENGER RAIL SYSTEMS

In the early- to mid-nineteenth century, settlement in Texas was primarily along the eastern and southern edges of the state, as well as the Gulf Coast, where rivers provided access to fresh water.[18] Most Texas rivers were not deep enough for transportation throughout the year, and roads were generally of poor quality, especially when wet.[19] To facilitate the movement of people and goods, the Republic of Texas chartered the Texas Railroad, Navigation, and Banking Company, the purpose of which was to construct railroads.[20] The state granted additional charters, and investment in railroads expanded to the point that, by 1861, nine railroad companies existed along with 470 miles of track, mostly centered around Houston.[21] To aid the construction of railroads, many cities and counties issued bonds, and the state provided loans and land grants.[22] By the early 1870s, Texas railroads stretched further north to Corsicana, Dallas, and soon after, the Red River.[23] By 1880, Texas had 2,440 miles of railroad, and within the next ten years it would add an additional 6,000 miles.[24] Railroads expanded west, connecting southeast Texas with El Paso and Fort Worth with the New Mexico state line.[25] Between 1900 and 1932 the railroad expanded into areas of the state still without lines: the Rio

18. *The Handbook of Texas Online: Railroads*, TEX. STATE HISTORICAL ASS'N, http://www.tshaonline. org/handbook/online/articles/eqr01.html (last visited Sept. 29, 2011).
19. *Id.*
20. *Id.*
21. *Id.*
22. *Id.*
23. *Id.*
24. *Id.*
25. *Id.*

Grande Valley, the South Plains, and the Panhandle.[26] Texas had over 17,000 miles of rail lines—more than any other state in the country—a title that Texas maintains today.[27]

### *A. The Dallas Rail Experience*

In the early 1900s, Dallas saw an explosion in growth and rail services because the "junction of two major rail lines would draw people and businesses from all over the U.S. as well as neighboring towns."[28] With rail lines crossing all over the city, especially the central business district, Dallas became a confusing place to try to navigate by rail.[29] Plans were developed to construct a "belt" line around Dallas to help alleviate congestion in the central business district and a new "union" station along the western edge of downtown.[30] Roughly eighty train arrivals and departures per day occurred at this new terminal during the height of business in the late 1920s.[31]

As the decades passed, the automobile and the interstate highway system signaled America's movement away from trains, and affordable air travel only added to the problems for passenger rail.[32] By 1969, Dallas was the largest United States city without passenger trains in operation.[33] In recent times, however, Dallas is experiencing a revival of passenger rail, with Amtrak, Dallas Area Rapid Transit Rail (light rail), and Trinity Railway Express commuter train service (between Fort Worth and Dallas) all passing through Union Station.[34] In an ironic twist of fate, "rail has become the ideal mode to alleviate future congestion in the air and on the roads in Dallas and North Texas. The very form of transportation that put the region on the map will ultimately play a significant role in addressing critical transportation issues."[35]

### *B. Austin's Electric Streetcars*

Around the turn of the twentieth century, electric urban rail networks began to emerge in and around cities across Texas.[36] Most of these lines had little to no freight capacity, which made them reliant on paying passengers and, thus, more susceptible to competition from automobiles.[37] In Austin, mules were used to pull the first streetcars along tracks laid mostly in and

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26. *Id.*
27. *Id.*
28. *A History of Railroads in Dallas*, MUSEUM OF THE AM. R.R., http://www.museumoftheamericanrailroad.org/Education/AHistoryofRailroadsinNorthTexas.aspx (last visited Oct. 1, 2012).
29. *Id.*
30. *Id.*
31. *Id.*
32. *Id.*
33. *Id.*
34. *Id.*
35. *Id.*
36. *The Handbook of Texas Online*, *supra* note 18.
37. *Id.*

around the downtown area in the late 1800s.[38] Streetcars soon became electrified and additional track added to provide passengers an efficient alternative to move across the city.[39] The Austin Electric Railway Company had twenty-three miles of track in total, but without tax support, turning a profit proved to be a challenge.[40] By 1939, the streetcar lines were operating on seventeen miles of track as buses and automobiles became the main forms of transportation.[41] A year later, however, Austin's streetcar system ceased to exist, and the city removed the majority of tracks to provide steel for World War II.[42]

With a keen eye toward future problems, an advertisement for the former Austin streetcar company tried to encourage ridership by addressing two problems familiar to most people living in cities today.[43] "Riding streetcars, it said, is not only 'more economical, but helps to solve the very difficult and ever growing parking problem, which is intimately tied into our traffic problem.'"[44] In what appears to be history repeating itself, Austin opened an urban light rail line on March 22, 2010, almost exactly seventy years after it dismantled its previous one.[45]

## III. THE GOVERNMENT'S ROLE IN THE DEVELOPMENT OF HIGHWAYS

It can be said that most of our major environmental problems are a result of the abundance of oil.[46] In this century, most of the problems we will face are due to the increasing lack of oil.[47] To become more environmentally friendly and reduce energy consumption, concentrating people in denser urban areas is key.[48] Governments tend to negate opportunities to support public transit in dense areas by building and expanding highways, often at huge costs, making it easier to get around in automobiles.[49]

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38. *See* Ben Wear, *From Mules to Scrap: Austin's First Rail Era*, AUSTIN AMERICAN-STATESMAN (Mar. 7, 2010 10:19 PM), http://www.statesman.com/news/local/from-mules-to-scrap-austins-first-rail-era-1/nRq7K/.

39. *See id.*

40. *Id.*

41. Robert Bryce, *End of the Line: The Short and Troubled History of Austin's Streetcar System*, AUSTIN CHRONICLE (July 21, 2000), http://www.austinchronicle.com/news/2000-07-21/77996/.

42. *Id.*

43. *See id.*

44. *Id.* (quoting an advertisement for the Austin Street Railway Company).

45. *See* Wear, *supra* note 38.

46. DAVID OWEN, GREEN METROPOLIS: WHY LIVING SMALLER, LIVING CLOSER, AND DRIVING LESS ARE THE KEYS TO SUSTAINABILITY 49 (2009).

47. *Id.*

48. *See id.* at 137.

49. *See id.* at 130.

### *A. The Interstate Highway System*

As automobiles became the preferred choice of travel, the pressure to build superhighways linking both sides of the country began to mount.[50] Congress decided to look at the idea, and in 1938, Congress asked the Bureau of Public Roads (BPR) to study a six-route toll network.[51] The BPR issued a two-part report analyzing both toll roads and free roads as a means of transcontinental travel.[52] The initial recommendation was for 43,000 kilometers of free highways containing "[m]ore than two lanes of traffic . . . where traffic exceeds 2,000 vehicles per day, while access would be limited where entering vehicles would harm the freedom of movement of the main stream of traffic."[53] Fearing a surplus of American soldiers returning home from the war unable to find jobs, President Roosevelt saw the construction of an interstate highway system as a way to promote jobs and counter fears of returning to the Depression.[54]

In 1943, the BPR issued an updated report based on the recommendations of the 1939 edition and proposed a 63,000 kilometer interregional highway system.[55] The Federal-Aid Highway Act of 1944 made few changes to the report; however, it notably expanded the designated 65,000 kilometers for a "National System of Interstate Highways."[56] The Public Roads Administration (PRA) began working with state and local officials to develop design standards for the highways.[57] In 1947, the PRA released plans for the first 60,000 kilometers of interstate highways, but more changes were to come.[58] By 1950, the United States was involved in another war, this time in Korea, and the importance of an interstate highway system shifted to meet the needs of the military.[59]

The election of President Eisenhower triggered a marked acceleration in efforts to get the ball rolling on the interstate highway system.[60] Lucius D. Clay headed the development of a financing scheme to pay for the construction; the plan called for two billion dollars in investment from the

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50. Richard F. Weingroff, *Federal-Aid Highway Act of 1956: Creating the Interstate System*, U.S. DEP'T OF TRANSP.: FED. HIGHWAY ADMIN., http://www.fhwa.dot.gov/publications/publicroads/96summer/p96su10.cfm (last updated Apr. 8, 2011).

51. *Id.*

52. *Id.* The amount of transcontinental traffic could not support tolled superhighways. *Id.*

53. *Id.*

54. *Id.*

55. *Id.* This system would be "designed to accommodate traffic 20 years from the date of construction." *Id.* It was also noted that the highways should "promote a desirable urban development." *Id.*

56. *Id.*

57. *Id.* The standards called for uniform design upon similarities in conditions: traffic, population density, topography, and other similar features. *Id.*

58. *Id.*

59. *Id.*

60. *See id.* He saw protecting the interests of citizens in a safe and efficient highway system as extremely important. *Id.*

states and twenty-five billion dollars from the federal government.[61] While the Clay Committee report would not survive Congress, many of its provisions were ultimately put forth in both House and Senate bills.[62] The Federal-Aid Highway Act of 1956 emerged from conference committee containing compromises to satisfy both sides.[63] The Secretary of Commerce, Sinclair Weeks, went on to call this "the greatest public works program in the history of the world."[64]

### *B. The Texas Solution: Toll Roads*

Within Texas, the expansion of highways and road capacity in general has not kept pace with a rapidly expanding population base.[65] TxDOT suggests that funding is the largest obstacle standing in the way of expanding more roads.[66] Building toll roads is the agency's preferred way to increase capacity because toll roads can be built with money borrowed upfront and then paid back through toll fees, rather than waiting on gas-tax money.[67] According to TxDOT, toll roads provide citizens more choices: they charge only those drivers who want to use them, reduce emissions because cars spend less time idling in traffic, and save drivers time by allowing them to bypass congestion.[68]

### *C. Lobbying Efforts*

Many lobbyists work to support private transport politically; they have come to be known collectively as the "road lobby."[69] Interstate highways are the end result of an aggressive lobbying campaign by industries that would benefit most from its construction: the asphalt, construction, automobile, coal, steel, glass, rubber, and trucking industries.[70] Oddly enough, at the time

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61. *Id.* The Clay Committee sought to issue $25 billion in bonds to finance this system through a Federal Highway Corporation. *Id.* The revenue brought in by gas taxes would be used to pay off the bonds over thirty years. *Id.*

62. *See id.*

63. *See id.* The federal government would cover ninety percent of overall costs. *Id.*

64. *Id.*

65. *About Toll Roads*, TEX. DEP'T OF TRANSP.: TEXAS TOLLWAYS, http://www.texastollways.com/content/about-toll-roads.php (last visited Jan. 26, 2012) [hereinafter TEXAS TOLLWAYS]. The state's population has gone up by fifty-seven percent and road capacity has increased by eight percent. *Id.*

66. *Id.* Gas taxes, at the state and federal level, cannot generate enough money to keep building new roads and maintaining the current ones. *Id.*

67. *See id.* New tolled roads can be constructed five times faster than waiting for funding through gas taxes. *Id.*

68. *Id.*

69. SOCIAL DETERMINANTS OF HEALTH, *supra* note 12, at 144.

70. David Wilens, *The Interstate Highway System and the Disfiguring of America, A Tale of Two Kinds of Cities: Part 5*, CAPITALISM MAGAZINE (Apr. 10, 2000), http://www.capitalismmagazine.com/200/04/The-Interstate-Highway-System-and-the-Disfiguring-America-Tale-Two-Kinds-Cities-Part-5.html. The American Road Builder's Association's constituents formed the

Congress passed the Interstate Highway Act of 1956, only about half of families in America owned a single car.[71] The public was not demanding a new road system be built.[72] Thus, as Sclove and Scheuer explained, "the asphalt highways—and the society around them—are a reflection of successful lobbying by powerful business interests and external compulsion, not simply the free choices of consumers."[73] These same interests continually resist any changes outside of highway creation and expansion to solve traffic problems, even though "it takes fifteen lanes of highway to move as many people as one lane of track."[74]

### *D. Subsidizing Automobile Travel*

Originally, the proposed way to pay for the interstate highway system was through tax increases.[75] This largely failed because of lobbying by industries that would benefit from the interstate highway system but did not want to pay for it.[76] What was ultimately agreed upon was increased revenue from highway users, including increases in the gasoline tax, to be put in the Highway Trust Fund.[77]

Government subsidies of automobile travel and the highway systems to support it continue to hamper efforts to move away from car-based human environments.[78] These subsidies amount to approximately $5,000 per car per year, which gets passed on to citizens in the form of more expensive products, as well as additional income, property, and sales taxes.[79] Thus, drivers are not paying the full price of driving; this is one of the main reasons "American cities continue to sprawl into the countryside."[80] The trucking industry continues to receive heavy subsidies compared to rail, despite the fact that trucks are consuming fifteen times as much fuel for doing the same job.[81]

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employee base of most of these industries. *See id.* The petroleum industry also favored the interstate highway system. *Id.*

71. *See* Richard Sclove & Jeffrey Scheuer, *For Architects of the Info-Highway, Some Lessons from the Concrete Interstate*, THE GHOST IN THE MODEM, http://loka.org/alerts/loka.1.6.txt (last visited Sept. 30, 2012) [hereinafter *Concrete Interstate*]. The majority of people used public transportation. *Id.*

72. *See id.*

73. *Id.*

74. DUANY, PLATER-ZYBERK & SPECK, *supra* note 7, at 96.

75. *See* Richard F. Weingroff, *Original Intent: Purpose of the Interstate Highway System 1954-1956*, U.S. DEP'T OF TRANSP.: FED. HIGHWAY ADMIN., http://www.fhwa.dot.gov/infrastructure/originalintent.cfm (last visited Jan. 26, 2012) [hereinafter *Original Intent*].

76. *See id.*

77. *See id.*

78. *See* DUANY, PLATER-ZYBERK & SPECK, *supra* note 7, at 94-97.

79. *Id.* at 94. The costs of driving are forced upon everyone, even those who do not drive. *See id.* Non-drivers increasingly suffer when the public transportation they depend on gets cut because it cannot compete with heavily subsidized highways. *Id.* at 94-95.

80. *Id.* at 95.

81. *See id.* at 95-96. The government pays out huge subsidies to trucks without a thought but cautiously scrutinizes anything allocated for transit. *Id.*

Any attempts at raising the gas tax are immediately deemed "anti-business."[82] Other reasons like fighting global warming and supporting public transit are also offered but rejected.[83] "[T]he real justification is economic: subsidized automobile use is the single largest violation of the free-market principle in U.S. fiscal policy."[84]

### *E. A Nation of Suburbs*

The interstate highways, especially in cities, had the profound effect of destroying many viable low- and middle-class neighborhoods, often populated by minorities.[85] Those who could afford it fled along the very interstates taxpayers subsidized to the suburbs, taking with them many economic and cultural resources from the cities.[86] The interstate highways took the former residents of the cities out past the reach of mass transit as well.[87] Because most suburbs lacked mass transit and were laid out in very low-density patterns, "distances between stores, workplaces and homes there became so great that one couldn't live there very effectively without having a car."[88] This caused suburbanites to become almost entirely dependent on automobiles.[89] And with more cars came more congestion, one of the main problems the interstate highway system was built to relieve.[90]

With this realization in mind, thinking about transportation as a connected, compatible system, rather than simply saying the answer is more roads, is necessary.[91] Citizens across the country, and especially in Texas, have become prisoners of economic geography because suburbanization after World War II made almost all forms of transportation besides automobiles impractical.[92] The origins and destinations of most people are too far apart to sustain rail services, which typically require greater population densities like in

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82. *Id.* at 96.

83. *See id.*

84. *Id.* America's ability to compete globally is greatly undermined due to the economic inefficiencies of subsidizing automobiles, estimated at $700 billion annually. *Id.* at 96-97.

85. *See Concrete Interstate*, *supra* note 71.

86. *See id.*

87. Wilens, *supra* note 70.

88. *Id.*

89. *See id.* More and more Americans were forced to purchase automobiles to hold jobs, shop, or go just about anywhere. *See Concrete Interstate*, *supra* note 71.

90. *See Original Intent*, *supra* note 75. Many of the comments about congestion today resemble those comments from the mid-1950s. *Id.*

91. *See* Ben Wear, *Did Austin's Transportation Bond Scoring Have Anti-Road Bias?*, AUSTIN AM.-STATESMAN (Oct. 23, 2010, 11:27 PM), http://www.statesman.com/news/special-report/statesman_focus/did-austins-transportation-bond-scoring-have-anti/nRyz9. Experience has shown that reacting to existing road congestion by adding more capacity is not working. *See id.*

92. *See* Robert J. Samuelson, *High-Speed Pork: Why Fast Machines Are a Waste of Money*, NEWSWEEK (Oct. 29, 2010, 1:00 AM), http://www.dailybeast.com/newseek/2010/10/29/why-high-speed-trans-don=t-make-sense.html.

Europe or Asia.[93] A shift from spending on road-based capacity to investments in transit, walking, and biking, as well as driving, is required to change the structure of the cities in which we live.[94] Suburbanites find themselves increasingly isolated from the world around them, as "[t]he noise and danger from growing numbers of autos dr[i]ve children's games out of the street, and neighbors and families off their front porches."[95] It is not uncommon these days to see suburbs without sidewalks—a sure signal that there is nothing worth walking to.[96]

## IV. THE TEXAS INTERCITY PASSENGER RAIL SITUATION

Successfully providing adequate transportation is a constant and ever-expanding challenge in Texas.[97] Since the rise of the automobile in the late 1930s, intercity rail services in Texas have declined to the point that, currently, there are three different Amtrak routes running at least partially through Texas: the Heartland Flyer, the Sunset Limited, and the Texas Eagle.[98] The Heartland Flyer offers daily service from Fort Worth to Oklahoma City.[99] Aboard the Sunset Limited, stops are offered along a path from Beaumont, through Houston and San Antonio, to El Paso.[100] Finally, the Texas Eagle stops in Texarkana, Dallas, Austin, San Antonio, El Paso, and smaller points in between.[101] This is the full extent of Amtrak service in Texas.[102]

### *A. The First Attempt: The Texas High-Speed Rail Authority*

Since the 1970s, the possibility of high-speed rail connecting major cities in Texas surfaces from time to time.[103] In 1982, the Texas Legislature received a study conducted the previous year, which highlighted the existing need for improved passenger rail within the Texas Triangle.[104] A study conducted by the Texas Transportation Institute (TTI) at Texas A&M University in 1985 examined the feasibility of using existing right-of-ways

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93. *See id.* The number of people living in the city centers fell from 56 percent to 32 percent between 1950 and 2000. *Id.*

94. *See* Wear, *supra* note 91.

95. *Concrete Interstate*, *supra* note 71.

96. *See id.*

97. *See* BURNS, *supra* note 4, at 9.

98. *See West Train Routes*, AMTRAK, http://www.amtrak.com/west-train-routes (last visited Sept. 29, 2012).

99. *Heartland Flyer*, AMTRAK, http://www.amtrak.com/heartland-flyer-train(last visited Sept. 29, 2012).

100. *See Sunset Limited*, AMTRAK, http://www.amtrak.com/sunset-limited-train (last visited Sept. 29, 2012).

101. *See Texas Eagle*, AMTRAK, http://www.amtrak.com/texas-eagle-train (last visited Sept. 29, 2012).

102. *See West Train Routes*, *supra* note 98.

103. *See* BURNS, *supra* note 4, at 12.

104. *See id.* at 13.

along interstate highways for high-speed rail and concluded it was a possible option.[105] The corridor between Dallas and Houston was favorable to passenger rail because of the distance of travel, and the study also noted reductions in highway and airway congestion would result from developing high-speed rail.[106]

The high-speed rail pursuit really began taking shape in 1987 when the Texas Legislature directed the Texas Turnpike Authority (TTA) to study high-speed rail between cities of the Texas Triangle.[107] At that time, the technology considered was in use in Europe and Japan, and the TTA study concluded that a "high-speed means of travel . . . would be a considerable improvement over earlier and existing (Amtrak) passenger train service in Texas."[108] The TTA study concluded the high-speed rail project would be highly marketable, attracting intercity travelers, and form a viable alternative to car and air travel.[109]

In 1989, the 71st Texas Legislature created the Texas High-Speed Rail Authority (THSRA).[110] The THSRA was given the power to award an exclusive franchise to construct and operate the high-speed rail lines if found to be in the public interest.[111] The THSRA governing board solicited potential applicants for the high-speed rail lines, and two consortiums ultimately applied: Texas FasTrac and Texas TGV.[112] Six different firms reviewed franchise applications and each firm submitted a report of its findings to the two applicants and Southwest Airlines, who was "granted intervenor status for the franchise application hearing process."[113] On May 10, 1991, the THRSA awarded the franchise to the Texas TGV consortium to "plan, construct, lease, operate, and maintain" a high-speed rail system in Texas.[114] Texas TGV complied with the initial requirements under the franchise agreement; however, it failed to receive $170 million in equity financing agreements as part of the Equity Financing Commitment to fund development and permitting costs.[115]

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105. *Id.*

106. *Id.* The report stated travel time between the central business districts of Houston and Dallas would be faster by rail than by air, accounting for the time taken to access airports and actually board the plane. *Id.*

107. *Texas High-Speed Rail Authority*: *Agency History*, TEX. STATE LIBRARY AND ARCHIVES COMM'N, http://www.lib.utexas.edu/taro/tslac/20071/tsl-20071.html (last visited on Sept. 29, 2012) [hereinafter *Agency History*].

108. BURNS, *supra* note 4, at 13.

109. *Id.*

110. *Agency History*, *supra* note 107.

111. BURNS, *supra* note 4, at 16.

112. *Agency History*, *supra* note 107.

113. *Id.* Southwest Airlines stood to lose a portion of its passengers should a high-speed rail system be built in the Texas Triangle. *See id.*

114. BURNS, *supra* note 4, at 20-21. Texas TGV likely won the franchise partly because it proposed better service, but most likely because it claimed it could build the high-speed rail system *without* public funds. *Id.* at 21.

115. *See Agency History*, *supra* note 107.

As part of the environmental analysis required by federal law, representatives from the THSRA, Texas TGV, and additional consultants held "scoping meetings" to take comments and address concerns of the public.[116] The majority of rural residents opposed the project, and turnout in rural areas often exceeded that of urban areas.[117]

Two major issues began to surface as the performance review was being conducted in late 1992: the environmental impact statement was incredibly over budget, and the equity financing commitment was soon due.[118] The THSRA board decided to grant an extension to Texas TGV to produce the required equity financing for the project.[119] Despite initial hopes, the second attempt by Texas TGV to fulfill its equity financing commitment by December 11, 1993, failed when the company providing the counter-guarantee withdrew.[120] After this, Texas TGV stopped its baseline environmental studies.[121]

In response to these issues, the THSRA issued a letter to the Texas TGV consortium stating that it had defaulted under the agreement by failing to meet the equity financing commitment deadline.[122] Then-Governor Ann Richards and fourteen legislators also urged the THSRA to terminate the franchise.[123] At the federal level, Southwest Airlines, with the help of Boeing, effectively killed any chance for the Texas TGV consortium to receive federal subsidies.[124] On April 27, 1994, the THSRA board began administrative proceedings to terminate the franchise agreement.[125] Then, in the spring of 1995, the Texas Legislature officially abolished the THSRA and repealed the High-Speed Rail Act.[126]

### *B. 2005 Assessment: The Texas Rail System Plan*

In 2005, the Texas Legislature passed legislation whereby TxDOT assumed all powers and duties from the Texas Railroad Commission related to railroads in the state.[127] TxDOT was also empowered to "finance, construct, maintain and operate freight or passenger rail" and administer federal funding

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116. BURNS, *supra* note 4, at 26-27. Concerns expressed included noise, impact on agriculture and quality of life, financing, locations and routing, road closures, and access issues. *Id.* at 27.

117. *Id.*

118. *Id.* at 28.

119. *Id.* at 31.

120. *Id.* at 33.

121. *Id.*

122. *Id.* This was done in order to preserve the THSRA's ability to collect on an abatement bond. *Id.*

123. *Id.* at 34.

124. *Id.*

125. *Id.* at 35.

126. *Id.* at 36.

127. *Texas Rail System Plan Summary*, TEX. DEP'T OF TRANSP. 6-7 (2005) (on file with author) [hereinafter *Plan Summary*].

for railroads in Texas.[128] "The purpose of the Texas Rail System Plan (TRSP) is to identify current and proposed rail projects, determine infrastructure and capacity needs on the Texas rail system, and develop an awareness of the issues and processes by which to address rail infrastructure needs by transportation policy makers."[129] This assessment was not conducted to outline future goals, but "to provide a baseline analysis of the current rail system in [Texas]."[130]

The TRSP's immediate focus is mainly on improvements to the freight rail systems in Texas.[131] The logic behind this appears to be that "by enabling a greater magnitude of freight rail efficiencies, commuter rail system development and high-speed passenger rail system development will follow with a greater degree of support."[132]

Since 1932, thirty-nine percent of total rail track miles have been lost in the State of Texas.[133] This represents a significant reduction in the transportation options of this state and consequently impacts area economies negatively, including many rural communities.[134] The people of Texas use transportation as a way to reach jobs, services, and recreation, and Texas businesses use transportation as a means to integrate into the global economy.[135] Increased trade opportunities, a strong economy, and larger population have led to increased traffic and congestion on roadways and additional safety concerns.[136]

Passenger rail within the TRSP focuses on both intercity and commuter rail that provide additional choices for meeting people's travel needs.[137] The TRSP summary specifies that intercity travel within Texas is provided solely by Amtrak along three designated routes.[138] In addition, as of 2005, the only regions with any existing metropolitan passenger rail services were Dallas–Fort Worth and Houston.[139] Importantly, while these metropolitan services are relatively new, there is now demand for expansion and increased transit-oriented development in the areas they serve.[140]

Because of increased traffic congestion along major intercity corridors in Texas, a market potentially exists for high-speed rail offering frequent

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128. *Id.* at 7.

129. *Id.* at 2.

130. *See id.* This report was done in part to help not only legislators, but also planners and the public, understand the potential for rail systems to fit into a long-term statewide transportation scheme. *Id.*

131. *See id.* at 6.

132. *See id.* at 11.

133. *Id.* at 12.

134. *Id.*

135. *Id.* at 3. Supporting freight and passenger rail systems through policies and programs will benefit the economic vitality of Texas. *Id.* at 4.

136. *Id.* at 6.

137. *Id.* at 10.

138. *Id.*; *see also supra* Part IV (noting the current Amtrak routes serving Texas).

139. *Plan Summary*, *supra* note 127, at 14.

140. *See id.*

departure and arrival times.[141] Amtrak has traditionally focused on developing national rail routes, making it inadequate to meet demands for fast, intercity travel.[142] Currently, passenger rail services are ineffective because "run-times between major cities in Texas are not competitive with either commercial air carriers or motor vehicles, and fare savings are not compelling when time considerations are taken into account."[143] This is at least partially due to increased freight rail operating along lines that are shared with passenger rail services.[144] A key to increasing the speed at which intercity passenger rail systems can operate is separating the freight lines from the passenger rail lines along many rail corridors of the state.[145] TRSP notes that upgrades are needed in addition to separate rail lines: improved tracks and control systems, potential "sealed corridors" with no crossings, and renovated stations.[146] In conclusion, the TRSP suggests improvements are needed to enhance transportation efficiency and rail systems are an essential component of the Texas transportation system.[147]

## V. RECENT PASSENGER RAIL LEGISLATION

Federal and state governments are quickly realizing that by falling behind in cutting-edge technologies, the effects will result in consequences paid by the next generation.[148] Charles M. Vest, President of the National Academy of Engineers, opined recently that "we have nothing remotely like fast, efficient, state of the art rail travel anywhere in the U.S."[149] Public commitment and leadership has become lethargic, but there are small signs of hope.[150]

### *A. Federal Involvement*

In 2008, the Passenger Rail Investment and Improvement Act (PRIIA) reintroduced the focus of strengthening the passenger rail network around the United States.[151] This piece of legislation centered on "intercity passenger rail, . . . state-sponsored corridors throughout the Nation, and the development of

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141. *Id.*
142. *See id.*
143. *Id.*
144. *Id.* Both traffic and tonnage have increased while total rail lines have decreased. *Id.*
145. *See id.*
146. *Id.* at 19.
147. *Id.* at 20.
148. *See* Alec Liu, *U.S. Could Lose the SciTech Edge to China, Experts Fear*, FOX NEWS (Nov. 1, 2010), http://www.foxnews.com/scitech/2010/11/01/losing-scitech-race-china-experts-fear/.
149. *Id.*
150. *See id.*
151. *Overview, Highlights and Summary of the Passenger Rail Investment and Improvement Act of 2008*, FED. R.R. ADMIN. 1 (Mar. 10, 2009), http://www.fra.dot.gov/downloads/PRIIA%20Overview%20031009.pdf [hereinafter *Passenger Rail*].

high-speed rail corridors."[152] PRIIA specifically instructed states to establish a rail transportation authority that would implement polices and set plans involving both freight and passenger rail systems in accordance with United States Department of Transportation (USDOT) minimum standards.[153] PRIIA regards Amtrak as vital to intercity rail systems and as an integral role in the nation's transportation system and economy.[154]

To help facilitate these goals, PRIIA created three assistance programs to provide federal funding for passenger rail systems.[155] The first assistance program provides investments and grants from the USDOT for intercity rail services to state and public agencies.[156] The second program allows for funding to create a high-speed rail corridor development program by individual states, groups of states, and even Amtrak.[157] High-speed rail differs from other intercity rail services because it achieves operating speeds of at least 110 miles per hour.[158] The final assistance program authorizes funding for high-speed rail projects that are necessary to reduce congestion or increase ridership of intercity rail.[159]

Another goal of PRIIA is to enhance opportunities for involving the private sector in the operation and improvement of intercity rail.[160] The most important program offered is to establish a public-private partnership for developing high-speed rail, specifically within any of the eleven designated high-speed rail corridors.[161] In addition, PRIIA develops a pilot program allowing rail carriers that own lines over which Amtrak operates to petition for consideration as a passenger rail service provider for a period of five years.[162] Knowing that this will adversely affect Amtrak, the Secretary of Transportation is tasked with developing financial incentives for the voluntary termination of Amtrak employees.[163] With the help of PRIIA, the hope is to greatly expand rail services, especially in designated high-speed rail corridors, and foster more partnerships between public and private entities for rail's future growth and development.[164]

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152. *Id.*

153. *Id.* at 3. The state plans must explain passenger rail objectives, analyze the impact of rail on transportation, economics, and the environment, and establish a long-term investment program for infrastructure. *Id.*

154. *Id.* at 2.

155. *See id.* at 4-5.

156. *Id.* at 4. This allows for federal funding to assist with the costs of facilities, infrastructure, and equipment for improving passenger rail transportation. *Id.*

157. *Id.* This assistance program includes the ten high-speed rail corridors already designated by the Secretary of Transportation. *Id.*

158. *Id.* at 5.

159. *Id.* The goal of this funding structure is reducing congestion and improving performance and reliability of trains, specifically for established rail systems. *See id.*

160. *Id.*

161. *Id.*

162. *Id.*

163. *Id.*

164. *See id.* at 1-5.

### *B. Direction from the Texas Legislature*

In response to the federal directives presented in PRIIA, Texas passed Senate Bill 1382 in 2009 requiring TxDOT to coordinate the planning, construction, operation, and maintenance of a statewide passenger rail system.[165] This bill also called for coordinated efforts between government and private entities and nonprofit corporations.[166] Each year, TxDOT is tasked with preparing and updating a long-term plan for a statewide passenger rail network.[167] Included in this annual update are existing and proposed rail systems, the status of rail systems under construction, any potential difficulties, ridership projections for proposed rail systems, and ridership figures for current rail systems.[168] The overall goal is to assess the status of the current rail systems in Texas and to find ways to expand as rail becomes a more important part of Texas's transportation infrastructure.[169]

## VI. THE NEW TEXAS RAIL PLAN

The newly released Texas Rail Plan (TRP) provides a critical assessment of Texas's current transportation systems and describes how rail needs to play a more important role in the future of this state.[170] This newest plan updates and expands on the Texas Rail System Plan (TRSP) published in 2005.[171] In doing so, the TRP fulfills the mandate by both the federal and state government for Texas to analyze current rail infrastructure and plan for the future expansion and improvement of rail systems in the state.[172]

### *A. Driving Forces of Rail Needs*

The TRP acknowledges that concerns over the cost of energy, climate change, and manufacturing prompted the federal government to pass PRIIA in 2008.[173] Along with this federal directive, TxDOT focuses on the importance of freight rail to the health of the state's economy and connecting the large urban areas via passenger rail.[174] Anticipated growth in both business and population, especially within the major metropolitan areas of the state, show the need for multimodal transportations systems, including high-speed and

165. Tex. S.B. 1382, 81st Leg., R.S. (2009).
166. *Id.*
167. *Id.*
168. *Id.*
169. *See id.*
170. *See* TEX. DEP'T' OF TRANSP., *Introduction*, *in* FINAL TEXAS RAIL PLAN, 1-1 (2010), http://www.txdot.gov/ public_involvement/rail_plan/trp.htm (click "Introduction") (hereinafter: *Introduction*, FINAL TEXAS RAIL PLAN).
171. *See supra* Part IV.B.
172. *See Introduction*, FINAL TEXAS RAIL PLAN, *supra* note 170, at 1-1.
173. *Id.*
174. *Id.* at 1-2.

intercity passenger rail.[175] While driving is the main option for most people, the TRP highlights the fact that driving is an inefficient, slow, and unproductive form of transportation.[176] The Dallas-to-Houston corridor, being less than 250 miles apart, is an ideal candidate for intercity or high-speed rail, as evidenced by the 800,000 passengers who flew between the two cities in 2006.[177] In addition, the connectivity of the mega-region between the cities of Houston, San Antonio, and Dallas–Fort Worth increases mobility for workers, information, and goods, creating a competitive advantage in an increasing global economy.[178]

Rail also offers many environmental benefits as compared to competing methods of transportation.[179] From a freight rail standpoint, one gallon of diesel moves one ton of freight an average of 480 miles.[180] This makes rail transport significantly more efficient than trucks, and increased fuel efficiency and decreased emissions among trains will likely increase this disparity.[181]

As part of developing a national rail plan under PRIIA, the federal government recognizes that rail travel has become increasingly safer, with fewer accidents despite increased train miles.[182] Passengers who use rail are twenty-one percent more fuel efficient than if using cars and seventeen percent more fuel efficient than if using short-haul air travel.[183] In addition, Environmental Protection Agency (EPA) standards for carbon monoxide in truck emissions are ten times those of locomotives.[184] As part of the Texas Transportation Commission's (TTC) strategic plan for 2011-2015, being developed in conjunction with TRP, TTC chair Deirdre Delisi stated,

> Rail is going to be an important part of the solution. For many, many years, really since the creation of the Texas Department of Transportation, roads were seen as the only solution and we're learning very quickly that . . . we need to be thinking more of a multimodal approach. We're behind in Texas, relative to other states that have more of a robust rail infrastructure.[185]

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175. *See id.* at 1-2 to -4. Outside of driving, few competitive options for travel exist between large metropolitan areas in Texas. *Id.* at 1-4.

176. *Id.* at 1-4 to -5.

177. *Id.* at 1-7 (noting that projected growth, the region's interconnectivity, and increased interest in rail transportation show the need for a rail option in addition to auto and air travel).

178. *Id.* at 1-9 to -10.

179. *Id.* at 1-10 (showing that rail accounted for less than three percent of United States transportation emissions in 2006).

180. *Id.* at 1-12.

181. *See id.*

182. *Id.* at 1-18. Nationally, rail accidents have decreased forty percent from 2000 to 2009, and fallen thirty percent during that same time in Texas. *Id.*

183. *Id.* (measuring BTU's per mile per person).

184. *Id.* Diesel truck engines can emit up to 15.5 grams per brake horsepower hour of carbon monoxide, while locomotives can emit only up to 1.5 grams. *Id.*

185. *Id.* at 1-23 (alteration original).

The TRP, in conjunction with the Statewide Long-Range Transportation Plan, promotes passenger rail in its plans to increase connectivity among forms of transportation and communities.[186]

### *B. Passenger Rail*

The TRP focuses on high-speed, intercity, and commuter rail services.[187] For this purpose, high-speed rail is defined as rail operating at speeds of 110 miles per hour with limited or no stops between cities, while intercity rail serves multiple cities over long distances at slower speeds with few stops.[188] Commuter rail, on the other hand, typically serves workers commuting within an urban region.[189]

High-speed rail, as an alternative to driving or flying, is needed in Texas based on population, travel trends, and the dependence on economic connectivity between regions.[190] As an additional transportation option, "[h]igher speed passenger trains that run frequently could meet much of the demand for travel between urban regions within a short airline distance."[191] Amtrak itself supports findings that demand exists for high-speed rail in Texas.[192] The speed the trains travel, the systems they use to operate, and the amenities they offer differentiate high-speed rail from services offered by Amtrak or commuter rail.[193] To create an effective system, however, significant improvements to existing facilities or the installation of completely new facilities is required for high-speed rail in Texas.[194] It must be noted as well that all proposals since 1991 serving routes between the Houston, San Antonio, and Dallas–Fort Worth regions indicate that operating revenue would exceed operating expenses.[195]

#### *1. High-Speed Rail Corridors*

The Federal Railroad Administration (FRA) has designated two high-speed rail corridors within Texas: the South Central and the Gulf Coast.[196] The

186. *See id.* at 1-25.

187. *See* TEX. DEP'T' OF TRANSP., *Passenger Rail System*, *in* FINAL TEXAS RAIL PLAN, 4-1 (2010), http://www.txdot.gov/public_involvement/rail_plan/trp.htm (click "Introduction") (hereinafter: *Passenger Rail System*). .

188. *Id.*

189. *Id.*

190. *Id.* at 4-3. Previous attempts at developing high-speed rail failed in both the 1980s and 1990s. *See id.* The need and reasoning behind those attempts are still very much present. *Id.*

191. *Id.* A developed and efficient high-speed rail line likely reduces the number of short-haul air travelers, especially for Southwest Airlines. *See id.*

192. *Id.* at 4-4.

193. *Id.* at 4-3.

194. *Id.*

195. *Id.* at 4-4.

196. *Id.* at 4-6.

South Central corridor runs from north Texas through Dallas–Fort Worth down to San Antonio, while the Gulf Coast corridor extends from Houston east to the Louisiana border.[197] These corridors connect mega-regions of Texas and allow the state to petition the federal government for funding to make improvements along existing lines within the corridors.[198] "By utilizing existing rail corridors and infrastructure, the 'high or higher speed' rail concept offers cost-effective transportation that has relatively low environmental impacts."[199]

### *2. Intercity Amtrak Services*

For intercity rail travel within Texas, Amtrak is the sole provider of passenger rail services.[200] Most of the state's major urban areas are served but not all are directly connected, leading to extended travel times by rail.[201] Texas formerly maintained an extensive passenger rail network that had greatly diminished since the 1930s.[202]

The Heartland Flyer allows passengers to travel by rail from Oklahoma City to Fort Worth with once-daily service in each direction.[203] This Amtrak service uses BNSF Railway Company tracks along its entire journey.[204] It takes four hours and fifteen minutes to complete the journey, forty-five minutes slower than the same trip made by vehicle.[205] "As is the case with all of the Texas Amtrak routes, the host railroad, in this case, BNSF, is primarily responsible for the delays (91.5% of the total minutes from 2000-2009) of the Heartland Flyer."[206] The most common delay is interference from BNSF freight trains operating along the same line of track.[207] As of 2009, over 69,000 riders annually used the Heartland Flyer, compared to roughly 228,000 air travelers between the two cities in 2006.[208] In 2009, Amtrak reported revenue of $1.75 million while total costs came in at $5.3 million.[209] After accounting for subsidies from Texas and Oklahoma, the total loss came in at

197. *Id.* at 4-7.
198. *Id.* at 4-6.
199. *Id.* at 4-7.
200. *Id.* at 4-8.
201. *See id.*; *see also supra* Part IV (noting the current Texas passenger rail routes).
202. *See Passenger Rail System*, *supra* note 187, at 4-8; *see also supra* Part II (regarding the previous extent of passenger rail systems in Texas).
203. *Passenger Rail System supra* note 187, at 4-10.
204. *Id.*
205. *Id.* at 4-11. Upgrades to increase speeds are currently on the table; however, travel by vehicle will remain faster. *See id.*
206. *Id.* at 4-14.
207. *Id.* at 4-17. This delay suggests separate lines for passenger and freight rail services would significantly decrease the length of travel time by rail. *See id.*; *see also Plan Summary*, *supra* note 127, at 14 (noting increased speeds are achieved by separating freight and passenger rail lines).
208. *Passenger Rail System*, *supra* note187, at 4-10 to -11.
209. *Id.* at 4-17.

$499,000.[210] Notably in 2008, however, the Heartland Flyer turned a profit of $100,000.[211]

Another Amtrak service in Texas, the Texas Eagle, provides services between Chicago and San Antonio, linking up with the Sunset Limited in San Antonio before continuing onto Los Angeles under that service's name.[212] Along the way, the Texas Eagle makes stops in Texarkana, Dallas, Fort Worth, Austin, and San Antonio.[213] The train operates on Union Pacific Railway track except where BNSF Railway Company owns the track between Fort Worth and Temple.[214] Despite concerns of the discontinuation of this service, ridership numbers have steadily climbed since 1998.[215] On-time performance has continued to fluctuate as the highest sources of delays continue to come from the host railroad that operates freight along the tracks.[216] The Texas Eagle operated at a $21.5 million loss in 2009, as operating costs of $42.8 million outpaced total revenue of $21.3 million.[217] During 2008, Amtrak lost $25.3 million on this route.[218]

The Sunset Limited, the third Amtrak service running through Texas, operates between New Orleans and Los Angeles, making stops in Texas cities such as Beaumont, Houston, San Antonio, and El Paso.[219] This service runs on 800 miles of Union Pacific Railway track across Texas and averages speeds of less than forty miles per hour.[220] This means that to cover the Texas portion, the Sunset Limited takes over twenty-one hours to make the journey.[221] Ridership numbers had generally declined since 1998, but since 2006, those numbers have steadily grown.[222] On-time performance was generally low since 2001; however, due to decreased delays in 2009 by the host railroad, Union Pacific, the trains were on schedule almost eighty percent of the time.[223] From 2000 to 2009, over eighty percent of the delays were caused by the host railroad, largely because freight services were operating on the same tracks as passenger rail.[224] In 2009, revenue from this service totaled $9.8 million while

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210. *Id.*
211. *Id.*
212. *Id.* at 4-17 to -18.
213. *Id.*
214. *Id.* at 4-17. In all, this service operates on 404.1 miles of Union Pacific track and 126.4 miles of BNSF track. *Id.*
215. *Id.* at 4-20.
216. *See id.* at 4-25. This fluctuation suggests separate lines for passenger rail service would greatly reduce delays. *See id.*; *see also Plan Summary*, *supra* note 127, at 14 (noting increased speeds are achieved by separating freight and passenger rail lines).
217. *Passenger Rail System*, *supra* note 187, at 4-25.
218. *Id.*
219. *Id.* at 4-26.
220. *Id.* at 4-26 to -27.
221. *Id.* at 4-27. The same route in a vehicle or aircraft takes significantly less time to cross. *See id.*
222. *Id.* at 4-28 to -29.
223. *Id.* at 4-29 to -30.
224. *Id.* at 4-32.

total costs came in at $36.8 million, leading to a $27 million overall loss.[225] By comparison, 2008 saw a loss of $29.2 million.[226]

### *3. Federal Financing*

From the funding standpoint, under PRIIA, the federal government authorized $3 billion in operating funding and $5.3 billion in capital funding to Amtrak.[227] In addition, $1.9 billion was allocated to fund capital grant programs for states managed by the FRA.[228] Under PRIIA, states that want to maintain Amtrak service for distances less than 750 miles must fully subsidize the routes, while routes over 750 miles will continue to be fully funded by Amtrak.[229] Any new services desired from Amtrak will likely need funding solely from state and local entities.[230] This essentially means the challenge of developing and expanding routes, at least those serviced by Amtrak, are retained by the states themselves.[231] Texas has received over $2.6 million from Amtrak, of which over $1.2 million went to station improvements in Beaumont and the remaining funds towards improvements to comply with the Americans with Disabilities Act.[232]

### *4. Ridership and Expanded Services*

Amtrak ridership numbers have rebounded considerably after a severe decline in the 1990s as a result of reduced services in an attempt to improve financial performance.[233] Returns to daily service, along with the introduction of the Heartland Flyer service and expanded services on the Texas Eagle, helped to facilitate an upward trend in ridership figures.[234] The increased number of riders has spurred Amtrak to consider daily service on the Sunset Limited and additional improvements along that route to increase speeds and cut down on travel time.[235] Additional considerations involve rerouting the Sunset Limited from Houston to Dallas and continuing out the Interstate 20 corridor, with the ability to capture mid-sized west Texas markets before reaching El Paso.[236] Another potential benefit for Amtrak involves connecting the major regions of Houston and Dallas–Fort Worth, a route that has lacked

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225. *Id.* at 4-34.
226. *Id.*
227. *Id.* This funding does not include any money devoted to service debts of Amtrak through 2013. *Id.*
228. *Id.*
229. *Id.*
230. *Id.*
231. *See id.*
232. *Id.*; *see* Americans with Disabilities Act of 1990, 42 U.S.C. §§ 12101-12213 (2006).
233. *Passenger Rail System*, *supra* note 187, at 4-41.
234. *Id.*
235. *Id.* at 4-42. With increased speeds and services on the Sunset Limited, the potential to develop additional services between Houston and San Antonio, Houston and New Orleans, or both is possible. *Id.*
236. *Id.* at 4-43.

passenger rail service for a considerable amount of time.[237] In addition, new services are being explored to bring expanded service to new areas: Dallas–Fort Worth to Meridian, Mississippi; Fort Worth to Denver, Colorado; San Antonio to Laredo, continuing into Monterrey, Mexico; and San Antonio to Austin.[238]

### *5. Planning and Prioritizing*

To effectively plan and prioritize high-speed and intercity passenger rail within Texas, the TTI used fifteen criteria to analyze pair-city corridors and prioritize rail development.[239] The results showed that the Dallas–Fort Worth to Houston corridor and the Dallas–Fort Worth to San Antonio corridor were best.[240] Interestingly, the Dallas–Fort Worth to Houston route is not designated by the federal government as a high-speed rail corridor, while Dallas–Fort Worth to San Antonio is part of the South Central high-speed rail corridor.[241] Designation as a high-speed rail corridor allows the state to petition the federal government for additional funding to make improvements along existing lines within the corridor.[242] The 1985 report by TTI concluded the use of the right-of-way along interstate highways within Texas as a location for high-speed rail was feasible.[243] Both Florida's high-speed rail system between Orlando and Tampa and the DesertXpress, a high-speed rail line between Los Angeles and Las Vegas, will utilize the existing right-of-way of the interstates currently linking the two cities.[244] Using existing right-of-way helps avoid additional costs and delays in acquiring property needed for the rail lines and is a viable option for future passenger rail development in Texas.[245]

## VII. A LOOK AT HIGH-SPEED RAIL SYSTEMS IN DEVELOPMENT

America's highways will continue to remain an integral part of the nation's transportation system for many years to come.[246] The economic

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237. *See id.* This would eliminate direct passenger rail services between Houston and San Antonio. *See id.*

238. *Id.*

239. *Id.* at 4-44. TTI considered population and demographics, travel demand, and transportation capacity of eighteen potential pair city corridors. *Id.*

240. *Id.*

241. *Id.*

242. *See id.* at 4-6.

243. *Id.* at 4-44; *see also* BURNS, *supra* note 4, at 13 (noting the feasibility of using existing right-of-ways).

244. *Passenger Rail System*, *supra* note 187, at 4-44; *see infra* Part VII.A.

245. *Passenger Rail System*, *supra* note 187, at 4-44.

246. Ray LaHood, *High-Speed Rail Will Be Our Generation's Legacy*, ORLANDO SENTINEL (Dec. 19, 2010), http://articles.orlandosentinel.com/2010-12-19/news/os-ed-high-speed-rail-121910-20101217_1_high-speed-rail-high-speed-rail-national-transportation-network.

growth of this country, however, can no longer rely exclusively on roads in the long term; each day, other countries continue to pass us by as they build faster trains and expand high-speed rail services.[247] The benefits are clear: integrate people and economies of large metropolitan communities, reduce congestion at our airports and on our roads, and decrease our oil reliance and carbon emissions.[248]

### *A. Florida's First High-Speed Rail Line*[249]

Florida has a combination of attributes that make it ideal for high-speed rail projects including flat terrain, high growth rates, and distances between its major cities.[250] As part of the federal government's commitment to high-speed rail services, Congress appropriated over $13.5 billion to help states fund these projects.[251] Florida received almost $2.4 billion in federal stimulus funds for its first high-speed rail line which links the cities of Tampa and Orlando.[252] In addition, the state contributed $280 million towards the project.[253] Once completed, at a cost of $2.6 billion, the Florida Department of Transportation (FDOT) projects that operating costs would have been completely covered by operating revenues.[254]

The construction of Florida's first high-speed rail line was set to occur in two phases.[255] Phase one, the Early Works Project, involved replacing bridges and realigning Interstate 4 within its right-of-way to make space for the rail lines.[256] The second phase involved bidding out the main rail project to private firms to build, operate, and maintain the high-speed rail, which was scheduled to open in 2015.[257] FDOT also invested $2 million dollars to start evaluating

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247. *Id.*

248. *Id.*

249. Since this Comment was written, the State of Florida has chosen to cancel the development of its high-speed rail line between Orlando and Tampa. *See* Josh Mitchell, *Florida Governor Cancels Rail Plan,* WALL ST. J. (Feb. 17, 2011), http://online.wsj.com/article/SB10001424052748703373404576148152623631280.html.Governor Rick Scott declined almost $2.4 billion dollars in federal funding committed to the project, effectively stopping it in its tracks. *Id.* Additionally, after this decision was made, the Florida Department of Transportation removed all information from its high-speed rail website, www.floridahighspeedrail.org, which is cited in footnotes below. All references to these websites below are no longer active but represent accurate URL information at the time this Comment was written.

250. *Florida High Speed Rail Fact Sheet*, FL. HIGH SPEED RAIL, http://www.floridahighspeedrail.org/storage/pi-docs/HSRProjectSummary121410.pdf (last visited Jan, 30, 2011) [hereinafter *Florida Fact Sheet*].

251. *Id.*

252. *Fast Facts*, FL. HIGH SPEED RAIL, http://www.floridahighspeedrail.org/fast-facts/ (last visited Jan, 30, 2011) [hereinafter *Florida Fast Facts*]. Trains will travel at speeds of up to 168 miles per hour. *Id.*

253. *Florida Fact Sheet*, *supra* note 250.

254. *Id.*

255. *Id.*

256. *Id.* The state preserved I-4 right of ways starting in the 1990s and built bridges that would eventually accommodate high-speed rail. *Id.*

257. *Id.*

costs and route proposals for an Orlando-to-Miami high-speed rail line and received an additional $8 million dollars in federal funding for this initiative.[258]

Florida planed to select one of the high-speed rail technologies already in operation on more than 7,800 miles of service in over twelve countries.[259] Along this Orlando –to-Tampa line, five stations were planned, each with their own parking and rental car facilities.[260] Strong connectivity to existing and proposed road, bus, and transit systems was another key feature of this high-speed rail project.[261] This was extremely important for the mobility of the projected 2.4 million high-speed rail passengers in the first year of operation.[262]

Additional benefits come from the jobs created by the construction and operation of this high-speed rail line.[263] Projections showed 10,000 workers employed during the peak construction period of 2012-2014, with 600 people employed directly and 500 indirectly once operations begin.[264] According to FDOT, high-speed rail "has the unique and integrating capacity to create a functional super-regional economy because of its ability to create a fast, affordable, safe and reliable transportation option connecting the two regions and their major assets."[265] This new super region connects the nineteenth and twentieth largest markets in the United States, according to population and gross domestic product.[266] A study by the University of Pennsylvania Urban Design Studio suggests:

> Counties can translate their specific assets into regional assets. Each county can leverage its talent, ideas, amenities, products and service by connecting these elements to similar ones held by Super Regional Partners. [A]menities across the region, rather than providing isolated benefits, can become part of a thriving system that coalesces into a national or global force.[267]

The benefits of high-speed rail are also seen in the growth management of the surrounding areas.[268] The University of Pennsylvania study used past development strategies to anticipate population growth and determined approximately 1.8 million acres of land is needed to accommodate such

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258. *Id.*
259. *Florida Fast Facts*, *supra* note 252.
260. *Id.*
261. *Id.*
262. *See id.* These ridership projections were based on a one-way ticket of fifteen to thirty dollars, which creates revenue of approximately $49 million for the first year. *Id.*
263. *See Florida High Speed Rail, Jobs & Florida's Future*, http://www.floridahighspeedrail.org/jobs/ (last visited Jan, 30, 2011) [hereinafter *Florida Jobs*].
264. *Id.*
265. *Id.*
266. *Id.*
267. *Id.*
268. *See id.*

growth.[269] Traffic networks, even when accounting for additional development, become overwhelmed, and the impacts to regional mobility are negative.[270] The alternative involved development around high-speed rail and the adjacent transit systems that are connected to it.[271] The projections are quite significant: approximately one million acres can be saved from development and Florida could avoid spending $270 billion over the next forty years on roadway construction and expansion.[272]

Florida recognizes that reducing pollution and decreasing energy costs provide substantial support for high-speed rail and transit-oriented development.[273] Compared to a plane trip, high-speed rail produces barely one-quarter the carbon dioxide per passenger and emits less per passenger than a similar trip in a car.[274] "High speed rail travel is the single most energy efficient transportation mode on land, in the air or on water for moving people . . . . HSR takes less energy to move a person one mile than any other travel mode."[275] America's transportation sector accounts for two-thirds of the oil use in this country.[276] High-speed rail helps reduce this country's dependence on foreign oil because it runs on electricity, which is capable of production from various domestic sources.[277] According to FDOT, reliance on domestic energy sources, less pollution, and increased energy efficiency make high-speed rail an ideal form of transportation.[278]

### *B. Britain Playing Catch-Up*

In Britain, high-speed rail typically describes railways that operate at up to 200 miles per hour and transport mainly passengers, not freight.[279] As of today, Britain has one high-speed rail line that links London to mainland Europe via the Channel Tunnel.[280] Britain's new plans call for a high-speed rail line between London and Birmingham, from which two lines will head

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269. *Id.* Approximately 1.5 million acres is currently used for agriculture and the other 300,000 has significant environmental value. *Id.*

270. *Id.*

271. *Id.*

272. *Id.* Public resources will still need to be spent on building and maintaining public transit systems. *Id.*

273. *See id.*

274. *Id.* The potential reductions in pollution only increase as high-speed rail produces transit-oriented development and systems that take cars off the road. *Id.*

275. *Id.* FDOT states "[h]igh speed rail is four times more efficient than automobile travel, and eight times more efficient than plane travel." *Id.*

276. *Id.*

277. *Id.*

278. *See id.*

279. *What Is HSR?*, HIGH SPEED RAIL UK, http://www.highspeedrailuk.com/?page_id=263 (last visited Sept. 30, 2012).

280. *Id.*

further north, one up the East Coast and one up the West Coast.[281] The European continent already has over 3,500 miles of high-speed rail lines and countries like Germany, Spain, Italy, France, Belgium, and the Netherlands are expanding high-speed rail services.[282] Britain is in the midst of a massive expansion of its high-speed rail services, recognizing the importance to its economy and environment.[283]

The cities of Britain drive its economic prosperity, and continued growth "depends upon a highly mobile workforce, access to large potential business markets and the interconnectivity that allows businesses to share ideas and develop new products."[284] By decreasing travel times through high-speed rail, business and leisure trips become more convenient, and economic centers are closer than ever before.[285] High-speed rail can help expand regeneration initiatives as well, as evidenced by the examples from Turin, Italy; Cordoba, Spain; and Cologne, Germany.[286] Because of the need for separate tracks, high-speed rail reduces congestion on the other rail networks, thereby increasing speeds and efficiency on those systems as well.[287]

Reducing emissions of pollutants is another key goal of the British government that is furthered by development of high-speed rail.[288] The number of rail users in Britain continues to grow, increasing congestion and delays on existing services, while traffic congestion threatens the mobility of drivers on overburdened roadways.[289] To ensure its full potential, Britain must support "transport infrastructure that not only meets the needs of business and leisure [travelers], but is also sustainable."[290] Once connected by high-speed rail, all major British cities are less than three hours apart, leading to a huge switch from short-haul flights to rail.[291] According to High Speed Rail UK, "experience has shown that when high-speed links mean a journey can be made in less than three hours, railways capture 50 to 60 per cent of the market from airlines—a figure that grows to 90 per cent if the journey takes less than two hours."[292] The environmental costs are significant given the fact that high-

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281. *High-Speed Rail Plans Announced By Government*, BBC NEWS (MAR. 11, 2010), http://news.bbc.co.uk/2/hi/8561286.stm [hereinafter BBC NEWS].

282. *What Is HSR?*, *supra* note 279.

283. *See Why Is HSR So Important?: Connectivity & Economic Development*, HIGH SPEED RAIL UK, http://www.highspeedrailuk.com/?page_id=95 (last visited Oct. 1, 2012).

284. *Id.* Enhanced ties between cities increases productivity, and the entire British economy benefits. *Id.*

285. *Id.*

286. *Id.* High-speed rail, as incorporated into land planning, provides for better quality of life and economic activity. *Id.*

287. *Id.*

288. *Why Is HSR So Important?: Environmental Change & Pollution*, HIGH SPEED RAIL UK, http://www.highspeedrailuk.com/?page_id=96 (last visited Oct. 1, 2012). The goal of the government is an eighty percent reduction in carbon emissions by 2050. *Id.*

289. *See id.*

290. *Id.*

291. *Id.*

292. *Id.*

speed rail emits thirty grams of carbon dioxide per passenger kilometer, while short-haul flights emit 120.[293] Additional pollution reductions are achieved as Britain reduces the carbon output of its electric supply because the trains run on electricity.[294]

The British government estimates the total cost of the project at thirty billion pounds, with the ability to produce 10,000 jobs and achieve a two-pound benefit for every one-pound spent.[295] This is one of the few political issues that is supported by the main opposing parties in Britain as an economic driver toward sustainability.[296] According to Network Rail chief executive Iain Coucher, "[i]t is the low-carbon, sustainable transport of the future."[297]

## VIII. FUTURE IMPLICATIONS FOR TEXAS AND SOLUTIONS

Trying to solve a problem by aggravating the conditions that created it in the first place may in the short term provide temporary relief but, in the long term, proves misguided.[298] Governments continue to waste resources doing just that, creating additional capacity on highways, which temporarily makes driving more pleasant, until additional vehicles strain the system once again.[299] The perceived dependence on cars, in Texas and elsewhere, stands between effective, sustainable change and a coming energy and economic nightmare.[300]

For Texas, this means proactively planning for future needs rather than suddenly reacting once the crisis is already in our midst.[301] For too long, reliance on cars and trucks has kept the state from developing efficient multimodal systems of transportation.[302] Part of this problem is because of a determination by the American Road Builders Association to lay out cities in low-density patterns, often beyond the reach of public transit.[303] The other key to this equation is reducing the number of drivers and air travelers for middle- and long-distance travel within Texas.[304]

As Florida initially demonstrated, an efficient high-speed rail system can make the most sense.[305] A reduction in pollution and energy costs was a driving force behind their high-speed rail development because by running on electricity, the power is generated domestically and from increasingly

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293. *Id.*
294. *Id.*
295. BBC NEWS, *supra* note 281.
296. *See id.*
297. *Id.* Having the ability to show up and quickly board a train remains a key attraction. *Id.*
298. OWEN, *supra* note 46, at 142.
299. *See id.*
300. *See id.* at 114.
301. *See* BURNS, *supra* note 4, at 9 (stating that the THSRA attempted to help solve this impending crisis before crippling the state and its economy).
302. *See id.*
303. *See* Wilens, *supra* note 70.
304. *See* SOCIAL DETERMINANTS OF HEALTH, *supra* note 12, at 141.
305. *See supra* Part VII.A.

renewable sources.[306] By limiting the main transportation options of Texans to driving and flying, both of which are heavily dependent on oil, economic disaster is always one sharp spike in oil prices away.[307] Continuing to subsidize automobiles and trucks not only violates free-market principles but also provides a disincentive to move towards more sustainable transportation options that can help avoid an all out crisis.[308] Without a reorientation of transportation policies, the Texas government, like many others already under financial stress, will continue wasting valuable taxpayer resources on the never-ending problem of road congestion.[309]

To effectively turn the corner in this daunting challenge, strong commitment from Texas political leaders, like that exhibited in the early days of the THSRA, is absolutely necessary.[310] Rather than succumbing to the efforts of the road and air lobby, a shift towards a more sustainable transportation alternative, high-speed rail, is required to soften the economic consequences of high oil prices. Once this shift occurs, it is equally important to have concrete high-speed rail plans in place to provide the federal government when opportunities to gain significant federal funding present themselves.[311] With the right plans in place, Florida initially received almost ninety percent of the $2.6 billion total price tag for its first high-speed rail line from federal stimulus funds because they were ahead of the curve.[312]

A significant push by the private sector, like in Britain, can help overcome the daunting odds stacked in favor of automobiles.[313] Texas can achieve greater economic prosperity and manage continued growth with the helpful addition of high-speed rail providing access and connectivity for people, businesses, and markets across the state and beyond.[314] Keeping a watchful eye on airline companies and the "road lobby" who attempt to undermine access to the market by high-speed rail is crucial.[315]

In regard to rail, the benefit of separate freight and passenger rail lines is monumental in preventing congestion and achieving maximum speed and on-time performance.[316] This could significantly improve services for Amtrak trains and expand the number of potential users for their intercity services.[317]

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306. *See Florida Jobs*, *supra* notes 263.

307. *See* OWEN, *supra* note 46, at 49.

308. *See* DUANY, PLATER-ZYBERK & SPECK, *supra* note 7, at 96.

309. *See* BURNS, *supra* note 4, at 9.

310. *See Agency History*, *supra* note 107.

311. *See Florida Fast Facts*, *supra* note 252.

312. *See id.*

313. *Business Reacts to Fast Rail Link*, BBC NEWS (Aug. 26, 2009), http://news.bbc.co.uk/2/hi/business/8222032.stm. Colin Stanbridge, chief executive of the London Chamber of Commerce stated "[r]educing journey times will make it easier for companies to do business across the country and will boost the UK and London economies." *Id.*

314. *See Why Is HSR So Important*, *supra* note 283.

315. *See* BURNS, *supra* note 4, at 34; *see* Wilens, *supra* note 70.

316. *See Plan Summary*, *supra* note 127, at 14.

317. *See supra* Part VI.B.2.

High-speed rail services require completely separate tracks, which relieve congestion on other rail networks, thereby increasing their speeds as well.[318] The use of existing right-of-ways presents a feasible location to construct new, segregated tracks.[319] Continuing to build and expand highways swallows up far more land than the construction of any rail line.[320]

In addition, a key to making high-speed rail more successful is connecting those networks with urban transit systems, so riders can easily transition from one service to another and reach their destination without requiring a car.[321] Florida understood this, but because of past development strategies, it was also planning to install rental car facilities at their high-speed rail stops to facilitate more rail users.[322] As cities and towns move towards denser development to support a more efficient and sustainable lifestyle, this will only enhance the appeal of public transit systems and high-speed rail connectivity.[323]

The development of high-speed rail in Texas presents opportunities for private companies to construct rail lines and charge riders to use their services, much like TxDOT's preferred strategy for toll roads.[324] High-speed rail fits nicely within TxDOT's goals of offering citizens more choices, charging only those who want to use the services, reducing emissions, and saving time by bypassing congestion.[325] Channeling the money that is currently spent on building and expanding highways to high-speed rail options would provide a huge jumpstart for developing the rail system.[326] Similar to Britain, high-speed rail has the ability to bring together public, private, and environmental interests that recognize efficient and sustainable transportation systems are the wave of the future.[327]

## IX. CONCLUSION

High-speed rail provides an alternative to the oil-dependent forms of transportation that Texas relies on so heavily to move people between its cities and regions.[328] Given projected population increases and concerns over the rising cost of oil, developing a high-speed rail system should be part of an overall reorganization of Texas's transportation system.[329] This will help

318. *See Why Is HSR So Important*, *supra* note 283.
319. *See* BURNS, *supra* note 4, at 13.
320. *See Florida Jobs*, *supra* note 263.
321. *See Florida Fast Facts*, *supra* note 252.
322. *Id.*
323. *See* OWEN, *supra* note 46, at 12.
324. *See supra* Part III.B.
325. *See* TEXAS TOLLWAYS, *supra* note 65.
326. *See* DUANY, PLATER-ZYBERK & SPECK, *supra* note 7, at 94-97.
327. *See supra* Part VII.B.
328. *See Final Texas Rail Plan*, *supra* note 170, at 1-4 to -5.
329. *See id.* at 1-2 to -4.

soften the economic blow of increased oil costs while providing Texans a safe, efficient, and sustainable travel option.[330] Florida and Britain make good cases for why they see high-speed rail as such an important investment for the future of their cities and people.[331] High-speed rail can connect regions of the state allowing additional mobility options for workers, opportunities for new markets, and increased connectivity.[332] In addition, it can promote transit-oriented development, which reduces pollution and decreases energy costs.[333] The distances between cities, especially within the mega-region known as the Texas Triangle, and relatively flat terrain make Texas well positioned to develop a high-speed rail system.[334] Texas can lead the nation in connecting its cities through high-speed rail, but this goal will require a concerted effort on the part of the state's leadership and a vision to see high-speed rail through this time around.[335]

330. *See Why Is HSR So Important?*, *supra* note 283.
331. *See supra* Part VII.A-B.
332. *See Final Texas Rail Plan*, *supra* note 170, at 1-9 to -10.
333. *See Florida Jobs*, *supra* note 263.
334. *See Florida Fact Sheet*, *supra* note 250.
335. *See* BURNS, *supra* note 4, at 36.

# DID WE REALLY TAKE ADVICE FROM A CHICKEN?: THE FAILURE OF THE DODD-FRANK ACT SAY-ON-PAY PROVISION

Comment

*Amanda R. McKinzie**

## I. THE CHICKEN & THE DUCK

What happens when the sounds of a clucking chicken and a quacking duck reach the ears of Congress? Disaster. The tale began in 2006 when a protestor donned a chicken suit and stood outside the Home Depot Annual Meeting in opposition to Robert Nardelli's golden parachute package of over $210 million.[1] The suit symbolized the alleged cowardliness of the directors who refused to allow shareholders to participate in an advisory vote on executive compensation packages received in the prior year, a practice commonly referred to as "say-on-pay."[2] Two years later, Aflac became the first publicly traded American company to adopt a say-on-pay provision into its bylaws, promising to conduct a shareholder vote in 2009.[3]

After Aflac adopted the proposal, Congress embraced the say-on-pay movement and amended the Troubled Asset Relief Program (TARP) to include a mandated shareholder vote, with the impression that this provision would be

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1. *See* Lisa M. Fairfax, *Government Governance and the Need to Reconcile Government Regulation with Board Fiduciary Duties*, 95 MINN. L. REV. 1692, 1699 (2011) [hereinafter Fairfax, *Government Governance*]; Parija B. Kavilanz, *Nardelli Out at Home Depot: No. 1 Home Improvement Retailer Gives Ex-CEO $210 Million Package; Vice Chairman Frank Blake Takes the Helm*, CNNMONEY (Jan. 3, 2007, 7:13 PM), http://money.cnn.com/2007/01/03/news/companies/home_depot/index.htm; Joe Nocera, *The Board Wore Chicken Suits*, N.Y. TIMES (May 27, 2006), http://www.nytimes.com/2006/05/27/business/27nocera. html?pagewanted=all.

2. Allan Sloan, *Aflac Looks Smart on Pay*, WASH. POST (May 29, 2007), http://www.washingtonpost.com/wp-dyn/content/article/2007/05/28/AR2007052801055.html.

3. Claudia H. Deutsch, *Aflac Investors Get a Say on Executive Pay, a First for a Publicly Traded U.S. Company*, N.Y. TIMES (May 6, 2008), http://www.nytimes.com/2008/05/06/business/06pay.html; Barbara Kiviat, *Giving Investors a Say on CEO Pay*, TIME BUS. (Apr. 9, 2008), http://www.time.com/time/business/article/0,8599,1729480,00.html.

an effective control on ever-increasing executive compensation.[4] TARP required corporations that accepted bailout money to conduct a say-on-pay vote every year.[5] Then, in July 2010, proponents of the say-on-pay movement achieved their greatest victory: Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or the Act), which included a provision that required all publicly traded corporations to conduct say-on-pay votes.[6]

As the Dodd-Frank Act's two-year anniversary approaches, the problems of the say-on-pay movement are becoming more apparent.[7] Among the many issues Congress unleashed, shareholder abuse of their new "power" is most disconcerting.[8] Although the provision clearly limits the influence that the voting results may have on board decisions and duties, shareholders have filed derivative suits, attempting to rescind the boards' previous executive compensation decisions.[9]

This development and other unintended consequences have emerged because Congress passed a poorly drafted law and failed to address any potential repercussions.[10] Furthermore, as a purely advisory practice, say-on-pay has not achieved the goals for which it was intended.[11] Because the law is inadequate, the say-on-pay provision should be repealed quickly in order to mitigate the backlash it created, or if Congress refuses, it should modify the language of the law to prevent further abuse.[12]

This Comment critiques the say-on-pay law and the repercussions that resulted during the 2011 proxy season. Part II of this Comment discusses the events leading up to the passage of the Dodd-Frank Act. Part III examines the say-on-pay precursors along with the Dodd-Frank Act say-on-pay provision. Part IV analyzes the results from the 2011 proxy season and the critiques that arose from its completion. Part V discusses the say-on-pay litigation resulting from negative say-on-pay feedback, including whether Congress intended for shareholders to pursue this type of action. Part VI and VII conclude this Comment by analyzing the impact of the poorly drafted law and proposes that Congress should repeal it. If, however, Congress refuses to repeal the law,

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4. *See* Executive Compensation and Corporate Governance Act, Pub. L. No. 111-5, § 7001, 123 Stat. 516 (2009) (to be codified as amended at 12 U.S.C. § 5221(e)) ("Any proxy or consent or authorization for an annual or other meeting of the shareholders of any TARP recipient during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding shall permit a separate shareholder vote to approve the compensation of executives . . . .").

5. *See id.*

6. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899-1900 (2010) (to be codified as amended at 15 U.S.C. § 78n-1).

7. *See infra* Part VI.

8. *See infra* Part V.B.3.

9. *See infra* Part V.

10. *See infra* Part VI.

11. *See infra* Part VI.B.

12. *See infra* Part VII.

Congress should amend it and insert new language that provides guidance for corporations and limitations on abusers of the law, such as shareholders.

## II. THE HATCHED EGG: CRISIS AVERTED OR CRISIS CREATED?

The financial crisis of 2008 transformed the lives of many Americans and shifted the public's attention to Wall Street. Reacting to public outcry, Congress enacted the Dodd-Frank Act. The purpose of the Act was to prevent a recurrence of the crushing economic downturn experienced in prior years.

### *A. The Financial Crisis of 2008*

Scholars have called the 2008 crisis the "worst recession since the Great Depression."[13] It began in 2006 with the housing market spike, which was quickly followed by a severe economic downturn.[14] Wall Street soon felt the effects of this boom and bust as banks failed, investments crumbled, and hedge funds were shuttered.[15] The United States Government took action to prevent the wobbling financial system from toppling.[16] As the crisis spread to the global markets, Congress passed billion-dollar bailouts to prevent "financial Armageddon."[17] Countries across the globe provided similar stimulus packages in hopes of boosting their economies in order to pull the world out from the recession into which it had fallen.[18]

Scholars have offered different explanations of the precise cause of the recession.[19] For example, one commentator concluded that executive compensation was a major factor in the financial crisis of 2008.[20] Specifically, he argued that the structure of executive compensation plans incentivized high-risk, speculative decisions, which were focused on short-term gain, thereby

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13. Helene Cooper, *Obama Signs Overhaul of Financial System*, N.Y. TIMES (July 21, 2010), http://www.nytimes.com/2010/07/22/business/22regulate.html; *accord* Cong. Oversight Panel, Special Report on Regulatory Reform 2 (2009), *available at* http://cop.senate.gov/documents/cop-012909-report-regulatory reform.pdf.

14. *See Economic Crisis and Market Upheavals*, N.Y. TIMES (Aug. 10, 2011), http://topics.nytimes.com/top/reference/timestopics/subjects/c/credit_crisis/index.html?inline=nyt-classifier.

15. *See id.*

16. *See id.*

17. *Id.*

18. *See id.*

19. See Hershey Friedman & Linda Friedman, *The Global Financial Crisis of 2008: What Went Wrong?*, *in* LESSONS FROM THE FINANCIAL CRISIS: CAUSES, CONSEQUENCES, AND OUR ECONOMIC FUTURE 31, 31 (Robert W. Kolb ed., 2010); André Douglas Pond Cummings, *Racial Coding and the Financial Market Crisis*, 2011 UTAH L. REV. 141, 141 (2011); Stephen Harper, *Credit Rating Agencies Deserve Credit for the 2007-2008 Financial Crisis: An Analysis of CRA Liability Following the Enactment of the Dodd-Frank Act*, 68 WASH. & LEE L. REV. 1925, 1926 (2011), for different discussions about the possible causes of the financial crisis.

20. Michael diFilipo, *Regulating Executive Compensation in the Wake of the Financial Crisis*, 2 DREXEL L. REV. 258, 280 (2009).

causing the crisis.[21] While agreeing that the high risk executive decisions partially led to the financial crisis, another scholar asserted that the expanding pay gap between executives versus middle- and lower-class workers forced the latter to obtain loans and increase debt levels, leading to the subprime mortgage crisis.[22]

Congress concluded that the following actions and institutions led to the economic crisis: "high risk lending," "regulatory failures," "inflated credit ratings," and "investment banks and structured finance."[23] The congressional report recommended that, among other possible solutions, "transparency in the marketplace" should be increased and issues regarding "conflicts of interest and abuses" should be addressed.[24]

### *B. The Dodd-Frank Act*

In order to address these concerns and to prevent the recurrence of this crisis, Congress began drafting new legislation.[25] For example, the Senate proposed the Restoring American Financial Stability Act of 2010 (Financial Stability Act), which sought to increase transparency and accountability throughout the financial system of the United States.[26] The Financial Stability Act created new solutions to solve these issues—"establish[] an early warning system to detect and address emerging threats to financial stability and the economy, enhanc[e] consumer and investor protections, strengthen[] the supervision of large complex financial organizations and provid[e] a mechanism to liquidate such companies should they fail without any losses to the taxpayer."[27]

On July 21, 2010, President Obama signed the Financial Stability Act into law under its changed name: the Dodd-Frank Wall Street Reform and

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21. *See id.*

22. *See* Erica Beecher-Monas, *The Risks of Reward: The Role of Executive Compensation in Financial Crisis*, 6 VA. L. & BUS. REV. 101, 104 (2011).

23. Press Release, U.S. S. Permanent Subcomm. on Investigations, Senate Investigations Subcommittee Releases Levin-Coburn Report on the Financial Crisis, 2-4 (Apr. 13, 2011), http://www.hsgac.senate. gov/download/psi-financial-crisis-report [hereinafter Levin-Coburn Report]; *see also* STAFF OF S. SUBCOMM. ON INVESTIGATIONS, 112TH CONG., REP. ON WALL STREET AND THE FINANCIAL CRISIS: ANATOMY OF A FINANCIAL COLLAPSE (Subcomm. Print 2011) (discussing at length the study that investigated the causes of the financial crisis and was the conducted by Senator Carl Levin and Senator Tom Coburn).

24. Levin-Coburn Report, *supra* note 23, at 4.

25. *See, e.g.*, Press Release, U.S. S. Comm. on Banking, Hous., & Urban Affairs, Dodd, Banking Committee Democrats Unveil Comprehensive Financial Reform: Bold Proposal to Create a Sound Economic Foundation to Grow Jobs, Protect Consumers, Rein in Wall Street, End Too Big to Fail, Prevent Another Financial Crisis (Nov. 10, 2009), http://banking.senate.gov/public/index.cfm?FuseAction=Newsroom.PressReleases&ContentRecord_id=df7bf893-bb40-6970-cd5f-c75f56d0fb64.

26. *See* S. REP. NO. 111-176, at 1 (2010).

27. *Id.*

Consumer Protection Act.[28] The self-proclaimed purpose of this Act is to "promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes."[29]

Because of the expansive nature of the issues believed to cause the financial crisis, the Dodd-Frank Act's scope is broad and influences many areas of the financial system of the United States.[30] Specifically, prevention and protection measures relating to corporate governance claim to enhance transparency of companies by adopting new practices in the area of executive compensation.[31] For example, under the new law, executives will not be permitted to pocket undeserved income earned through misreported incentives; instead, the issuer will be required to recover these improper payouts for the three previous years.[32] Furthermore, compensation committees now have strict guidelines regarding their independence as board members and the hiring of consultants.[33] Of the provisions implemented to increase accountability in the corporate governance sphere, the newly created shareholder vote is, arguably, the most drastic, new policy enacted by Congress to control executive compensation practices.[34]

## III. FOLLOWING THE SAY-ON-PAY FLOCK

Because many critics claimed that executive compensation was a major factor in the financial crisis, Congress adopted a provision to regulate the allegedly destructive compensation practices.[35] Specifically, the Dodd-Frank Act gives shareholders the ability to voice their opinions about the executives' paychecks.[36] Congress fashioned this arrangement through mandating an advisory shareholder say-on-pay vote; it supposedly aligns executive compensation with shareholder interests to increase board accountability.[37]

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28. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, 124 Stat. 1376 (2010) (to be codified as amended at 15 U.S.C. § 78).

29. *Id.*

30. *See id.*; *see also* STAFF OF U.S. S. COMM. ON BANKING, HOUS., & URBAN AFFAIRS, 112TH CONG., DODD-FRANK WALL STREET REFORM: CONFERENCE REPORT SUMMARY (Comm. Print 2011) (summarizing the scope of the Dodd-Frank Act).

31. *See* § 951, 124 Stat. at 1899-1900.

32. *See* § 954, 124 Stat. at 1904.

33. *See* § 952(a), 124 Stat. at 1900-03 (requiring additional guidance from the SEC for implementation).

34. *See* § 951, 124 Stat. at 1899-1900.

35. *Id.*; *see, e.g.*, Beecher-Monas, *supra* note 22, at 104; Aldo Svaldi, *Bonus Outrage Could Put AIG in Bankruptcy*, DENVER POST (Mar. 18, 2009, 12:30 AM), http://www.denverpost.com/business/ci_11937896?source=pkg (discussing the AGI bailout and stating that executive compensation was "the common denominator in everything that went wrong" in 2008).

36. *See* § 951, 124 Stat. at 1899-1900.

37. *See id.*; Jeremy Ryan Delman, *Structuring Say-on-Pay: A Comparative Look at Global Variations*

### *A. The Precursors to the Dodd-Frank Act Say-on-Pay Vote*

#### *1. The United Kingdom Model*

The United Kingdom was one of the first countries to adopt legislation requiring a say-on-pay vote.[38] In 2002, the U.K. implemented this type of shareholder vote in response to rapid pay increases received by corporate executives.[39] The legislation, called the Directors Remuneration Report (DRR) Regulations of 2002, sought to enhance both the accountability and the transparency of corporate governance practices and to decrease the controversially high payments accepted by executives.[40] Proponents of say-on-pay believed that a key to impacting the payment of executives was the threat of negative public opinion created by dissenting shareholder votes.[41] This negative publicity would cause the boards to decrease the executive compensation packages in order to recover from the embarrassment of receiving a negative vote.[42]

In order to achieve the desired effect, the DRR Regulations mandated that firms conduct a non-binding, advisory shareholder vote on executive compensation based on disclosures at the Annual General Meeting.[43] The DRR Regulations further required that corporations provide shareholders with more detailed disclosures about severance packages, compensation advisors, and other similar practices in order to assist shareholders in making informed decisions.[44]

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*in Shareholder Voting on Executive Compensation*, 2010 COLUM. BUS. L. REV. 583, 586 (2010).

38. Jeffrey N. Gordon, *"Say on Pay": Cautionary Notes on the U.K. Experience and the Case for Muddling Through*, *in* PERSPECTIVES ON CORPORATE GOVERNANCE 189, 198 (F. Scott Kieff & Troy A. Paredes eds., 2010).

39. Laraine S. Rothenberg & Todd S. McCafferty, *'Say-on-Pay': Linking Executive Pay to Performance*, N.Y. L.J. (Sept. 24, 2008), http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1202424735938; Fabrizio Ferri & David A. Maber, *Say on Pay Vote and CEO Compensation: Evidence from the UK*, at 1 (Mar. 2009), *available at* http://ssrn.com/abstract=1420394 (last visited September 27, 2011).

40. Ferri & Maber, *supra* note 39, at 8.

41. Minor Myers, *The Perils of Shareholder Voting on Executive Compensation*, 36 DEL. J. CORP. L. 417, 420 (2011) ("[S]hareholder voting will amplify the 'outrage constraint'—the potential for shame and embarrassment in the media, which according to many observers constitutes the operative constraint on directors' ability to offer pay packages that are too high and not sensitive enough to performance.").

42. *Id.*; *see also Empowering Shareholders on Executive Compensation: H.R. 1257, The Shareholder Vote on Executive Compensation Act, Hearing Before the H. Comm. on Fin. Serv.*, 110th Cong. 68 (2007) [hereinafter Hearing on H.R. 1257] (statement of Lucian Bebchuk, Professor of Law, Economics and Finance, Harvard Law School) ("I expect that advisory votes on executive pay would similarly induce boards to give greater weight to shareholder views and preferences on this subject . . . .").

43. Companies Act, 2006, c. 46, §§ 4201(1), 385(2) (Eng.); Martin Conyon & Graham Sadler, *Shareholder Voting and Directors' Remuneration Report Legislation: Say on Pay in the UK*, 18 CORP. GOVERNANCE: AN INT'L REV. 296, 298 (2010), *available at* http://onlinelibrary.wiley.com/doi/10.1111/j.1467-8683.2010.00802.x/abstract; Andrew C.W. Lund, *Say on Pay's Bundling Problems*, 99 KY. L.J. 119, 126 (2011).

44. *See* Conyon & Sadler, *supra* note 43, at 298.

Over the ten years since its implementation, scholars have studied the DRR Regulations' impact on corporate governance in the U.K.[45] In 2009, for instance, Ferri and Maber conducted a study that examined the success of the say-on-pay vote in controlling executive compensation.[46] During the various proxy seasons, only approximately 14.6% of corporations received a dissenting vote, indicating that shareholders generally return a positive vote.[47] They also found that when shareholders disapproved, the boards of directors changed compensation practices in order to receive approval the next year.[48]

Although altering practices of failing corporations seems encouraging, the say-on-pay vote did not actually affect the increasing levels of CEO compensation.[49] Instead, it merely spotlighted the corporations that compensated executives in spite of the corporation's poor performance.[50] For these companies, shareholder disapproval was more likely because the voters "care[d] much more about pay-for-failure than they [did] about overpayment-for-success."[51] Thus, shareholders are willing to turn a blind eye to overcompensated executives if they know that the company is doing well economically, and they are reaping the benefits.[52]

In a study conducted in 2010, scholars found that "[t]ypically over 90 per cent [sic] of shareholders vote in favor of the [Directors' Remuneration Report]."[53] This statistic demonstrates that the vast majority of executive compensation practices are unaffected by the shareholder vote.[54] First, the shareholders normally approve of the packages, and second, the rate of shareholder approval of CEO compensation is only increasing.[55] Furthermore, contrary to the previous study, the authors found no evidence suggesting that shareholder votes changed the decision of the board when deciding executive compensation.[56]

Although the U.K. strove to change the executive compensation practices of its major corporations through the DRR Regulations, these studies indicate that shareholders increasingly support the compensation packages presented by directors, and in some instances, the board disregards the results completely.[57] Perhaps recognizing the failure of the say-on-pay system, the Prime Minister

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45. *See, e.g.*, *id.*; Ferri & Maber, *supra* note 39, at 8.

46. Ferri & Maber, *supra* note 39, at 2.

47. *Id.* Of the corporations who received a negative vote, only 13.8% received a dissenting vote from their shareholders the next year. *Id.*

48. *Id.*

49. *See id.* at 2, 22.

50. *See id.*

51. Lund, *supra* note 43, at 134.

52. *See id.*

53. Conyon & Sadler, *supra* note 43, at 309.

54. *See id.* at 304.

55. *See id.*

56. *See id.*

57. *See* Gordon, *supra* note 38, at 205; Lund, *supra* note 43, at 126-29.

of the U.K. recently pledged to change the non-binding status of these votes and to give the shareholders actual power.[58]

### *2. The U.S. Shareholder Proposals*

In the United States, the movement for say-on-pay voting began with a chicken suit, worn outside the Home Depot Annual Meeting in 2006 in protest of the golden parachute package that an executive had received and as a symbol that the directors feared the consequences of allowing shareholders to have a say on executive compensation.[59] In 2008, Aflac adopted a say-on-pay provision and promised to conduct a shareholder vote in 2009.[60] Following in Aflac's shadow that same year, Par Pharmaceuticals, Verizon Communications, and Blockbuster pledged to implement shareholder say-on-pay proposals.[61]

Even though other shareholders drafted similar proposals in following months, the boards of directors were less inclined to welcome the say-on-pay movement, likely because executive compensation has historically been a matter completely within their discretion.[62] In the first proxy season following 2008, only three corporations adopted their say-on-pay shareholder proposals, even though at least eight corporations' shareholders had voted in favor of the proposals.[63] In the following years, even shareholder support of these proposals had declined dramatically.[64]

### *3. The Troubled Asset Relief Program*

In 2009, while shareholders were still submitting proposals, Congress expressed its support for this campaign.[65] As part of the requirements for corporations accepting TARP bailout money, the law mandated that these corporations conduct an advisory shareholder vote on executive

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58. *See* Jill Treanor, *David Cameron's Plans for Executive Pay May Not End Spiralling Bonuses*, THE GUARDIAN (Jan. 8, 2012, 2:42 PM), http://www.guardian.co.uk/business/2012/jan/08/david-cameron-executive-pay-bonuses.

59. *See* Sloan, *supra* note 2.

60. *See* sources cited *supra* note 3.

61. *See* Gretchen Morgenson, *Verizon to Put Executive Pay to Shareholder Vote*, N.Y. TIMES (Nov. 2, 2007), http://www.nytimes.com/2007/11/02/business/02phone.html?adxnnl=1&adxnnlx=1317578811-hzZMcxyz0LnFbxK2tQ6XlA; Gordon, *supra* note 38, at 201; Tomoeh Murakami Tse, *'Say on Pay' Movement Loses Steam*, WASH. POST (May 6, 2008), http://www.washingtonpost.com/wp-dyn/content/article/2008/05/05/AR2008050502470.html.

62. *See* Gordon, *supra* note 38, at 201; Tse, *supra* note 61.

63. Tse, *supra* note 61.

64. *Id.*

65. *See* Emergency Economic Stabilization Act of 2008 (EESA), 12 U.S.C. § 5221(e) (2006 & Supp. 2011).

compensation.[66] Unlike the Dodd-Frank say-on-pay vote, institutions receiving bailouts held this vote annually.[67] The purpose behind the mandatory say-on-pay vote was to decrease executive compensation packages from corporations that were struggling to remain profitable during the crisis.[68]

### *B. The Dodd-Frank Act Say-on-Pay Vote*

#### *1. The Implementation*

Not long after the TARP legislation passed, Congress extended the reach of the say-on-pay mandate to the remaining publicly traded corporations that had not received bailout money.[69] As a result, § 951 of the Dodd-Frank Act amended § 14 of the Securities Exchange Act to include shareholder votes on several aspects of executive compensation.[70] Prior to the SEC passing the final rules implementing the Dodd-Frank Act provisions controlling executive compensation, the Commission received comments from the public about their individual beliefs, critiques, and ideas regarding the new regulations.[71]

Of the questions presented to the public by the SEC, the issues regarding the treatment of smaller corporations and the necessity of disclosure after the vote were among the most discussed topics.[72] The first issue arose as a result of Congress including an exemption option in the concluding subsection on shareholder approval of executive compensation in the Dodd-Frank Act.[73] The provision allowed the Commission to consider "whether the requirements under subsections (a) [say-on-pay vote] and (b) [golden parachute

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66. *Id.*

67. *Id.*

68. *See* Fairfax, *Government Governance*, *supra* note 1, at 1697-98. The results and implications from the say-on-pay vote required by TARP will be discussed in a later portion of this Comment. *See infra* Part V.B.2.

69. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899-1900 (2010) (to be codified as amended at 15 U.S.C. § 78n-1).

70. *See id.*

71. *See generally* Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 75 Fed. Reg. 66,590, 66,592-610 (Oct. 28, 2010) (to be codified at 17 C.F.R. pts. 229, 240, 249) (presenting the questions about which the SEC sought commentary), *available at* http://www.sec.gov/rules/proposed/2010/33-9153.pdf; Subcomm. on Annual Review, Comm. on Fed. Regulation of Secs., *Annual Review of Federal Securities Regulations*, 66 BUS. LAW. 669, 689-701 (2011) (providing an in-depth discussion of the various parts of the say-on-pay provision and proposed rules).

72. *See, e.g.*, Letter from the Comm. on Fed. Regulation of Secs., Section of the Business Law of Am. Bar Ass'n (ABA) 21-23 (Nov. 22, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-59.pdf; Letter from Time Warner, Inc., 1-2 (Dec. 7, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-64.pdf; *see also* Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 75 Fed. Reg. at 66,592-610 (presenting the questions about which the SEC sought commentary).

73. *See* § 951(e), 124 Stat. at 1900.

compensation approval] disproportionately burdens small issuers."[74] Unsure of whether to exercise this option, the SEC asked the public.[75]

The responses that the Commission received varied.[76] On the one hand, commentators agreed with Congress's assertion that smaller companies would benefit from the opportunity to analyze a larger corporation's experience as it progressed through the say-on-pay process and to implement changes to their own practices according to those observations.[77] In altering their own systems of compensation prior to shareholder voting, the smaller companies could ensure positive results.[78] The ABA, in fact, suggested that the SEC should exempt smaller reporting companies entirely because the implementation of say-on-pay would unduly burden companies that did not struggle with overpaying executives.[79]

On the other hand, a substantial number of commentators disagreed with Congress and the Commission about the benefits of exempting smaller reporting companies.[80] For example, Glass Lewis, a proxy advisory firm, argued that regardless of the size of the corporation, shareholders should have the opportunity to judge the compensation the executives receive each year and that these smaller corporations would actually benefit most from the vote.[81] Moreover, another commentator asserted that no evidence existed proving that smaller corporations had better compensation practices that did not overcompensate executives.[82] Based on these comments, the Commission compromised; it allowed smaller reporting companies to postpone shareholder say-on-pay votes until January 21, 2013, after which time, they must conduct shareholder votes as well.[83]

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74. *Id.*

75. *See* Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 75 Fed. Reg. at 66593.

76. *Compare* ABA, *supra* note 72, at 22 (advocating for complete exemption for smaller companies), *with* letter from Glass Lewis & Co. (Glass Lewis) 5 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-48.pdf (advocating that smaller companies receive no exemption).

77. ABA, *supra* note 72 at 23; Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. 6,010, 6,013 (Feb. 2, 2011) (to be codified at 17 C.F.R. pts. 229, 240, 249).

78. Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. at 6013.

79. ABA, *supra* note 72, at 22.

80. *See, e.g.*, Letter from Am. Fed. of State, Cnty., & Mun. Emps. (AFSCME) 2 (Nov. 15, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-15.pdf; letter from Calvert Group, Ltd. (Calvert) 5, *available at* http://www.sec.gov/comments/s7-31-10/s73110-45.pdf; Glass Lewis, *supra* note 76, at 5; Letter from Public Citizen 3 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-50.pdf.

81. Glass Lewis, *supra* note 76, at 5.

82. Public Citizen, *supra* note 80, at 3.

83. Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. at 6,010.

Along with divided feedback concerning the exemption of smaller reporting companies, commentators disagreed about whether corporations should be required to disclose the impact the say-on-pay result had on the boards' later compensation decisions in their Compensation Discussion and Analysis (CD&A).[84] Many commentators agreed with the SEC that, in order to achieve the transparency goal of the Act, directors should provide shareholders with such information.[85] Therefore, the responders argued that disclosure should be mandated.[86]

In contrast, many commentators believed that the SEC should not require the CD&A disclosure of the voting results' impact on the boards' decisions.[87] Some argued that corporations should be allowed to decide whether to include this disclosure depending on their own circumstances.[88] They explained that if companies are prevented from considering whether to disclose this information, the required disclosures would eventually become boilerplate language included in the CD&A for the sole purpose of satisfying the mandate.[89] Other commentators further asserted that because the Dodd-Frank Act itself did not suggest this disclosure, the SEC should not introduce the requirement either.[90] These arguments proved to be futile, however, because

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84. *Compare* Letter from Cal. State Teachers' Ret. Sys. (CalSTRS) 3 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-49.pdf (supporting disclosure requirements (arguing additional disclosures would not add a significant burden), *and* Calvert, *supra* note 80, at 3 (supporting CD&As), *and* Letter from Colo. Pub. Emps.' Ret. Ass'n (COPERA) 2 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-39.pdf (same), *and* Letter from Meridian Comp. Partners (Meridian) 3 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-42.pdf (same), *and* letter from Pensions Inv. Research Consultants, Ltd. (PIRC) 2 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-61.pdf (same), *with* Letter from Center on Exec. Comp. 1-2 (Nov. 18, 2010), *available at* (opposing CD&As as inconsistent with purpose of non-binding votes and constituting a duplicative, burdensome filings), *and* Letter from Compensia, Inc. (Compensia) 2-3 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-51.pdf (same), Letter from Davis Polk & Wardwell LLP (Davis) 2 (Nov. 16, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-16.pdf (same), *and* Letter from Nelda B. Radin, Chair, Secs. Law Comm., Soc'y of Corp. Secs. & Governance Prof'ls (Society of Corp. Sec.) 2-3 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-32.pdf (same), *and* Letter from Sullivan & Cromwell, LLP (Sullivan) 2-3 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-41.pdf (same), *and* Letter from United Bhd. of Carpenters (UBC) 2-3 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-44.pdf (same).

85. *See, e.g.*, COPERA, *supra* note 84, at 2; *see also* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899-1900 (2010) (to be codified as amended at 15 U.S.C. § 78n-1) (stating the goals of the Dodd-Frank Act, including improved transparency and accountability of corporate governance).

86. *See, e.g.*, PIRC, *supra* note 84, at 4.

87. *See, e.g.*, Center on Exec. Comp., *supra* note 84, at 1-2; Compensia, *supra* note 84, at 2-3; Davis, *supra* note 84, at 2; Society of Corp. Sec., *supra* note 84, at 2-3; UBC, *supra* note 84, at 2-3.

88. ABA, *supra* note 72, at 5; letter from Financial Services Roundtable (FSR) 2 (Nov. 18, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-46.pdf; Society of Corp. Sec., *supra* note 84, at 2-3; Sullivan, *supra* note 84, at 2-3.

89. Sullivan, *supra* note 84, at 2-3.

90. Center on Exec. Comp., *supra* note 84, at 1-2; Compensia, *supra* note 84, at 2-3; Davis, *supra* note 84, at 2; Society of Corp. Sec., *supra* note 84, at 2-3; UBC, *supra* note 84, at 2-3.

the SEC passed the final rules with a provision creating a compulsory disclosure of the most recent say-on-pay votes' impact on subsequent decisions.[91]

While many of the comments the SEC received were in direct response to the issues raised, several replies maintained that a say-on-pay vote should not be mandated by the SEC or the Dodd-Frank Act.[92] One commentator argued that shareholders did not have the appropriate knowledge and understanding of corporate practices to vote on executive compensation issues.[93] Another commentator contended that executive compensation should be a product of market forces in order to allow corporations to be competitive in hiring these executives, thereby increasing profit returns.[94] Yet another person speculated that allowing shareholders to vote on executive compensation would create an "unjust opportunity to punish management in a reactionary and sometimes emotional way" and that this would cause executives to focus on short-term popularity instead of long-term corporate success.[95] As will be discussed in Part IV, several of these assertions are similar to the critiques the say-on-pay system had received prior to and after its adoption in the U.S.

### *2. The Structure*

Because of the Dodd-Frank Act and the implementing rules, corporations are now required to conduct three separate shareholder votes.[96] First, shareholders will vote on the golden parachute compensation, or severance packages, developed for executives during merger or acquisition transactions.[97] Second, shareholders participate in a non-binding, advisory vote

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91. Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. 6,010, 6,013-14 n.68 (Feb. 2, 2011) (to be codified at 17 C.F.R. pts. 229, 240, 249).

92. Letter from Clifton Halladay, (Halladay) (Dec. 15, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-68.htm; Vostok Eisenhower (Eisenhower) (Dec. 15, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-67.htm; Brian Vaio (Dec. 14, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-66.htm; Robert Park (Dec. 13, 2010), *available at* http://www.sec.gov/comments/s7-31-10/s73110-65.htm.

93. Eisenhower, *supra* note 92.

94. *Id.*

95. Halladay, *supra* note 92.

96. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899-1900 (2010) (to be codified as amended at 15 U.S.C. § 78n-1); Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. at 6,013, n.68 (quoting Instruction to Rule 14a-21(a)).

97. § 951, 124 Stat. at 1899-1900. Golden parachutes are "executive officer compensation of both acquiring and acquired companies in connection with a merger, acquisition, consolidation, or proposed sale or other disposition of all or substantially all of a company's assets." Walter Hall et al., *Report of the Finance & Transactions Committee*, 32 ENERGY L.J. 323, 337 (2011). For example, when the CEO of Home Depot was removed in 2007, he received $210 million even though the company itself was suffering from a decrease in profits. Fairfax, *Government Governance*, *supra* note 1, at 1699. Along with the frustration from the exorbitant amounts often paid to these executives, some critics believe these packages are a method of removing the executives that only causes harm to the shareholders. *See* Miriam A. Cherry

on the executives' compensation packages received in the previous year.[98] Corporations will conduct this "say-on-pay" vote at least once every three years.[99] Third, in order to determine whether shareholders will participate in a say-on-pay vote every one, two, or three years, shareholders will also take part in another type of vote: "say-on-frequency," which must be held at least once every six years.[100]

According to the Act, corporations are to present each type of vote to shareholders in separate resolutions.[101] During the first year after the legislation was passed, companies presented one resolution to shareholders with the say-on-pay vote and a separate resolution describing the say-on-frequency vote.[102] An example of an appropriate say-on-pay resolution is as follows: "RESOLVED, that the compensation paid to the company's named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion is hereby APPROVED."[103]

In addition to providing procedural rules for corporations regarding the implementation of these shareholder votes, the Act also describes the rules of construction for interpreting these advisory votes.[104] It states,

> The shareholder vote referred to in subsections (a) and (b) shall not be binding on the issuer or the board of directors of an issuer, and may not be construed—(1) as overruling a decision by such issuer or board of directors; (2) to create or imply any change to the fiduciary duties of such issuer or

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& Jarrod Wong, *Clawbacks: Prospective Contract Measures in an Era of Excessive Executive Compensation and Ponzi Schemes*, 94 MINN. L. REV. 368, 374 (2009).

98. § 951, 124 Stat. at 1899-1900; 17 C.F.R. § 229.402(a)(3); Lund, *supra* note 43, at 124-25.

99. § 951, 124 Stat. at 1899.

100. *Id.* The purpose behind the say-on-frequency vote is a procedural vote to allow shareholders to determine how often they would prefer to vote on executive compensation. *See id.*

101. § 951, 124 Stat. at 1899-1900. A resolution proposing a golden parachute shareholder vote is only required if the company is participating in a merger or other similar transaction. *See id.*

102. *See* § 951, 124 Stat. at 1899. Depending on the results from the say-on-frequency vote, a corporation may not be required to present both proposals each year a say-on-pay vote is conducted. *See id.* For example, if shareholders vote to conduct a say-on-pay vote every year but decide that they would prefer to only vote on frequency every six years, then that corporation would present a say-on-pay resolution every year, including a say-on-frequency resolution every sixth year. *See id.*

103. Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. 6010, 6013, n.68 (Feb. 2, 2011) (to be codified at 17 C.F.R. pts. 229, 240, 249) (quoting Instruction to Rule 14a-21(a)). During the commentary stage of this process, commentators argued that the language to be used in these proposals should be flexible according to the needs of the corporation. *See* AFSCME, *supra* note 80, at 2; FSR, *supra* note 88, at 1-2; Public Citizen, *supra* note 80, at 2. They further suggested that the SEC include a non-exhaustive list of examples of the language corporations should place in their shareholder voting proposals. *See* Calvert, *supra* note 80, at 3; Society of Corp. Sec., *supra* note 84, at 4-5; Sullivan, *supra* note 84, at 1-2. Accordingly, the SEC included this discussed example to demonstrate the proper language that should be included; however, the Commission did not require that corporations utilize this example. *See* Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. at 6010, n.68 (quoting Instruction to Rule 14a-21(a)).

104. *See* § 951, 124 Stat. at 1899-1900.

> board of directors; (3) to create or imply any additional fiduciary duties for such issuer or board of directors; or (4) to restrict or limit the ability of shareholders to make proposals for inclusion in proxy materials related to executive compensation.[105]

Based on the language in the statute, the shareholder vote is completely advisory and should not overrule the board's decisions or change or create additional duties for the board of directors unless already provided for by other controlling statutes.[106]

## IV. PECKING AWAY AT THE 2011 PROXY SEASON

### *A. The Results from the 2011 Say-on-Pay Vote*

The first Dodd-Frank Act say-on-pay vote was scheduled to occur at each corporation's first shareholder meeting held after January 21, 2011.[107] Over a year later, the results are in and the analysis has begun. While many people believed that shareholders would instinctively reject the pay packages, the 2011 proxy season vote indicated that shareholders were, overall, very satisfied with the compensation their executives received in the previous year.[108] Of the thousands of companies who conducted the say-on-pay vote, over 98% of the corporations received the stamp of approval from their shareholders, and generally, when a company received a positive vote, over 98% of its shareholders had approved.[109]

Although the majority of corporations passed their first say-on-pay vote with a high rate of shareholder approval, several companies failed to satisfy the voters.[110] Between the Russell 3000 Index and the S&P 500 companies, thirty-seven corporations received a negative vote.[111] When a corporation "fails" a say-on-pay vote, it means that less than 50% of the votes cast approved of the executive compensation practices.[112] During the 2011 proxy

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105. § 951, 124 Stat. at 1900.

106. *Id.* Congress likely limited the influence of the vote to advisory status because the U.S. has historically only allowed the board to determine executive compensation issues. *See generally* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000) (discussing the leeway the business judgment rule affords boards of directors).

107. § 951, 124 Stat. at 1900.

108. *See* Ted Allen et al., *Preliminary 2011 U.S. Postseason Report*, INSTITUTIONAL SHAREHOLDER SERVS. 2 (Aug. 8, 2011), http://www.issgovernance.com/docs/2011USSeasonPreview (free registration required); Noam Noked, *The Votes Are in—Deconstructing the 2011 Say on Pay Vote*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE & FIN. REGULATION (July 29, 2011, 9:09 AM), http://blogs.law.harvard.edu/ corpgov/2011/07/29/the-votes-are-in-%E2%80%94-deconstructing-the-2011-say-on-pay-vote/.

109. Allen, *supra* note 108, at 2.

110. *Id.* at 3.

111. *Id.*

112. *Id.*

season, eleven companies did not achieve approval from even 40% of their shareholders.[113]

In addition to the basic passing and failing rates, another important statistic has emerged: shareholder reliance on proxy advisory firms' recommendations.[114] During the 2011 proxy season, Institutional Shareholder Services (ISS), a proxy advisory firm, provided shareholders with recommendations about how they should vote.[115] Of all the 2011 recommendations it provided, ISS suggested that 11% of public companies should receive disapproving votes from shareholders regarding the executive compensation plans.[116] Of these 11%, approximately 1.6% of shareholders agreed, voting against their executives' compensation plans.[117] The shareholders of the remaining 89% of corporations followed ISS's recommendations and gave an approving vote.[118] In other words, only 9.4% of shareholders voted contrary to the recommendation of the ISS.

Along with conducting a say-on-pay vote, the Dodd-Frank Act required these corporations to conduct a say-on-frequency vote, at least during the first proxy season.[119] ISS recommended that all shareholders vote in favor of an annual vote, and in most instances, shareholders voted accordingly.[120] Less than 600 of the thousands of companies implemented a triennial vote, and less than fifty supported a biennial vote.[121]

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113. *Id.*

114. *See* Noked, *supra* note 108.

115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.*

119. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899-1900 (2010) (to be codified as amended at 15 U.S.C. § 78n-1(2)).

120. *U.S. Corporate Governance Policy 2011 Updates*, INSTITUTIONAL SHAREHOLDER SERVS. 16 (Nov. 19, 2010), http://www.issgovernance.com/files/ISS2011USPolicyUpdates20101119.pdf; Edward Kamonjoh, *U.S. Season Review: 'Say on Pay' Votes*, INSTITUTIONAL SHAREHOLDER SERVS., http://www.issgovernance.com/docs/USReviewCompensation (last visited Jan. 16, 2012).

121. Allen, *supra* note 108, at 4. Although this frequency vote reflected the shareholders' preference of annual say-on-pay proposals, some corporations disregarded the shareholder vote and implemented a triennial vote. *See* Ted Allen, *Two Firms Defy Investors View on Pay Vote Frequency*, ISS GOVERNANCE (July 8, 2011, 3:56PM), http://www.blog.issgovernanc.co/gov/2011/07/two-firms-defy=investors-views-on-pay-vote-frequency.html [hereinafter Firms Defy]. Because the vote is only advisory, the corporations had the right to choose their frequency preference. Shareholder Approval of Executive Compensation and Golden Parachute Compensation, 76 Fed. Reg. 6,010, 6,013 (Feb. 2, 2011) (to be codified § 17 C.F.R. pts. 229, 240, 249); Firms Defy, *supra*.

### *B. The Analysis of the 2011 Say-on-Pay Vote*

#### *1. The Failing Companies*

Because only thirty-seven companies failed the 2011 proxy season say-on-pay vote, critics have hastily begun to inquire into the factors separating the thousands of successful corporations from the few failures.[122] Consistent with the trend in the U.K., the negative vote has been linked to a pay-for-performance disconnect.[123] The pay-for-performance system of compensation computation encourages executives to better the wealth of shareholders by taking risks, and in turn, these executives receive the promised pay packages.[124] In order to maintain shareholder satisfaction, corporations with the ability to pay executives according to their rate of success try to attract higher performing businesspersons.[125] The problem arises, however, when the executives are overcompensated, or when the pay packages they receive are incongruent with the shareholder return realized during the year.[126]

Scholars have attributed the overcompensation of executives to the division between corporations that fail the say-on-pay vote versus companies receiving positive feedback, but not every company that has a pay-for-performance disconnect will draw a negative vote.[127] During the 2011 proxy season, only companies that were not profitable, or whose shareholder return decreased, received a disapproving vote.[128] Corporations that have higher annual shareholder returns will likely pass the say-on-pay votes in future years, even if they, too, struggle from a pay-for-performance disconnect.[129]

In contrast, companies that have "shareholder returns . . . in the bottom half of the company's industry" should be more concerned about a pay-for-performance disconnect.[130] Commentators have found that when putting their

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122. *See, e.g.*, Allen, *supra* note 108, at 3; Steve Quinlivan, *ISS Signals 2012 Voting Policies*, DODD-FRANK.COM (Oct. 18, 2011), http://dodd-frank.com/iss-signals-2012-voting-policies/; Joann S. Lublin, *Pay Starts to Bend to Advisory Votes*, WALL ST. J. (July 29, 2011), http://online.wsj.com/article/SB10001424053111903635604576474231868112632.html.

123. *See, e.g.*, Allen, *supra* note 108, at 3; *supra* Part II.A.1.

124. Beecher-Monas, *supra* note 22, at 106-07.

125. *Id*.

126. *See id.*; Edward D. Herlihy et al., *Federal Court Dismisses Claims Against Bank Arising Out of Negative Say on Pay Vote*, WACHTELL, LIPTON, ROSEN & KATZ (Jan. 12, 2012), http://newsandinsight.thomsonreuters.com/uploadedFiles/Reuters_Content/2012/01_-_January/umpquahclientalert.pdf (mentioning that a bank was sued because the shareholder return decreased even though the corporate performance had increased).

127. *See* Allen, *supra* note 108, at 3.

128. *Voting Analytics: An Analysis of Voting Results and Performance at Russell 3000 Corporations*, EQUILAR 2 (July 2011), [hereinafter *Voting Analytics*] http://www.equilar.com/knowledge-network/research-articles/2011/pdf/Equilar-Voting-Analytics-July2011.pdf.

129. *See* Noked, *supra* note 108.

130. *Id.*

pen to paper, shareholders vote based on the dollar signs.[131] The fact that "almost half of the fail-vote firms have reported double-digit negative three-year total share return" evidences the shareholders' motivation.[132] Essentially, because the shareholders received less in returns that year, they believed the executives' compensation should be decreased accordingly.[133] As seen in the studies of the U.K., when shareholders of successful companies vote on the compensation of their executives, they are willing to disregard the overcompensation, but shareholders of less successful corporations are not.[134]

### *2. The Scholars' Criticisms*

After the results from the 2011 proxy season materialized, critics began to reevaluate the say-on-pay movement by renewing previous arguments and developing new criticisms. Many of the pre-Dodd-Frank Act criticisms about say-on-pay were general assertions as to why the provision should not become law.[135] For example, one scholar argued that shareholders should not vote on a subject about which they had insufficient knowledge.[136] Others have agreed, stating that shareholders are capable of making "honest but poor decisions" about executive compensation because the depth of understanding on the matter is shallow.[137]

Professor Kaplan also claimed that the practice would create substantial cost without having any proportional benefit because the "current system is not broken."[138] Among other reasons, he contended that market forces drive the compensation of executives and, accordingly, the compensation is not excessive.[139] Therefore, this additional cost imposed on corporations is unwarranted.[140]

Other scholars have focused on the impact that say-on-pay will have on the board's decision making and have argued that this system will merely shift the power from the board to the proxy advisory firms like ISS.[141] These firms

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131. *See, e.g.*, Allen, *supra* note 108, at 3; Da'Morus A. Cohen et al., *ISS Releases Results on Say on Pay*, LEXOLOGY.COM (July 25, 2011), http://www.lexology.com/library/detail.aspx?g=5d82bc0a-5038-4b97-983d-9dc250a98d3e.

132. Allen, *supra* note 108, at 3.

133. *See* sources cited *supra* note 131.

134. *See* Noked, *supra* note 108.

135. *See, e.g.*, Hearing on H.R. 1257, *supra* note 42, at 16-17 (statement of Steven N. Kaplan, Neubauer Family Professor of Entrepreneurship and Finance, University of Chicago School of Business).

136. *Id.*

137. Lund, *supra* note 43, at 129.

138. Hearing on H.R. 1257, *supra* note 42, at 16-17 (statement of Steven N. Kaplan, Neubauer Family Professor of Entrepreneurship and Finance, University of Chicago School of Business).

139. *Id.*

140. *Id.*

141. *See* Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779, 1802, 1810-11 (2011).

annually provide shareholders with a recommendation on whether to approve or disapprove of executive compensation packages.[142] Because of this influence on shareholder decisions, the boards will heavily rely on the guidance of the firm instead of making their own, independent decision.[143]

Furthermore, boards' decisions may also be influenced by consultations with shareholders, and while many scholars depict this practice as advantageous and proffer it as evidence that say-on-pay has been successful, they fail to acknowledge the disadvantage: distribution of bad publicity between directors and shareholders.[144] If a party later challenges a decision, the board will likely present the consultations as a defense, thereby mitigating the consequences of a bad decision.[145] Although the shareholders themselves escape liability, the board will direct all of the blame to the consenting shareholders, thus relieving the board of the reputational damage, the very source of say-on-pay's "power" to influence.[146]

Not only are critics revealing the flaws in the alleged beneficial influence of say-on-pay on the boards, but they are also exposing the shortcomings of relying on shareholders to change compensation practices.[147] First, critics have argued that while shareholders do have the ability to vote for or not vote for directors, the say-on-pay law does not afford shareholders with the authority to remove directors who disregard say-on-pay results, which diminishes the voters' power to influence these practices.[148] Second, because shareholders often benefit from excessive risk-taking, they have "no incentive to deter managers from it" by decreasing overinvestment incentives and compensation.[149] Third, some companies have a single majority shareholder that is also an executive, and this executive will likely vote in favor of the executive compensation package, overruling other voters or skewing the results.[150]

In sum, scholars agree that the say-on-pay provision minimally impacted the majority of corporations, causing only a few corporations to lower

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142. *See id.*

143. *See id.* at 1811.

144. *See* Myers, *supra* note 41, at 435-36.

145. *See id.*

146. *See id.* at 436-37.

147. *See, e.g.*, Simone M. Sepe, *Making Sense of Executive Compensation*, 36 DEL. J. CORP. L. 189, 230 (2011).

148. *Id.* at 231; Lund, *supra* note 43, at 125.

149. Sepe, *supra* note 147, at 201. This lack of shareholder incentive became evident after the 2011 proxy season when scholars realized that high, even excessive, pay to executives of successful corporations did not stir shareholder action, whereas compensation of executives of struggling companies garnered disapproval. Allen, *supra* note 108, at 2-3; *Voting Analytics*, *supra* note 128, at 2-6; Noked, *supra* note 108.

150. *Cf.* Cally Jordan, *The Chameleon Effect: Beyond the Bonding Hypothesis for Cross-Listed Securities*, 3 N.Y.U. J. L. & BUS. 37, 54 (2006) ("Concentrated ownership patterns do present the danger of minority shareholder expropriation at the hands of the majority shareholder."); Cally Jordan, *The Conundrum of Corporate Governance*, 30 BROOK. J. INT'L L. 983, 1019-20 (2005) (stating that "a majority shareholder, through voting procedures, could elect an entire slate to the board of a U.S. corporation").

executive compensation. Say-on-pay inspired the primary effect of more extensive consultation between boards and shareholders about compensation; some scholars, however, argue that this new communication will only undermine any impact say-on-pay might have on the majority of corporations.[151] Although attempting to transform executive compensation practices and control pay through empowering shareholders is a novel idea, the execution of that goal has failed thus far.

## V. WALKING ON EGGSHELLS: THE SAY-ON-PAY DERIVATIVE LITIGATION

Because the say-on-pay vote during the 2011 proxy season did not result in decreased compensation figures, many of the shareholders who did not approve of their corporations' executive compensation packages brought derivative litigation.[152] The shareholders sought to use the negative voting result as evidence to overcome the presumption in favor of the board created by the business judgment rule.[153] While it is unlikely that Congress intended this action, one court has already approved of the use of the vote as rebuttal evidence in the future.[154]

### *A. Did Congress Intend for Lawsuits to Result From the Say-on-Pay Provision?*

Based on the statutory language and legislative history, Congress likely did not intend for shareholders to bring derivative suits based on the say-on-pay voting results. First, the language of the statute states that the vote should not be used to "overrul[e] a decision by such issuer or board of directors" or "to create or imply any change to the fiduciary duties of such issuer or board of directors."[155] Essentially, shareholders cannot construe this provision in a manner that changes a board's decision or alters the board-shareholder relationship.[156] By offering the say-on-pay result as evidence in a derivative suit, shareholders are acting in direct opposition to this mandate: they are attempting to overrule a decision the board has made regarding executive compensation by forcing them to rescind it.[157]

Not only are the statutory limitations present, but legislative history also indicates the prohibitions were of great importance to Congress.[158] In the

151. *See* Myers, *supra* note 41, at 436.
152. *See infra* Part V.B.
153. *See infra* Part V.B.3.a.
154. *See infra* Part V.A, B.3.c.ii.
155. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1900 (2010) (to be codified as amended at 15 U.S.C. §§ 78n-1(c)(1)-(4)).
156. *See id.*
157. *See id.*; *supra* Part V.B.3.
158. *See* H.R. REP. NO. 110-88, 3-5 (2007).

initial draft of the statute, it only stated that "[t]he shareholder vote . . . shall not be construed as overruling a decision by such board."[159] Congress, however, likely understanding the vulnerability of this prohibition, removed the sentence and drafted a completely separate subsection with further instruction about the say-on-pay provision.[160] The updated version includes four different limitations on the use of the voting results.[161] Therefore, Congress probably did not intend for litigation to result from the say-on-pay voting results because it actively restricted the reach of the provision.

### *B. Will the Litigation Be Successful?*

If Congress was indifferent about the possibility of litigation arising from the say-on-pay voting results, then shareholders may have the opportunity to dodge the language of the statute through litigation, regardless of the protection of the business judgment rule.[162] They have already been, and likely will continue to be, victorious in achieving executive compensation reforms through settlements.[163]

#### *1. Derivative Lawsuits & the Business Judgment Rule*

In order to effectively bring a derivative lawsuit, such as the say-on-pay suits, a shareholder must first make a written demand asking the board to address the issue that the shareholder has presented.[164] Once a shareholder makes a demand, the board of directors decides whether to bring the lawsuit, and if they decide against taking action, the shareholder can pursue the lawsuit, assuming the board acted "wrongfully."[165] If the shareholder chooses not to make a demand, he must demonstrate the futility of the demand by pleading particularized facts that create reasonable doubt regarding whether the board exercised good business judgment or whether the board members were independent.[166] Thus, if a shareholder makes a demand or if a court decides a demand would have been futile, then the shareholder may bring the action.

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159. *Id.* at 2.

160. *See id.*

161. *See* § 951, 124 Stat. at 1900.

162. *See infra* Part V.B.3.

163. *See infra* Part V.B.2.

164. GREGORY V. VARALLO ET AL., FUNDAMENTALS OF CORPORATE GOVERNANCE: A GUIDE FOR DIRECTORS AND CORPORATE COUNSEL 116 (2009). While the applicable law may vary slightly depending on the jurisdiction, most of the lawsuits will look to Delaware law because many of the corporations involved are incorporated in that state. *See infra* Part V.B.3.

165. VARALLO, *supra* note 164, at 116-17.

166. *See* FED. R. CIV. P. 23.1(b); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000) (overruling the abuse of discretion standard of review used by *Aronson* and, instead, reviewing the issue de novo); VARALLO, *supra* note 164, at 117-18. For example, a court will

After making a proper demand or pleading against the necessity of it, shareholders must conquer another obstacle in order to be successful; they must overcome the business judgment rule.[167] This rule creates a powerful presumption that the board made the decision in favor of the corporation, and it protects the directors from decisions they made that they believed were in the best interest of the corporation.[168] In other words, it ensures that the directors of corporations do not become personally liable for the decisions they make.[169] By shielding the board from personal liability, the directors have the ability to consider all the options and make an informed decision without the looming threat of a lawsuit.[170]

In order to rebut the protection provided by the presumption, generally, the opposing party must prove one of the following: (1) the majority of the board members did not consider whether this decision would be in the best interest of the corporation; (2) they did not consider the information available before deciding; or (3) they had an interest in the decision that was made.[171] Without evidence supporting a rebuttal of the presumption, the plaintiff will fail, and the board members will not be liable.[172]

### *2. The Pre-Dodd-Frank Act Lawsuits*

#### *a. The* KeyCorp *Case*

Demonstrating the power of derivative litigation, shareholders of KeyCorp and Occidental Petroleum Corporation brought the first TARP say-on-pay derivative suits after disapproving of their corporations' executive compensation packages.[173] In the litigation concerning KeyCorp, plaintiffs alleged "breaches of . . . fiduciary duties . . . , corporate waste, and [unjust] enrichment," among other claims, but before the defendants could file a

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not require a demand if the shareholder can plead specific facts demonstrating a wasteful transaction. *See* Saxe v. Bardy, 184 A.2d 602, 610 (Del. Ch. 1962); VARALLO, *supra* note 164, at 120.

167. *See* Douglas M. Branson, *The Rule That Isn't a Rule—The Business Judgment Rule*, 36 VAL. U. L. REV. 631, 637 (2002).

168. *See id.* at 632. The protection afforded by the business judgment rule was demonstrated in a case involving a severance package of over $100 million to an executive of Walt Disney who had performed poorly during his time with the corporation. Brehm v. Eisner (*In re* Walt Disney Co. Derivative Litig.), 906 A.2d 27, 36-46 (Del. 2006). The court held that the board of directors had acted in good faith when negotiating this agreement, and therefore, the plaintiffs had failed to overcome the business judgment rule. *Id*. at 68-73; Sarah Helene Duggin & Stephen M. Goldman, *Restoring Trust in Corporate Directors: The Disney Standard and the "New" Good Faith*, 56 AM. U. L. REV. 211, 213 (2006).

169. *See* Branson, *supra* note 167, at 637.

170. *See* Branson, *supra* note 167, at 637.

171. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); VARALLO, *supra* note 164, at 60-61.

172. VARALLO, *supra* note 164, at 60.

173. Adam Piore, *What About Those Say on Pay "No" Votes?*, CORP. SEC'Y: GOVERNANCE, RISK & COMPLIANCE (July 29, 2011), http://corporatesecretary.com/articles/proxy-voting/11956/what-about-those-say-pay-no-votes/.

motion to dismiss, the parties settled the lawsuit.[174] The defendants agreed to pay $1,750,000 in attorney's fees and expenses and agreed to change their compensation policies to better align with shareholders' interests.[175] Perhaps because no court had previously decided the issues present in the KeyCorp litigation, the defendants sought to escape the unknown quickly and avoid potential liability.

#### *b. The* Occidental Petroleum Corp. *Case*

Shortly after shareholders brought a derivative suit against KeyCorp, Occidental Petroleum Corporation became party to a lawsuit with similar claims.[176] The plaintiff alleged that the defendants distributed false and misleading proxy statements that led to "breaches of fiduciary duties, and . . . economic consequential harm . . . ."[177] The defendants responded with a motion to dismiss that stated the plaintiff had failed to state a claim because the plaintiff did not create reasonable doubt to overcome the presumption created by the business judgment rule.[178] Eventually, the parties settled with the defendant agreeing to lower the maximum payment potential for executives along with other compensation alterations.[179] They also agreed to pay over $600,000 in attorney's fees and expenses.[180] In sum, both of the two lawsuits filed based on the TARP say-on-pay results swiftly settled with the plaintiffs receiving substantial awards.

### *3. The Post-Dodd-Frank Act Lawsuits*

#### *a. The Plaintiffs' Allegations*

The trend that began in 2010 with the KeyCorp litigation has continued through the 2011 proxy season with the Dodd-Frank Act say-on-pay negative results, and the allegations generally remain similar.[181] The plaintiffs claim that in the previous year, shareholder return decreased while executive compensation increased dramatically, establishing that the company did not

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174. Complaint at 1, *In re* KeyCorp Derivative Litigation, No. 1:10-CV-01786-DAP (N.D. Ohio July 6, 2010); *accord* Stipulation and Agreement of Settlement (as amended April 25, 2011) at 9-16, *In re* KeyCorp Derivative Litigation, No. 1:10-CV-01786-DAP (N.D. Ohio July 6, 2010) [hereinafter Stipulation and Agreement of Settlement, *KeyCorp*].

175. *See* Stipulation and Agreement of Settlement, *KeyCorp*, *supra* note 174, at 9-16.

176. Complaint at 1, Resnik v. Abraham, No. 10-CV-00390-RK (D. Del. May 10, 2010).

177. *Id.* at 3.

178. Opening Brief at 3, 11-29, Resnik v. Abraham, No. 10-CV-00390-RK (D. Del. Sept. 9, 2010). *See generally* King v. Baldino, 648 F. Supp. 2d 609, 616 (D. Del. 2009) (discussing pleading demand futility).

179. Order and Final Judgment at 2, Resnik v. Abraham, No. 10-CV-00390-RK (D. Del. Feb. 8, 2011).

180. *Id.* at 6.

181. *See* Danny David, *"Say-on-Pay" Litigation*, 2011 A.B.A. SEC. TAX. 1-5.

pay for performance as declared in its disclosure.[182] Then, the plaintiffs proffer the negative say-on-pay voting results and the boards' failure to rescind the payment as evidence of board misconduct.[183] They claim that the board breached the duties of loyalty and care and wasted corporate assets, and the executives received unjust enrichment.[184]

Furthermore, the plaintiffs argue that they were excused from making a demand because it would have been futile.[185] First, they contend that the board would not have been disinterested because they approved of the high level of compensation.[186] The plaintiffs also typically name at least one person who received incentive pay during the period in question to prove a lack of independence.[187]

Second, the plaintiffs assert that the board did not exercise valid business judgment when deciding the executive compensation plans.[188] Offering the negative say-on-pay vote as evidence to rebut the business judgment rule, the plaintiffs argue that the shareholders' own "independent business judgment" in voting in opposition to the boards' decision demonstrates that the boards did not act in the interest of the shareholders.[189] Based on this rebuttal evidence, they contend that the burden of proof has shifted to the defendants.[190]

### *b. The Defendants' Responses*

In response, defendants have alleged that the plaintiffs failed to make a proper demand on the board and to state a claim for breach of fiduciary duties, corporate waste, or unjust enrichment upon which relief can be granted.[191] To support their argument that a demand would not have been futile, the defendants typically argue the boards' approval of a transaction without other particularized facts is not sufficient to create an interest or remove independence.[192] Moreover, they state that the plaintiffs must plead facts creating a reasonable doubt that the *majority* of the board members were not

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182. *See, e.g.*, Complaint at 11-19, Plumbers Local No. 137 Pension Fund v. Davis, No. 3:11-CV-00633-AC (D. Or. May 25, 2011) [hereinafter Complaint, *Umpqua Holdings Corp.*]; Complaint at 12-20, Matthews v. Rynd, No. 4:11-CV-2706 (S.D. Tex. July 21, 2011) [hereinafter Complaint, *Hercules Offshore*].

183. *See, e.g.*, Complaint, *Umpqua Holdings Corp.*, *supra* note 182, at 18-20; Complaint, *Hercules Offshore*, *supra* note 182, at 20.

184. *See, e.g.*, Complaint, *Hercules Offshore*, *supra* note 182, at 20-21, 23-24.

185. *See, e.g.*, *id.* at 21.

186. *See, e.g.*, *id.* at 21-22.

187. *See, e.g.*, *id.* at 21.

188. *See, e.g.*, *id.*

189. *See, e.g.*, Complaint, *Umpqua Holdings Corp.*, *supra* note 182, at 21.

190. *See, e.g.*, *id.* at 19.

191. *See, e.g.*, Individual Defendants' Memorandum of Law in Support of Their Motion to Dismiss at 7-25, Plumbers Local No. 137 Pension Fund v. Davis, No. 3:11-CV-00633-AC (D. Or. June 27, 2011).

192. *See, e.g.*, *id.* at 11-12.

independent, which is not satisfied by simply discussing one or two directors who potentially were not independent.[193]

Along with arguing that the plaintiffs failed to show that the defendants were not disinterested or independent, the defendants assert that the plaintiffs have also failed to plead, with particularized facts creating reasonable doubt, that the boards did not exercise valid business judgment.[194] Because the law delegates executive compensation decisions to the board, the defendants assert that a simple disagreement about the amount of compensation is not sufficient by itself to overcome the presumption that the board did not act in good faith.[195] Furthermore, they contend that the plaintiffs' attempt to offer the voting results as evidence against the boards' decision violates the language of the Dodd-Frank Act by creating additional fiduciary duties for boards and, therefore, is not permitted.[196]

### *c. The Courts' Decisions*

#### *i. The* Beazer Homes *Case*

Although many of the lawsuits are currently ongoing, two contradictory decisions regarding motions for dismissals were released in September 2011.[197] In the first decision, which involved Beazer Homes, a Georgia court granted the defendants' motion to dismiss because the court held that making a pre-suit demand would not have been futile.[198] The plaintiffs had argued that the demand would have been futile because the board did not exercise valid business judgment in making the compensation decisions, and they presented the negative say-on-pay vote as particularized facts to support this assertion and to rebut the business judgment rule.[199] The court, however, disagreed; among other reasons, the court stated that the shareholders were attempting to create or imply new duties based on the say-on-pay vote, a proposition that the Dodd-Frank Act prohibits.[200] Moreover, the plaintiffs failed to provide support for their argument that this type of vote could overcome the presumption created by the business judgment rule.[201]

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193. *See, e.g.*, *id.* at 10.

194. *See, e.g.*, *id.* at 16-19.

195. *See, e.g.*, *id.*

196. *See, e.g.*, *id.* at 18-19.

197. Steve Quinlivan, *A Comparison of the* Cincinnati Bell *and* Beazer *Say-on-Pay Decisions*, DODD-FRANK.COM (Oct. 6, 2011), http://dodd-frank.com/a-comparison-of-the-cincinnati-bell-and-beazer-say-on-pay-decisions/.

198. Teamsters Local 237 Additional Sec. Benefit Fund v. McCarthy, No. 2011-cv-197841 (Ga. Super. Ct. Sept. 16, 2011) [hereinafter *Beazer Homes*].

199. *Id.*

200. *Id.*

201. *Id.*

### *ii. The* Cincinnati Bell *Case*

In direct opposition to the Georgia decision, an Ohio court denied the defendant's motion to dismiss in a lawsuit involving Cincinnati Bell.[202] According to Ohio law, plaintiffs must present facts demonstrating that the board could not have made an unbiased decision in the best interest of the company, but a presumption in favor of futility exists if "directors are antagonistic, adversely interested, or involved in the transactions attacked."[203] Because the directors were responsible for the compensation plans, the court found that there might be reason to doubt whether they could have acted independently when confronted with the shareholders' demand.[204] The court also stated that to overcome the business judgment rule, shareholders were not required to rebut the presumption in their pleading, and it further asserted that the say-on-pay results might provide sufficient support to overcome the presumption during trial.[205]

### *iii. The* Umpqua Holdings Corp. *Case*

Recently, a federal court decided that the reasoning in *Cincinnati Bell* was flawed.[206] In a case involving Umpqua Holdings Corp., the court found that the plaintiffs were basically arguing that if corporate performance declined in one year, so should the executive compensation, and if corporate performance did not, then sufficient evidence existed to overcome the business judgment rule.[207] To support this assertion, the plaintiffs contended that the say-on-pay result was prima facie evidence against the board's decision as good business judgment; the court disregarded the plaintiffs' offer of proof, stating that say-on-pay results were not sufficient rebuttal evidence to overcome the presumption.[208] Consequently, the court dismissed the case for failing to raise reasonable doubt that the board had used good business judgment.[209]

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202. *Compare id.* (granting the defendant's motion to dismiss and declaring that negative say-on-pay vote alone was insufficient to rebut the business judgment rule), *with* NECA-IBEW Pension Fund v. Cox, No. 1:11-cv-451, 2011 WL 4383368, at *2-3 (S.D. Ohio Sept. 20, 2011) [hereinafter *Cincinnati Bell*] (denying the defendant's motion to dismiss and noting that in a pleading, a negative say-on-pay vote is sufficient to create reasonable doubt that the directors did not exercise valid business judgment).

203. *Cincinnati Bell*, 2011 WL 4383368, at *3 (quoting *In re* Ferro Corp., 511 F.3d 611, 618 (6th Cir. 2008)).

204. *Id.*

205. *Id.* at *2-4.

206. *See* Plumbers Local No. 137 Pension Fund v. Davis, No. 03:11-633-AC, 2012 WL 104776, at *5-6 (D. Or. Jan. 11, 2012) [hereinafter *Umpqua Holdings Corp.*].

207. *Id.*

208. *Id.*

209. *Id.* at *6-8.

### *d. The Consequences*

Even though two courts have ruled consistently regarding the use of negative say-on-pay votes as evidence in a derivative suit, because of the threat of success instilled by the *Cincinnati Bell* decision, shareholders will likely continue to file derivative actions against their directors.[210] In turn, defendants of such suits will likely reach settlements in order to avoid a potential judgment against them.[211] One case, in fact, has already ended in a settlement, and soon, other say-on-pay parties will likely follow suit.[212]

## VI. DON'T LISTEN TO THE BIRDS

The problem with say-on-pay stems from one issue: Congress failed to consider the full impact of this law before enacting it, and the repercussions of a poorly drafted law are becoming apparent. Before Congress passed the Dodd-Frank Act, it should have outlined each goal of the say-on-pay provision and the possible consequences. Instead, Congress simply wrote "Accountability and Executive Compensation" in the section title and called it a day.[213] Without further explanation, it is difficult to determine to whom the accountability is owed—shareholders, consumers, or some unknown third party.[214] Congressional failure to discuss its underlying motivation and to account for future repercussions has produced an evolution of suggested goals, few of which have been accomplished, and has unleashed a plethora of complications.

### *A. The Unachieved Goals*

One motivation, proposed by scholars, in passing the say-on-pay law is that Congress was addressing public outrage over the amount of compensation executives received.[215] Many commentators mention the AIG bailout, which angered the public because the company was bankrupt yet paying its

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210. *See* Quinlivan, *supra* note 197.

211. *See, e.g.*, Steve Quinlivan, *One Cincinnati Bell Say-on-Pay Case Settled, Second in Limbo*, DODD-FRANK.COM (Dec. 22, 2011), http://dodd-frank.com/one-cincinnati-bell-say-on-pay-case-settled-second-in-limbo/.

212. *See id.*

213. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899-1900 (2010) (to be codified as amended at 15 U.S.C. § 78n-1).

214. *See id.*

215. *See, e.g.*, Beecher-Monas, *supra* note 22, at 104; Gordon, *supra* note 38, at 189. In the United States, executive compensation dramatically increased between the years of 1993 and 2008, rising from $2 million paychecks to $7.7 million, or put differently, compensation paid to executives increased from "one hundred times greater than median household income" in 1993 to "more than 200 times greater" in 2006. Martin J. Conyon, *Executive Compensation Consultants and CEO Pay*, 64 VAND. L. REV. 399, 400-01 (2011).

executives excessive amounts in bonus.[216] Thus, many labeled executive compensation as "the common denominator in everything that went wrong."[217] If Congress believed this law would pacify the public, it should have first read the case studies from the U.K.[218] According to several studies published before the Dodd-Frank Act passed, executive compensation in the U.K. continued to steadily increase each year, even after the country adopted a say-on-pay system.[219] Because the U.S. say-on-pay provision models the U.K. system, executive compensation will likely increase each passing year.[220]

Another suggested goal is the empowerment of shareholders in an effort to better align shareholder interests with corporate decisions.[221] Shareholders have not, historically, had any influence on executive compensation issues because it is a matter solely within the discretion of the board.[222] If, however, Congress has decided to bypass this tradition by giving shareholders a say, then shareholders should use their own judgment in deciding whether they approve of the executive compensation packages. But instead of shareholders being the decision-makers, advisory firms such as ISS and Glass Lewis are influencing shareholders' decisions through recommendations about whether their corporation should pass or fail the vote.[223] Thus, the say-on-pay law has not provided shareholders with a true say because they are relying on third parties for what their vote should be.[224]

In addition to advisory firms dictating shareholder decisions, the voice of the majority shareholder will likely quiet the voices of his fellow shareholders. For example, if one significant institutional investor dislikes the pay practices of the company and votes no, but other shareholders, holding a lesser number of shares, approve of the compensation plan, the outcome will likely reflect the majority shareholder's vote.[225] Even if a corporation does not have one

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216. Svaldi, *supra* note 35; *accord* H.R. REP. NO. 110-88, *2-3 (2007).

217. Svaldi, *supra* note 35; *accord* H.R. REP. NO. 110-88, *2-3 (2007).

218. *See* Gordon, *supra* note 38, at 205.

219. *See, e.g.*, *id.* Because of say-on-pay's inability to affect change in the U.K., the government is currently considering making the vote binding in order to enhance shareholder voices. David Sneyd, *The U.K. Considers Binding Say-on-Pay Votes*, INSTITUTIONAL SHAREHOLDER SERVS. (Jan. 13, 2012, 9:16 AM), http://blog.issgovernance.com/gov/2012/01/the-uk-considers-binding-say-on-pay-votes.html.

220. *See* Gordon, *supra* note 38, at 205.

221. *See* Hearing on H.R. 1257, *supra* note 42.

222. *See* Brehm v. Eisner, 746 A.2d 244, 263 (Del. 2000) (noting that "[i]t is the essence of business judgment for a board to determine if" an executive's actions deserve payment); Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 843-44 (2005) (noting the longstanding role of shareholders in relation to the board of directors).

223. *See* James D.C. Barral & Matteo Tonello, *Say on Pay in 2011: Lessons and Coming Attractions,* HARV. L. SCH. FORUM ON CORP. GOVERNANCE & FIN. REGULATION (Aug. 5, 2011, 9:26 AM) http://blogs.law.harvard.edu/corpgov/2011/08/05/say-on-pay-in-2011-lessons-and-coming-attractions; Kamonjoh, *supra* note 120.

224. *See* Barral & Tonello, *supra* note 223; Kamonjoh, *supra* note 120.

225. *See, e.g.*, Robert B. Thompson & Paul H. Edelman, *Corporate Voting*, 62 VAND. L. REV. 129, 151 (2009) ("The likelihood of the correct decision when there is a vote with a majority shareholder is exactly

majority shareholder, significant shareholders' votes also have the potential to mislead the board.[226] Their vote could cause the board to believe that the majority of shareholders generally approve or disapprove of a package when, in actuality, the vote of the significant institutional investor simply bolstered the percentage of approval or disapproval.[227]

Not only will this imbalance mute shareholder voices and mislead the board, but it also has the potential to remove the minority shareholders from any consultation about executive compensation.[228] Conscientious of the significant institutional investors' vote, the board will approach majority shareholders regarding their opinions.[229] In fact, one law firm has already advised board members that before the 2012 proxy season, they should seek out majority shareholders.[230] By encouraging board members to rely on the opinions of significant institutional investors, the voice to all shareholders that Congress intended to provide through a say-on-pay provision will grow silent.

### *B. The Ineffective Law*

Congress's failure to fully understand the consequences of this law caused it to draft an overly broad law, which has confused corporations, permitted third parties to control the voting process, and allowed shareholders to sue. The law states that corporations must conduct a vote, but the provision never discusses what should occur after the vote.[231] Consequently, corporations receive the yes or no votes without guidance on how the results should be interpreted or applied.[232] The 2011 proxy season has demonstrated that if the corporation fails to act according to the wishes of others, it could suffer the consequences, ultimately leading to derivative litigation.[233]

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the likelihood of the majority shareholder alone getting the right answer.").

226. *See, e.g.*, Steven D. Kittrell, *High Say-on-Pay Vote Not Protection from Shareholder Compensation Suit*, JUST COMPENSATION (Nov. 28, 2011), http://www.justcompblog.com/2011/11/28/high-say-on-pay-vote-not-protection-from-shareholder-compensation-suit/ (discussing the 96% passage rate of say-on-pay at Ralph Lauren Corp but the 84% rate with the majority shareholder removed); *see also* Summons at 11-13, City Pension Fund for Firefighters and Police Officers v. Ralph Lauren, No. 11113265 (N.Y. App. Div. Nov. 22, 2011) [hereinafter Summons, *Ralph Lauren*] (describing the share distribution at Ralph Lauren).

227. *See* Kittrel, *supra* note 226; *see also* Summons, *Ralph Lauren*, *supra* note 226, at 11-13.

228. *See, e.g.*, Joshua A. Agen et al., *Say on Pay From the 2011 Proxy Season*, FOLEY & LARDNER, LLP (Oct. 17, 2011), http://www.foley.com/say-on-pay-report-from-the-2011-proxy-season-10-17-2011/.

229. *See, e.g.*, *id.*

230. *See id.*

231. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899-1900 (2010) (to be codified as amended at 15 U.S.C. § 78n-1).

232. *See id.*

233. *See id.*; *supra* Part V.B.3.

### *1. The Shareholders Who Are Suing*

The "others" who corporations must appease are the shareholders and advisory firms because the broad language of the law has allowed these parties to interpret it and decide how the corporations should respond. Even though the law explicitly states that the say-on-pay results should not be used to overrule board decisions or create new duties, the shareholders have decided how the board should react to a negative vote, a decision that involves rescinding the executive compensation plan the board created.[234] If the board fails to rescind the plan, the shareholders, more often than not, sue the corporation to overrule the board's decision.[235] Because of the broad language of the law, one court has allowed such litigation to continue.[236]

Along with attempting to overrule a board decision through litigation, shareholders are also creating additional duties for the board. Shareholders are, first, trying to force the board to consider the negative vote in future decisions.[237] Then, if the board chooses to disregard the say-on-pay voting results, shareholders expect the board to submit a report explaining their reasoning for not considering the results.[238] In other words, the shareholders are attempting to fabricate new duties based on the voting results by interpreting the language of the law as it benefits them.[239]

### *2. The Proxy Advisory Firms That Are Controlling*

In addition to abuse by shareholders, advisory firms like ISS are also interpreting the law based on their own beliefs about how corporations should interpret the law and react to the say-on-pay results.[240] For example, because the law is silent about a "passing" percentage, corporations considered a majority vote in favor of a compensation plan as passing during the 2011 proxy season.[241] ISS, however, decided that a simple majority was not sufficient to indicate satisfactory executive compensation, so the proxy advisory firm devised a new standard for the 2012 proxy season of 70% as an acceptable passage rate.[242]

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234. *See supra* Part V.B.3.

235. *See supra* Part V.B.3.

236. *See* NECA-IBEW Pension Fund v. Cox, No. 1:11-cv-451, 2011 WL 4383368, at *2-3 (S.D. Ohio Sept. 20, 2011).

237. *See* Martin Roxenbaum, *ISS 2012 Policy Updates, Continued: Board Response to a High Negative Vote*, ONSECURITIES.COM (Dec. 1, 2011), http://www.onsecurities.com/tags/sayonpay/.

238. *See id.*

239. *See id.*

240. *See U.S. Corporate Governance Policy 2012 Updates*, INSTITUTIONAL SHAREHOLDER SERVS. 8 (Nov. 17, 2011), http://www.issgovernance.com/files/ISS_2012US_Updates20111117.pdf.

241. *See supra* note 112 and accompanying text.

242. *See U.S. Corporate Governance Policy 2012 Updates*, *supra* note 240, at 8; Roxenbaum, *supra* note 237 (discussing ISS's 70% policy).

If a corporation did not pass the say-on-pay vote with at least a 70% during the previous proxy season, ISS will consider additional factors when determining whether to recommend approval of executive compensation for the next year, thereby subjecting the corporation to greater scrutiny.[243] Such factors include examining the corporation's response to the say-on-pay vote—"[d]isclosure of engagement efforts with major institutional investors regarding the issues that contributed to the low level of support; [s]pecific actions taken to address the issues that contributed to the low level of support; [o]ther recent compensation actions taken by the company."[244] ISS will also consider "[w]hether the issues raised are recurring or isolated; [t]he company's ownership structure; and [w]hether the support level was less than 50 percent, which would warrant the highest degree of responsiveness."[245] Basically, these factors will likely act to decrease the corporation's ability to receive a positive recommendation from ISS.[246]

ISS, in conjunction with deciding the appropriate voting passage rate, has developed a formula through which it determines whether the executive compensation plan is excessive by evaluating pay-for-performance alignment.[247] Because the say-on-pay provision does not prohibit this type of objective factor-analysis, the advisory firm utilized it during the 2011 proxy season.[248] In making its 2011 recommendations based on the pay-for-performance formula, ISS first identified underperforming companies, meaning "those with 1- and 3-year total shareholder returns (TSRs) below the median of their 4-digit GICS industry group."[249] After categorizing the corporations and comparing each to its peer group, ISS examined each corporation's executive compensation trends over the years, along with several other factors, and gave its recommendations.[250]

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243. *See* sources cited *supra* note 242.

244. *U.S. Corporate Governance Policy 2012 Updates*, *supra* note 240, at 8.

245. *Id.*

246. *See* Roxenbaum, *supra* note 237.

247. *See 2011 ISS U.S. Proxy Voting Guidelines Concise Summary*, INSTITUTIONAL SHAREHOLDER SERVS. 9-13 (Jan. 3, 2011), http://www.issgovernance.com/files/ISS2011USPolicyConciseGuidelines 20110103.pdf.

248. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899-1900 (2010) (to be codified as amended at 15 U.S.C. § 78n-1); *see generally 2011 ISS U.S. Proxy Voting Guidelines Concise Summary*, *supra* note 247.

249. *Evaluation of Executive Pay (Management Say-on-Pay) (US*)*, INSTITUTIONAL SHAREHOLDER SERVS., http://www.issgovernance.com/policy/2012comment/MSOP (last visited Jan. 15, 2012) [hereinafter *Evaluation on Executive Pay*].

250. *See U.S. Corporate Governance Policy 2012 Updates*, *supra* note 240, at 9-11; *Evaluation of Executive Pay*, *supra* note 249. After ISS gave its recommendations for the 2011 proxy season, corporations that received a no-recommendation disputed it and provided information to shareholders regarding the incorrectness of ISS decisions. *See, e.g.*, Exxon Mobil Corp., Proxy Statement-Definitive Additional Materials (Form DEFA14A) (May 6, 2011). In those SEC filings, many companies attacked the peer groups by which ISS compared each company's executive compensation package. *See, e.g.*, J.C. Penney Co., Proxy Statement-Definitive Additional Materials (Form DEFA14A) (May 3, 2011). Others criticized ISS's failure

While this formula-to-recommendation process appears to be harmless because it merely guides shareholders in making their own decisions, ISS's recommendations influence both the voting decisions of the shareholders and the actions of the shareholders after the vote.[251] As discussed earlier, only 9.4% of shareholders voted contrary to ISS recommendation.[252] Shareholders who agree with ISS's no-recommendations vote accordingly, but in instances where corporations did not receive a negative vote in light of the no-recommendation, shareholders have brought derivative suits claiming that executive compensation was excessive, an idea likely planted by the no-recommendation.[253]

Because corporations have seen the potential effects these recommendations have on shareholders, companies will likely conform their decision-making processes to satisfy the factors used by these advisory firms in determining if a corporation passes or fails.[254] By conforming to this formula, corporations will garner a positive recommendation from ISS, which will likely prompt shareholders to approve of the executive compensation plans as seen in the 2011 proxy season.[255] Furthermore, companies will avoid a negative recommendation, which, if received, has the potential to cost the corporation great sums of money defending derivative litigation.[256] Consequently, the decision-making process for formulating executive compensation will no longer be based on good business judgment, but on a checklist.[257]

The potential for this checklist to encourage the board to deviate from decisions that encompass good business judgment in later years was exposed during the 2011 proxy season. ISS recommended that shareholders vote no for Hercules Offshore Inc.'s executive compensation package in the 2011 proxy season because the executives were paid more than the company's performance allegedly should have allowed.[258] What ISS failed to consider, however, was the impact that the BP oil spill and the resulting halt on offshore

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to consider outside influences, like the global economy, on the corporate earnings. *See, e.g.*, Allegheny Technologies Inc., Proxy Statement-Definitive Additional Materials (Form DEFA14A) (Apr. 12, 2011). While some corporations overcame ISS's negative recommendations through their rebuttals, not all companies were as fortunate. *See* Robert McCormick et al., *Say on Pay—Preparing for Year Two*, PEARL MEYER & PARTNERS 3 (Sept. 20, 2011), http://www.pearl meyer.com/Pearl/media/PearlMeyer/PDF/PMP-PPT-NACD-NorCal-SOP-EsserWetzel-09-20-11.pdf. Many, after receiving a negative vote, became parties to derivative litigation. *See infra* Part V.B.

251. *See* Kamonjoh, *supra* note 120.

252. *Id.*

253. *See, e.g.*, Summons, *Ralph Lauren*, *supra* note 227, at 15-16.

254. *See* Bainbridge, *supra* note 141, at 1802, 1810-11.

255. *See* Kamonjoh, *supra* note 120.

256. *See supra* Part V.B.3.

257. *See* Bainbridge, *supra* note 141, at 1802, 1810-11.

258. *See* Complaint, *Hercules Offshore*, *supra* note 182, at 12-20; Hercules Offshore, Inc., Preliminary Proxy Statement (PRE 14A) 23-46 (Mar. 16, 2012) [hereinafter Hercules Offshore, Preliminary Proxy Statement].

drilling in the Gulf of Mexico—events completely outside of the control of Hercules—had on the company's performance.[259] If the board had decided to pay the executives less simply because their corporation had suffered a loss, not because the executive had performed poorly, the executive would likely be able to find better pay at a competing corporation.[260] ISS, however, did not consider this outside influence when recommending that shareholders vote no.[261] To avoid this outcome in the future, boards will automatically decide to lower compensation if their corporations' profits decrease one year in order to satisfy the checklist, even if that decision leads to the company losing a valuable executive.

For the 2012 proxy season, ISS has updated its recommendation policies, perhaps recognizing the errors in not accounting for subjectivity along with many other flaws.[262] For instance, ISS in 2012 will consider "special circumstances" such as recruiting a new executive, but the advisory firm emphasized the limitations this factor will have.[263] Because ISS was adamant in restricting the reach of this factor before it could be tested, the advisory firm will likely be hesitant in allowing the special circumstances to actually affect the recommendation.[264]

Unfortunately, ISS's efforts to revise its methodology will not reverse the damage initiated by the recommendations in the 2011 proxy season. While some corporations overcame ISS's negative recommendations through providing shareholders with information about ISS's faulty formula, not all companies were as fortunate.[265] Many companies, after receiving a negative vote, were sued by their shareholders.[266] Even if a negative ISS recommendation is overcome and a positive vote is received, corporations may still be sued by shareholders.[267] Thus, the consequences of that negative recommendation have appeared even after corporations received a high say-on-pay voting result, demonstrating the power of ISS's formula and recommendations.[268]

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259. *See* Hercules Offshore, Preliminary Proxy Statement, *supra* note 258, at 23-46; *U.S. Corporate Governance Policy 2012 Updates*, *supra* note 240. *See generally* Steve Hargreaves, *Offshore Drilling: Slow Comeback After BP*, CNNMONEY (April 20, 2011, 11:27 AM), http://money.cnn.com/2011/04/20/news/economy/bp_oil_spill_drilling/index.htm.

260. *See* Hercules Offshore, Preliminary Proxy Statement, *supra* note 258.

261. *See U.S. Corporate Governance Policy 2012 Updates*, *supra* note 240, at 9-11; Hercules Offshore, Preliminary Proxy Statement, *supra* note 258.

262. *See* Gary Hewitt & Carol Bowie, *Evaluating Pay-for-Performance Alignment: ISS Quantitative and Qualitative Approach*, INSTITUTIONAL SHAREHOLDER SERVS. 11-12 (Dec. 20, 2011), http://www.issgovernance.com/sites/default/files/EvaluatingPayForPerformance_20111219.pdf (explaining the revisions and the new factors that will be considered during the 2012 proxy season).

263. *Id.*

264. *See id.*

265. *See* McCormick, *supra* note 250, at 14.

266. *See supra* Part V.B.3.

267. *See, e.g.*, Summons, *Ralph Lauren*, *supra* note 226, at 15-16.

268. *See, e.g.*, *id.*

If Congress had drafted the say-on-pay provision, mindful of its potential consequences, the harm caused by the proxy advisory firms' objective formulas would have been avoided. Instead, profit-seeking advisory firms and misinformed shareholders are persecuting corporations, and at least one court has allowed it based on its own interpretation of the say-on-pay provision.[269] If this law remains unchanged, shareholders will continue to sue, and corporations will likely lose the power to fight against the recommendation submitted by ISS because ISS's formula for executive compensation will become the industry standard.

## VII. HOW TO FIX A "QUACK" LAW

The problems created by listening to a person who wore a chicken suit are expansive and have affected corporations across the nation. Because the issues that Congress released have had a negative impact on the business community, Congress must address these unintended consequences quickly. The most effective means of reversing the damage Congress caused is repealing the say-on-pay provision. If, however, an outright repeal is too drastic, Congress and the SEC should amend the law and the rules to guide corporations and restrict the actions of shareholders and proxy advisory firms.

### *A. Repeal the Law*

Because of the problems with say-on-pay discussed above, Congress should repeal the say-on-pay law. While executive compensation may be abused in some circumstances, Congress should have diligently researched the issues and other say-on-pay models before frantically responding to the financial crisis of 2008 to soothe the public outrage about the amounts executives were paid.[270] In their research, Congress likely would have found the disconcerting problems created by the program they were seeking to enact.[271] These problems include proxy advisory firms' manipulation of the say-on-pay process according to their own interpretation of the law and shareholders consenting to the proxy advisory firms' takeover by following their recommendations.[272] As a result, the shareholders voices have been replaced by the ideas of firms like ISS.[273] But the proxy advisory firms are not the only system-abusers; shareholders have also interpreted the law according to their desires.[274] Consequently, they have sued corporations for not obeying the

269. *See supra* Part V.B.3.c.ii.
270. *See supra* Part VI.A.
271. *See supra* Part VI.
272. *See supra* Part VI.B.2.
273. *See* text accompanying notes 223-27; *supra* Part VI.B.2.
274. *See supra* Part VI.B.1.

shareholders' interpretation.[275] Because Congress enacted the law before understanding that these problems were likely to result, they should repeal the law and leave the issue of executive compensation to the states, as was traditionally accepted.[276]

Repealing the say-on-pay law would not be a drastic, unexpected congressional action at the present time because the country after which the U.S. system was modeled is also reconsidering its say-on-pay law.[277] After ten years of observing the ineffectiveness of the say-on-pay law in the U.K., the Prime Minister stated his intent to make the shareholder vote binding on boards of directors.[278] Because the U.S. does not allow shareholders to decide executive compensation issues, Congress should not follow the U.K.'s example in moving towards a binding vote.[279] Instead, it should repeal the law entirely because the say-on-pay provision fails to achieve its intended result, as evidenced by the U.K.'s decision to change the law after ten years of its implementation.[280]

### *B. Amend the Law*

In the alternative, if an outright repeal is unachievable, Congress should amend the language of the law. The new law should include explicit limitations on shareholders and proxy advisory firms. It should also require clearer voting-results instructions and provide guidance for corporations receiving the results. By drafting new language to include direction and restriction, many of the unintended consequences of the poorly drafted law will not continue into the next proxy season.

#### *1. Restrictions on Shareholders*

Under § 951(c), the Rule of Construction, in the Dodd-Frank Act, shareholder votes are non-binding and cannot be "construed (1) as *overruling a decision* by . . . [the] board of directors" or "(2) to *create or imply any change to the fiduciary duties* . . . [of the] board of directors."[281] This

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275. *See supra* Part VI.B.1.

276. *See generally* E. Norman Veasey et al., *Federalism vs. Federalization: Preserving the Division of Responsibility in Corporation Law*, *in* CORP. LAW 1543, at 221, 231 (PLI Corp. & Law Handbook Servs. No. 8423, 2006) ("Congress and the SEC should leave the states to regulate the internal affairs of businesses and return to their own area of expertise: ensuring that public companies present uniform, and uniformly vetted, information to the capital markets.").

277. *See* Treanor, *supra* note 58.

278. *See id.*

279. *See id.*

280. *See id.*

281. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1900 (2010) (to be codified as amended at 15 U.S.C. § 78n-1) (emphasis added).

language, however, inadequately insulated boards from shareholder abuse of the voting results in the 2011 proxy season.[282] Not only did the shareholders express to their boards the expected response to the voting results, but shareholders also filed derivative litigation if the board failed to react properly to the vote.[283]

Because the limiting language failed to achieve its intended purpose of protecting boards, Congress should amend the law to include more explicit restrictions on shareholder reaction to the voting results. It should expound on the language already present in "(c) Rule of Construction" and include the following restriction on the use of voting results: (5) construed as evidence in a derivative suit alleging misconduct by a board of directors.[284] This limitation will prevent shareholders from ignoring the intent of Congress that the votes should be advisory by removing the possibility of litigation based on the voting results.

While some may argue that shareholders should be allowed to present the vote as evidence in a derivative suit, the language of the law indicates that Congress did not intend for this result.[285] Permitting shareholders to bring say-on-pay litigation shifts the final decision-making power to the shareholders of a successful suit and binds the board of directors to an executive compensation decision of which it did not approve; current law accepts neither result.[286] Therefore, Congress should amend the law to include the proposed restricting language to prevent shareholders from making executive compensation decisions through litigation.

### *2. Restrictions on Proxy Advisory Firms*

During the 2011 proxy season, shareholders were not the only abusers of the poorly drafted say-on-pay provision; proxy advisory firms such as ISS seized control of the voting process by providing recommendations to shareholders.[287] These recommendations acted as a script for shareholders to voice ISS's decision.[288] In future years, the ability of boards to decide executive compensation issues will shift to proxy advisory firms because the firms control the voice of the shareholders.[289]

In order to protect shareholders voices and board members' decision-making power, the amended language of the say-on-pay provision should

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282. *See supra* Parts V.B.3 & VI.B.1.

283. *See supra* Part VI.B.1.

284. *See* § 951, 124 Stat. at 1900.

285. *See id.*

286. *See id.*; Aronson v. Lewis, 473 A.2d 805, 811-12 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000).

287. *See supra* Part VI.B.2.

288. *See supra* Part VI.B.2.

289. *See* Bainbridge, *supra* note 141, at 1802, 1810-11; *supra* Part VI.B.2.

restrict proxy advisory firms' pre-vote interaction with shareholders. Congress should add a section to the provision that states: "Proxy advisory firms cannot provide shareholders with voting recommendations prior to the shareholder vote on executive compensation." This prohibition will enhance shareholders' voices by shielding them from improper influence.[290] Once the board has received the say-on-pay results from a given proxy season, then proxy advisory firms should be allowed to submit a recommendation to the corporations.

Although many may contend that shareholders have insufficient knowledge to vote without guidance, the disclosures that corporations must provide contain adequate information for the shareholders to decide if they agree or disagree with the amount their executives received.[291] Furthermore, removing these firms from the pre-vote process will maintain the purity of shareholders' voices, conveying the shareholders' true opinions to the board instead of re-announcing the proxy advisory firms' recommendations.[292]

Moreover, the proposal to eliminate the advisory firms from the pre-vote process will not remove the firms from the process entirely. Rather, the firms will still draft recommendations, but they will present this information directly to the board after the vote, instead of through the shareholder vote. This guidance from proxy advisory firms will contain beneficial information for future board decisions, and the post-submission will prevent the board from relying on the firms' formula because the shareholders will not depend on the formula-created recommendation during the vote.[293]

### *3. Breakdown of Voting Results & Corporate Reaction to a Negative Vote*

Along with protecting shareholders' voices from proxy advisory firms' influence, shareholder say will be further enhanced by preventing significant institutional investors from muting the voices of shareholders who have less power.[294] To achieve this balance, the SEC should amend the implementing rules to require that the voting results be categorized based on each type of shareholders' overall vote. For example, if a single, majority shareholder approved of the executive compensation package but the majority of other shareholders disagreed, then the board should receive the voting results categorized to reflect that divergence. Thus, even though the overall vote of all shareholders may only reflect the majority shareholder's vote, the board will understand that the other shareholders disagreed.

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290. *See supra* Part VI.B.2.

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

292. *See* text accompanying footnotes 250-52.

293. *See supra* Part VI.B.2. Because this proposal only affects the timing of certain events and does not substantially change the voting process, the cost of implementation will be minimal.

294. *See supra* notes 231-35 and accompanying text.

In addition to requiring votes to be categorized, the SEC should recommend that the board examine the breakdown of the voting results and identify the particular types of shareholders who overwhelmingly disapproved of the executive compensation plan. If the board determines that the majority of one group returned a negative vote, the board should conduct a general meeting and consult with the shareholders who disapproved about which piece of the executive compensation plan they disapproved. This consultation will achieve the goal of providing shareholders with a true say on executive compensation and will furnish the board with valuable information regarding improvements of the executive compensation plans for the next year.

Because this proposal requires the corporation to take additional action regarding the voting results, the cost of implementation may be significant. The benefits, however, of supplying the board with this in-depth information will outweigh the cost. First, the board will have the opportunity to study the results and ensure that it is maintaining other shareholders' satisfaction with the company and not just the single, majority shareholder's approval. Based on this information, the board will have a better understanding of shareholder opinions when deciding executive compensation issues in the future.

Second, the shareholders themselves will benefit from the proposal because of the recommended consultation process. By allowing the shareholders to express their actual concerns instead of a general yes or no, their opinions will be more effective in influencing the board. Furthermore, the shareholders will not turn to expensive litigation, but instead, they will have the ability to discuss their thoughts with the board, outside of the courtroom. Therefore, any cost the proposal might cause will be outweighed by the benefits of the new process and the avoidance of litigation.

## VIII. CONCLUSION

Because Congress failed to fully develop the goals of say-on-pay and to consider the potential consequence of the provision, the law does not provide guidance for the parties it actually affects—the corporations and the shareholders. Furthermore, the say-on-pay provision does not dictate specific limitations on the actions of third parties such as ISS, which will allow these parties to control the decisions of corporations. Thus, the say-on-pay provision should be repealed.

If, however, the provision is not repealed, the language should be amended to include guidance for corporations and limitations for other parties. First, language should be included in the provision that prevents shareholders from suing based on the voting results.[295] Second, proxy advisory firms' involvement in the say-on-pay process should be limited to a post-vote

295. *See supra* Part VII.B.1.

recommendation to enhance shareholders' voices and to protect the boards' ability to make decisions based on good business judgment, not a proxy advisory firm's formula.[296] Third, instead of receiving a general yes or no vote, corporations should receive a breakdown of the type of shareholder-voter results; then, the board should determine if a consultation of particular group of shareholders should be conducted to understand their disapproval.[297] With these alterations, the unintended consequences will fade, and the say-on-pay practice may begin to affect change.

296. *See supra* Part VII.B.2.
297. *See supra* Part VII.B.3.

# A WIND(OW) OF OPPORTUNITY: WHY TEXAS IS IN THE BEST POSITION TO DEVELOP OFFSHORE WIND ENERGY

Comment

*Lauren Murphree**



## I. TURNING THE BIG BLUE GREEN

Currently, the United States faces political, economic, and environmental pressure to diversify its fuel sources due to the risks presented by heavy reliance on foreign fuels.[1] At the same time, to meet the

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1. *See* U.S. DEP'T OF ENERGY, 20% WIND ENERGY BY 2030: INCREASING WIND ENERGY'S CONTRIBUTION TO U.S. ELECTRICITY SUPPLY 1 (2008), [hereinafter 20% WIND ENERGY BY 2030]

country's growing demand for electricity, the United States must increase its electricity supply by 22.5% by the year 2035.[2] As a result, industry leaders are turning to alternative energy sources and exploring unchartered territory.[3] Fortunately, an estimated 900,000 megawatts (MWs) of wind energy exists off of the United States coastline—an untapped resource that presents an opportune solution for the industry's needs.[4] Offshore wind energy presents several advantages over onshore wind energy and traditional fuels.[5] Notably, offshore wind energy emits fewer greenhouse gases than traditional energy producers, has the potential to create tens of thousands of long-term jobs, and is located closer to the majority of the United States population than onshore wind resources.[6] Analysis of European success with offshore wind energy development illuminates the importance of centralized planning and effective economic incentives in meeting renewable energy quotas.[7] Conversely, analysis of the hopelessly flawed and stalled Cape Wind project in the United States sheds light on the shortcomings of America's federal regulatory scheme.[8]

Complementary to the EU's centralized renewable energy regulatory scheme are the individual member states' national goals, financial incentives, and mandates for renewable energy.[9] It follows that an integral part of Texas's success will be the ability to create a favorable environment for offshore wind development in the state, independent of the federal government.[10] Texas played a leading role in the energy market, and its continued pioneering of onshore wind energy, makes it seem natural, if not likely, that Texas will be among the "first in the water" to develop offshore

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*available at* http://www1.eere.energy.gov/wind/ pdfs/41869.pdf; WALTER MUSIAL & BONNIE RAM, NAT'L RENEWABLE ENERGY LAB., LARGE-SCALE OFFSHORE WIND POWER IN THE UNITED STATES 10 (2010), *available at* http://www.nrel.gov/docs/fy10osti/40745.pdf (noting the dwindling supply of fossil fuels that are increasingly imported from unreliable nations).

2. U.S. DEP'T OF ENERGY, 2010 WIND TECHNOLOGIES MARKET REPORT 5 (2011), [hereinafter 2010 WIND TECHNOLOGIES MARKET REPORT] *available at* http://www1.eere.energy.gov/wind/pdfs/51783.pdf.

3. *See* WALTER MUSIAL & SANDY BUTTERFIELD, NAT'L RENEWABLE ENERGY LAB., FUTURE FOR OFFSHORE WIND ENERGY IN THE UNITED STATES 1 (2004), *available at* http://www.nrel.gov/docs/fy04osti/36313.pdf.

4. *Id.* at 4.

5. *See* Erica Schroeder, *Turning Offshore Wind On*, 98 CALIF. L. REV. 1631, 1639 (2010).

6. *See* President Barack Obama, Earth Day Speech (Apr. 22, 2009), http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-in-Newton-IA [hereinafter Earth Day Speech]; Schroeder, *supra* note 5, at 1640.

7. *See* discussion *infra* Part II.B (explaining the successful evolution of the European offshore win energy industry).

8. *See* Dominic Spinelli, *Historic Preservation & Offshore Wind Energy: Lessons Learned from the Cape Wind Saga*, 46 GONZ. L. REV. 741, 743 (2011); *see also* discussion *infra* Part II.C (explaining the impact of a fractured federal regulatory scheme in delaying the United States' first proposed wind farm for over a decade).

9. *See* Brian Snyder & Mark J. Kaiser, *A Comparison of Offshore Wind Power Development in Europe and the U.S.: Patterns and Drivers of Development*, 86 APPLIED ENERGY 1845, 1850 (2009).

10. *See* discussion *infra* Part VI.B (explaining the proposal for Texas's offshore wind industry).

wind energy.[11] In addition to its history as an energy leader, Texas retains within its jurisdiction an additional six miles off of its coastline.[12] This means that offshore wind farm developments will be primarily subject only to state regulations, thereby avoiding the confusion that stalled the Cape Wind project for so long.[13] Championing the industry will not come without a fair amount of sweat equity, however, because formidable opponents remain even after regulatory impediments are overcome.[14] Environmental concerns, aesthetic opposition, and cost hindrances may block development just as easily as poor legislating has.[15]

Consequently, forethought and centralized planning are critical to the United States and Texas's success in developing a viable offshore wind industry.[16] In addition to favorable legislation, economic incentives and a statewide commitment to the development of offshore wind energy will aid the industry's growth within the state by bolstering arguments in favor of the industry instead of cultivating opposition.[17]

This Comment will compare and contrast the successes and failures of the European offshore wind industry with the United States' and offer solutions for Texas moving forward. Part III of this Comment will discuss the federal regulations affecting offshore wind in the United States in depth, while Part IV will primarily address Texas's statutory environment, as well as its energy history in general, and wind energy history specifically. Part V briefly covers additional barriers to the development of offshore wind in the United States and Texas. Lastly, Part VI presents a recommendation for both the Federal and Texas legislatures moving forward, with an emphasis on avoiding the mistakes made in the Cape Wind project and capitalizing on inherent advantages in Texas law. The analysis will show that cooperation is key to completing the transition from blue American waters to green.

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11. *See* Jesse Jenkins, *Texas Offshore Wind Energy Project Poised to be 'First in the Water'*, THE ENERGY COLLECTIVE (June 9, 2011), http://www.theenergycollective.com/jessejenkins/58832/texas-offshore-wind-energy-project-poised-be-first-in-water.

12. *See* United States v. Louisiana, 363 U.S. 1, 65 (1960); *see also infra* notes 104-14 and accompanying text (explaining Texas's jurisdictional history).

13. *See* Press Release, TOWER Conference 2011, Texas Close to Get the Nation's First Offshore Wind Farm (Aug. 10, 2011), [hereinafter TOWER Conference 2011] http://tower-conference.com/fileadmin/ahk_usa/Dokumente/Press/Press_2011/180810_1st_Press_Release_TOWER_JZ.pdf.

14. *See* discussion *infra* Part V (explaining the environmental, political, and economic barriers to expansion).

15. *See* discussion *infra* Part V (explaining the environmental, political, and economic barriers to expansion).

16. *See* Schroeder, *supra* note 5, at 1639.

17. *See id.*; Benjamin Nussdorf, *Emulating Europe: Setting a Course for Offshore Renewable Energy*, 25 NAT. RESOURCES & ENV'T 29, 29 (2011).

## II. THE WIND PATTERN THUS FAR

Despite the global financial crisis and an overall reduction in energy demand, cumulative wind power generation in the United States grew by 15% in 2010 and is projected to continue growing.[18] This growth is undoubtedly intentional and can be attributed in part to legislative support at both the federal and state levels.[19] President George W. Bush, in his 2007 State of the Union Address, stressed:

> It is in our vital interest to diversify America's energy supply, and the way forward is through technology . . . . Let us build on the work we have done and [set a goal to] reduce gasoline usage in the United States by 20 percent in the next 10 years . . . . To reach this goal, we must increase the supply of alternative fuels . . . . Achieving these ambitious goals will dramatically reduce our dependence on foreign oil . . . .[20]

As part of a collaborative effort on the heels of President Bush's broad directive, the Department of Energy, in 2008, called for a national goal of 20% wind energy by the year 2030.[21] Then, in response to elevated energy prices, environmental pressures, and supply uncertainties, Congress further promoted the wind industry through the American Recovery and Reinvestment Act of 2009, which renewed production tax credits for wind energy projects through 2012.[22] The tax credits represent a continued commitment to the national goal of diversifying energy sources and developing clean, renewable energy by extending benefits to the marine renewable industry.[23]

President Barack Obama continued the trend of support and openly addressed the need for more renewable energy development in his 2010 State of the Union Address: "[P]roviding incentives for energy efficiency and clean energy are the right thing to do for our future, because the nation that leads the clean energy economy will be the nation that leads the global economy. And America must be that nation."[24] Currently, industry leaders

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18. *See* 2010 WIND TECHNOLOGIES MARKET REPORT, *supra* note 2, at 5.

19. *See* American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5 §§ 1101-02, 1603, 123 Stat. 319, 364 (codified as amended at I.R.C. § 45 (West 2011)); *see also* Tex. S.B. 20, 82d Leg., R.S. (2011) (relating to grant programs for certain natural gas motor vehicles and alternative fuel facilities).

20. President George W. Bush, State of the Union Address (Jan. 23, 2007), *available at* http://georgewbush-whitehouse.archives.gov/stateoftheunion/2007/.

21. *See* 20% WIND ENERGY BY 2030, *supra* note 1, at 1.

22. *See* Schroeder, *supra* note 5, at 1631-32.

23. *Id.*; *Stimulus Bill Promises to Buoy Marine Renewables Industry*, OCEAN RENEWABLE ENERGY COALITION (Feb. 20, 2009), http://www.oceanrenewable.com/2009/02/20/stimulus-bill-promises-to-buoy-marine-renewables-industry (discussing applicable provisions of the stimulus bill that affect marine renewable energy, including offshore wind development).

24. President Barack Obama, State of the Union Address (Jan. 27, 2010), *available at* http://www.whitehouse.gov/the-press-office/remarks-president-state-union-address.

are creating alliances to influence legislation and increase interest in offshore wind energy as part of the energy solution.[25] In his testimony before the House Natural Resources Committee, the Offshore Wind Development Coalition President, Jim Lanard, addressed two specific legislative priorities of the coalition: (1) long-term extension of the Federal Investment Tax Credit and (2) restoration of the Department of Energy Loan Guarantee Program for renewable energy projects.[26] Most recently in 2011, the Department of Energy awarded $43 million to forty-one projects across twenty states to spur offshore wind development, research, and administration.[27]

Many states, including Texas, are similarly establishing their own renewable energy goals and incentives.[28] Texas's Public Utility Regulatory Act, for example, sets a goal of "10,000 megawatts of installed renewable [energy] capacity by January 1, 2025."[29] In 2010, New Jersey passed what is arguably the most innovative state initiative regarding offshore wind.[30] In its incentive package, the New Jersey legislature created not only financial incentives but also a megawatt goal for offshore renewable energy, as well as a streamlined application process.[31] Similarly, a number of private groups have formed to address and overcome barriers to offshore wind energy.[32] Despite this widespread support and recognition of the need for alternative energies, the United States has seen nothing but controversy concerning offshore wind development—one of the country's most plentiful, advantageous, and untouched resources.

### *A. The Case for Offshore Wind*

Marine renewable energy as a whole presents distinct advantages over both onshore renewable energy and traditional energy sources.[33] First, the

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25. *See* American Energy Initiative: Identifying Roadblocks to Wind and Solar Energy on Public Lands and Waters, Part II—The Wind and Solar Industry Perspective: Hearing Before the H. Comm. on Natural Res., 112 Cong. 1-2, 4 (2011), [hereinafter Lanard] *available at* http://www.gpo.gov/fdsys/pkg/CHRG-112hhrg66728/html/CHRG-112hhrg66728.htm. The Offshore Wind Development Coalition is comprised of developers, service providers to the industry, environmental consultants, law firms, the American Wind Energy Association, and more. *Id.* at 1.

26. *Id.* at 4.

27. *Department of Energy Awards $43 Million to Spur Offshore Wind Energy*, U.S. DEP'T OF ENERGY (Sept. 8, 2011, 9:46 AM), http://apps1.eere.energy.gov/news/daily.cfm/hp_news_id=323.

28. *See* TEX. UTIL. CODE ANN. § 39.904(a) (West 2007); Gregory K. Lawrence, *The Race Is On: N.J. Legislature Passes Offshore Wind Incentive Package*, 15 GREEN ENERGY NEWS NO. 16 (July 9, 2010), http://www.green-energy-news.com/contribute/articles2010/2010sub003.html.

29. UTIL. § 39.904(a).

30. *See* Lawrence, *supra* note 28.

31. *Id.*

32. *See* MUSIAL & RAM, *supra* note 1, at 34 (discussing the U.S. Offshore Wind Collaborative, American Wind Energy Association Offshore Wind Working Group, Offshore Wind Development Coalition, and more).

33. Peter J. Schaumberg & Ami M. Grace-Tardy, *The Dawn of Federal Marine Renewable Energy*

waters off of the United States' coastlines offer steadier and more powerful wind resources.[34] Thus, for the same amount of technology, offshore wind reaps increased production and greater benefits than onshore wind.[35] Cumulatively, the United States' offshore wind resource is approximated at almost four times the electric capacity currently on the United States' electric grid.[36] Secondly, once installed, wind farms emit fewer greenhouse gases and air pollutants than traditional fuel sources.[37] While the minimal environmental impacts of wind energy production apply to both on-and-offshore wind energy, onshore wind energy is naturally produced far from population centers, whereas offshore wind tends to be located closest to the country's population centers—the coastline.[38] In fact, 75% of the United States' population is expected to live near the coast by 2025.[39] As opposed to onshore wind farms, which are typically located in rural areas far from population centers, offshore wind farms can deliver energy to high population areas without the need for an extensive transmission system, thereby avoiding higher costs and an increased carbon footprint.[40] Lastly, expanding any industry creates jobs.[41] President Obama recognized this valuable potential in his 2009 Earth Day Speech:

> It's estimated that if we fully pursue our potential for wind energy on land and offshore, wind can generate as much as 20 percent of our electricity by 2030 and create a quarter-million jobs in the process . . . jobs that pay well and provide good benefits. It's a win-win: It's good for the environment; it's great for the economy.[42]

Lest one infer that federal support is single-handedly turning the United States' waters green—a look beyond the words in speeches and statutes reveals that federal legislation is precisely where the problem lies and why Texas holds a superior advantage.

### *B. Europe: Leading by Example*

While the United States led the world in installed onshore wind capacity through 2010, falling only to China at the turn of 2011, it has

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*Development*, 24 NAT. RESOURCES & ENV'T 15, 15 (2010).

34. MUSIAL & BUTTERFIELD, *supra* note 3, at 3-4.
35. *See id.*
36. MUSIAL & RAM, *supra* note 1, at 1.
37. Schroeder, *supra* note 5, at 1639.
38. *See id.* at 1640.
39. Schaumberg & Grace-Tardy, *supra* note 33, at 16.
40. *See id.*; MUSIAL & BUTTERFIELD, *supra* note 3, at 3.
41. *See* Earth Day Speech, *supra* note 6.
42. *Id.*

generated no offshore wind capacity to date.[43] Instead, Europe first pioneered offshore wind and continues to be the leader with over 3,000 MW of installed offshore wind capacity.[44] As of June 2011, Europe had a total capacity of 3,924 MW operating in forty-nine wind farms throughout the continent.[45] Much of Europe's success in the offshore renewable energy arena is attributable to the comprehensive legal framework, created by the European Union (EU) in 2001, that imposes mandatory national targets on member nations.[46] Notably, the EU was able to bring the Thanet Offshore Farm—one of the world's largest offshore farms—online in just under four years.[47] Not only is Europe leading the industry in capacity, but also it leads in technology as well.[48] In the first half of 2011, Europe was able to increase average capacity per turbine, using fewer turbines, due to advanced technology and larger machines.[49] Europe is also expanding both the size of its wind farms and the depth of the water in which the turbines stand.[50]

The EU has demonstrated a unified commitment to thwarting climate change and increasing renewable energy for a number of years, as is evidenced by its participation in treaties such as the Kyoto Protocol, the Maastricht Treaty of 1992, and the Amsterdam Treaty of 1997.[51] To meet the mandated emissions reductions in the treaties, member nations set goals and offered financial incentives through tax credits, feed-in tariffs, credits, tenders, grants, and carbon taxes.[52] In particular, the feed-in tariff, thought

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43. *See* Wu Qi, *China Takes Total Capacity to 41.8GW*, WIND POWER MONTHLY (Jan. 13, 2011, 2:50 PM), http://www.windpowermonthly.com/news/rss/1049368/China-takes-total-capacity-418GW/ (indicating that China's installed wind capacity is up 62% over 2010); *see also* MUSIAL & RAM, *supra* note 1, at 34.

44. EUROPEAN WIND ENERGY ASS'N, THE EUROPEAN OFFSHORE WIND INDUSTRY – KEY TRENDS AND STATISTICS: 1ST HALF 2011 (2011), *available at* http://www.ewea.org/fileadmin/ewea_documents/documents/00_POLICY_document/Offshore_Statistics/20112707OffshoreStats.pdf.

45. *Id.*

46. *See* Nussdorf, *supra* note 17, at 29. *See generally* EUROPEAN WIND ENERGY ASS'N, *supra* note 44, at 2-3 (describing the key aspects of the renewable energy directive).

47. *See* Nussdorf, *supra* note 17, at 29 (noting that "[t]his project is illustrative of how the [EU] is planning, approving, and building offshore wind farms in roughly half the time it takes simply to get regulatory approval in the United States"). Beyond the scope of this Comment, but an important side effect, is that the EU's lead in the industry leaves American manufacturers—such as General Electric—at a serious disadvantage, causing them to lose bids in the United States to European manufacturers—such as Siemens and Vestas—who have offshore experience. *See id.*

48. *See generally* EUROPEAN WIND ENERGY ASS'N, *supra* note 44, at 2-3 (describing the particular technologies utilized by European countries' offshore wind farms).

49. *See id.*

50. *See* Snyder & Kaiser, *supra* note 9, at 1846.

51. *See* Nussdorf, *supra* note 17, at 30; Kyoto Protocol to the United Nations Framework Convention on Climate Change, Dec. 11, 1997, 2303 U.N.T.S. 162, http://unfccc.int/resource/docs/convkp/kpeng.pdf; Treaty on European Union and Final Act, Feb. 7, 1992, 31 I.L.M. 247; Treaty of Amsterdam Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts, Oct. 7, 1997 O.J. (C 340) 1; Snyder & Kaiser, *supra* note 9, at 1845-48, 1850.

52. *See* Snyder & Kaiser, *supra* note 9, at 1850 (describing the feed-in tariff as the price submitted by the developer, thereby assuring profitability of the project).

by many to be the most beneficial to the industry, provides more certainty to developers than traditional federal incentives and programs in the United States because contracts are awarded based on a guaranteed price.[53] Additionally, European regulatory schemes encourage and expedite offshore development.[54] The central planning efforts of the member nations speed development by offering a streamlined process and stipulating minimal fees for use of the seabed.[55]

Promotion of renewable energy has also played a crucial role in the EU.[56] Member countries typically select a framework for implementation and then connect that framework with political tools such as subsidies, tax exemptions, or information campaigns to promote the industry.[57] While the individual countries' planning procedures, incentives, and goals vary greatly throughout the nations, the EU's unified commitment to renewable energy development is the driving force behind its success.[58] At the other end of the spectrum, the lack of such a commitment is a primary reason why the United States has not experienced similar success.[59]

### *C. The U.S. Offshore Experience: Cape Wind*

It is widely acknowledged that the United States has led the world in onshore wind energy, yet this edge has not translated to offshore development.[60] Along with unprecedented federal support of the industry, however, the United States has seen a recent increase in interest in offshore wind development.[61] The infamous Cape Wind project was first proposed in 2001, only to endure federal jurisdictional issues and state and local opponents for over nine years.[62] The Cape Wind project remained the only player in the game while other developers sat by watching, taking notes, and waiting for a move from the federal government.[63] In 2010, however, eight offshore wind developers bid to lease land off the coast of Maryland and more than twenty projects nationwide are in the planning and permitting process.[64] Most illustrative of the current state of the United States' offshore production, though, is the Cape Wind project.

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53. *See id.*; Danyel Reiche & Mischa Bechberger, *Policy Differences in the Promotion of Renewable Energies in the EU Member States*, 32 ENERGY POL'Y 843, 843-45 (2004).

54. *See* Snyder & Kaiser, *supra* note 9, at 1851.

55. *Id.* at 1846 (contrasting the minimal seabed use fees in Europe with the royalties required in the United States that affect the profitability of projects).

56. Reiche & Bechberger, *supra* note 53, at 846.

57. *Id.*

58. *See id.* at 843-45.

59. *See infra* notes 184-189 and accompanying text.

60. See MUSIAL & RAM, *supra* note 1, at 7-10, 24.

61. *Id.*

62. *See* Spinelli, *supra* note 8, at 742-43; *see also* Nussdorf, *supra* note 17, at 30.

63. *See* Spinelli, *supra* note 8, at 742-43.

64. *See* Lanard, *supra* note 25, at 2; MUSIAL & RAM, *supra* note 1, at 24.

Cape Wind Associates proposed to develop a 420 MW wind farm in 2001 in the Nantucket Sound in Massachusetts.[65] As the first proposed offshore wind farm in the United States, every move made by all of the players involved was novel and unprecedented. Not long after its proposal, Cape Wind faced its first challenge when the Army Corps of Engineers took control of the permitting process of what was thought would be the first offshore wind farm in the country.[66] A group of Massachusetts taxpayers, known as Ten Taxpayers, claimed that the project needed a state fisheries permit because, even though the project was to be located in federal waters, the activities would affect state fish.[67] The First Circuit ultimately held that the federal government had jurisdiction under the Outer Continental Shelf Act and denied the Ten Taxpayer's claim.[68] Unfortunately for Cape Wind Associates, *Ten Taxpayers* would not be the last jurisdictional battle they would face.[69]

The Cape Wind project faced its second obstacle with the "Not in My Backyard," or "NIMBY," groups.[70] Interest groups such as the Alliance to Protect Nantucket Sound and Ocean Public Trust Initiative of Earth Island that opposed the Cape Wind project proved to be formidable opponents to the project, and support from individuals such as former U.S. Senator Edward Kennedy, former Massachusetts Governor Mitt Romney, and various other powerful Massachusetts public figures only bolstered their efforts.[71] Focused primarily on environmental concerns, the Alliance to Protect Nantucket Sound brought suit against the Army Corps of Engineers in 2003.[72] Namely, the Alliance alleged that the Army Corps of Engineers was not in proper compliance with the National Environmental Policy Act.[73] The Army Corps, which had continued the permitting process in spite of the legal uncertainties surrounding the project, prevailed at the district court level and again in the First Circuit.[74]

Not long afterward, Congress passed the Energy Policy Act, which finally granted jurisdictional authority to the Department of the Interior's Mineral Management Service, which then took control of the permitting

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65. *See* Schroeder, *supra* note 5, at 1648-50.

66. *See* Ten Taxpayers Citizen Grp. v. Cape Wind Assocs., 278 F. Supp. 2d 98, 99 (D. Mass. 2003), *aff'd*, 373 F.3d 183 (1st Cir. 2004); *see also* Schroeder, *supra* note 5, at 1650 (discussing the uncertainty surrounding the permitting process when the Cape Wind project began).

67. *See Ten Taxpayers Citizen Grp.*, 278 F. Supp. 2d at 99; Schroeder, *supra* note, 5 at 1651.

68. *See Ten Taxpayers Citizen Grp.*, 373 F.3d at 197; Schroeder, *supra* note 5, at 1651.

69. *See infra* text accompanying notes 72-76.

70. *See generally* Susan Lorde Martin, *Wind Farms and NIMBYS: Generating Conflict, Reducing Litigation*, 40 FORDHAM ENVTL. L. REV. 427, 446 (2010) (describing NIMBY as a term to refer to those who fight against the siting of developments that may adversely affect the community in some way).

71. *See* Spinelli, *supra* note 8, at 748; Schroeder, *supra* note 5, at 1651-52.

72. *See* Alliance to Protect Nantucket Sound, Inc. v. U.S. Dep't of the Army, 398 F.3d 105, 108 (1st Cir. 2005).

73. *See id.*; Schroeder, *supra* note 5, at 1651-52.

74. *See Alliance to Protect Nantucket Sound,* 398 F.3d at 108; Schroeder, *supra* note 5, at 1651-52.

process from the Army Corps of Engineers.[75] In 2009, a new obstacle was brought to the forefront of the project: the Aquinnah and Mashpee Wampanaoag Indian Tribes.[76] Despite series of negotiations with the tribes and stakeholders in Cape Wind, Secretary of the Interior Ken Salazar was unable to allay the tribes' insistence that the Nantucket Sound is sacred tribal ground and should be placed on the National Register of Historic Places—posing a threat of yet another delay.[77] Nonetheless, Secretary Salazar completed the federal siting process in 2010.[78] That same year, Cape Wind successfully negotiated a power purchase agreement for one-half of the electricity the project will produce[79] and is continuing negotiations to reach a second agreement.[80] The Cape Wind project serves two purposes in this analysis: (1) to commend the pioneering and perseverance of the project's proponents and (2) to serve as an example of when the project faced delays (whether self-imposed or as a result of regulations) so that subsequent developers and legislatures may remedy the mistakes that postponed the Cape Wind project for over a decade.

## III. THE UNITED STATES' FEDERAL REGULATORY FRAMEWORK

The decentralized regulatory process facing developers in the United States represents a critical element in the United States' inability to compete on a global level with other nations developing offshore wind energy. To be sure, the Department of Energy is taking great strides to make the permitting process more efficient, but even after settling the jurisdictional dispute between the Army Corps of Engineers and the Minerals Management Service, the regulatory process for renewable energy projects in federal waters is far from ideal.[81] Veritably, almost all statutes governing

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75. *See* Energy Policy Act of 2005, 43 U.S.C. § 1337 (2007); Schroeder, *supra* note 5, at 1651-52. *See generally* Thomas C. Jensen, *Offshore Renewable Energy Development After the Energy Policy Act of 2005* 3 (Mar. 2007) (unpublished paper presented at the American Bar Association Section of Environment, Energy, and Resources 36th Annual Conference on Environmental Law, *available at* http://www.oceanrenewable.com/wp-content/uploads/2007/03/aba-ocs-paper-final.pdf (discussing the chain of authority over offshore permitting).

76. *See* Schroeder, *supra* note 5, at 1652 (citing Graham Jesmer, *Federal Decision Could Make or Break Cape Wind's Future*, RENEWABLEENERGYWORLD.COM (Jan. 20, 2010), http://www.renewable energyworld.com/rea/news/article.2010/01/federal-decision-could-make-or-break-cape-winds-future).

77. *See* Katie Zezima, *Interior Secretary Sees Little Hope for Consensus on Wind Farm*, N.Y. TIMES (Feb. 3, 2010), http://www.nytimes.com/2010/02/03cape.html.

78. *See* Schroeder, *supra* note 5, at 1653.

79. *See* Exec. Office of Energy & Envtl. Affairs, *Department of Public Utilities Approves Contract for Offshore Wind Power*, MASS.GOV (Nov. 22, 2010), http://www.mass.gov/eea/pr-pre-p2/ cape-wind.html.

80. *See* Erin Ailworth, *Cape Wind Seeks Utility Deal Tie-In*, BOSTON GLOBE (Oct. 24, 2011), http://www.boston.com/business/articles/2011/10/04/cape_wind_wants_nstar_northeast_utilities_to_buy _its_power_as_part_of_merger/.

81. *See* Energy Policy Act of 2005, 43 U.S.C. § 1337 (2007); Schroeder, *supra* note 5, at 1651-52. *See generally* Jensen, *supra* note 75, at 2 (stating that U.S. policymakers have not developed a straightforward regulatory system).

the development of offshore wind in the United States were not written with offshore wind in mind, but instead were pieced together from various areas of the law to formulate a piecemeal system of regulation.

### *A. Primary Jurisdiction*

The Department of the Interior holds the ultimate authority and jurisdiction over matters in federal waters under the Outer Continental Shelf Lands Act (OSCLA) as amended by the Energy Policy Act of 2005.[82] The Department of the Interior delegated much authority to the Minerals Management Service (MMS), now the Bureau of Ocean Energy Management, Regulation, and Enforcement (BOEMRE), to oversee non-traditional uses of the Outer Continental Shelf.[83] Additionally, the MMS published its final rule establishing a program to issue leases, rights-of-ways, and easements for renewable energy projects on the Outer Continental Shelf and clearly outlined the responsibilities of the MMS and the Federal Energy Regulatory Committee (FERC).[84] In October of 2011, the MMS split into two divisions: BOEMRE and the Bureau of Safety and Environmental Enforcement.[85] BOEMRE will play the most active role in the siting and regulation of offshore development.[86] Specifically, the Office of Offshore Renewable Energy Programs oversees renewable energy development on the Outer Continental Shelf.[87] To assist potential offshore developers, the Office promulgated a set of initial guidelines, which set out qualification requirements for interested parties, information about the Outer Continental Shelf, lease and grant administration processes and details, pertinent financial information, planning requirements including design and installation, environmental and safety requirements, and lastly, decommissioning requirements.[88] The guidelines present a fairly comprehensive look at the applicable rules and regulations, but they are not all

82. Outer Continental Shelf Lands Act, 43 U.S.C. § 1801 (2007); 43 U.S.C. § 1337.

83. *See* 43 U.S.C. § 1801; Atlantic Wind Energy Workshop, Synopsis of Federal & State Regulatory & Research Activities, at 1 (July 2011), *available at* http://www.boem.gov/offshore/renewableenergy/PDFs/AWEW_Handout.pdf [hereinafter Atlantic Wind Energy Workshop].

84. Renewable Energy and Alternative Uses of Existing Facilities on the Outer Continental Shelf, 74 Fed. Reg. 19,638-871(Apr. 29, 2009). FERC oversees and regulates the wholesale market for electricity, including transmission and grid connection and, under the MMS Final Rule, has exclusive jurisdiction over hydrokinetic projects. *See* FED. ENERGY REGULATORY COMM'N, *Overview of FERC*, www.ferc.gov/ about/overview.asp (last updated Apr. 9, 2012); MINERAL MGMT. SERV. GUIDELINES FOR THE MINERALS MANAGEMENT SERVICE RENEWABLE ENERGY FRAMEWORK 1 (July 2009), *available at* http://www.boemre.gov/offshore/renewableenergy/PDFs/REnGuidebook_03August2009_3_pdf [hereinafter MMS GUIDELINES].

85. *Regulatory Update on Wind Energy Permitting and Development*, 41 ENVTL. L. REP. NEWS & ANALYSIS 10977, 10979 (Nov. 2011).

86. *Id.*

87. *See* Atlantic Wind Energy Workshop, *supra* note 83, at 4.

88. *See* MMS GUIDELINES, *supra* note 84, at 2.

inclusive.[89] As the Cape Wind project demonstrates, federal interests are not the only interests that must be satisfied.[90]

Beyond its initial guidelines, BOEMRE executed Memoranda of Understanding with several federal administrative agencies, such as the National Oceanic and Atmospheric Administration, the Department of Energy, and the U.S. Fish and Wildlife Service.[91] These memoranda help to define respective parties' roles and priorities within the permitting and development process.[92] While the MMS was ultimately granted jurisdiction over offshore wind in federal waters, the Army Corps of Engineers still plays a part insofar as developers are required to obtain a permit from the Corps and are subject to Corps review and regulation of certain structures and work located in, or affecting, the navigable waters of the United States.[93] The United States Coast Guard plays a similar role pursuant to the Ports and Waterways Safety Act, which authorizes the Coast Guard to implement safety and traffic control measures.[94]

### *B. Supplementary Statutory Control*

Beyond the agencies that have jurisdiction over the safety, navigation, and construction in federal waters, the Environmental Protection Agency has significant control over energy structures and providers in the United States and imposes stringent standards upon development.[95] The United States Fish and Wildlife Service plays a complimentary role in ensuring compliance with the Migratory Bird Treaty Act, the Bald and Golden Eagle Protection Act, and the Endangered Species Act.[96] The National Oceanic and Atmospheric Administration also assists agencies in developing environmental review documents under the National Environmental Policy Act (NEPA), and the Council on Environmental Quality provides oversight for all federal agencies affected by NEPA.[97] Likewise, the Federal Aviation

89. *See id.*

90. *See supra* Part II.C.

91. Atlantic Wind Energy Workshop, *supra* note 83, at 2.

92. *See id.*

93. *See, e.g.*, Rivers and Harbor Appropriation Act of 1899 § 10, 33 U.S.C. § 403 (2006).

94. *See* Ports and Waterways Safety Act, 33 U.S.C. § 1221 (2006).

95. *See generally* Clean Water Act, 33 U.S.C. § 1251 (2006) (enumerating the responsibilities of the Environmental Protection Agency regarding the United States' water).

96. *See* Migratory Bird Treaty Act, 16 U.S.C. § 703 (2006); Bald and Golden Eagle Protection Acts, 16 U.S.C. § 668 (2011); Endangered Species Act of 1973, 16 U.S.C. § 1531 (2006); Exec. Order No. 13,186 § 3, 66 Fed. Reg. 3,853 (Jan. 17, 2001).

97. National Environmental Policy Act of 1969, 42 U.S.C. § 7401 (2011); Environmental Quality Improvement Act of 1970, 42 U.S.C. § 4371 (2011). The number of environmental protection statutes that require compliance is seemingly endless. *See, e.g.*, Endangered Species Act, 16 U.S.C. § 1531; Marine Mammal Protection Act of 1972, 16 U.S.C. § 1361 (2006); Magnuson-Stevens Fishery Conservation and Management Act of 1976, 16 U.S.C. § 1341 (2006); National Marine Sanctuaries Act, 16 U.S.C. § 1431 (2006); Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), 42 U.S.C. § 9601 (2006); Atlantic Wind Energy Workshop, *supra* note 83, at 12.

Administration must approve of turbines erected in the navigable airspace as far out as twelve nautical miles in federal waters.[98] The Advisory Council on Historic Preservation may also play a role in the permitting process, as it did in the Cape Wind project.[99]

As a whole, the regulatory patchwork lends itself easily to doubt and criticism but not necessarily pessimism. Maureen Bornholdt, who currently manages the Department of the Interior's Offshore Renewable Energy Program, conceded "[t]he statutory environment that we're operating in is not as simple, perhaps, as with state lands or local lands."[100] But Congress is not raising a white flag yet; in 2010, Secretary Salazar launched the "Smart from the Start" Initiative to facilitate offshore wind development on the Atlantic Coast, where offshore wind energy has piqued the greatest interest.[101] The initiative will permit the newly created BOEMRE to identify priority areas, collect data, and promote efficiency, with a goal of eliminating up to one year from the leasing process by doing much of the preliminary work in advance of bidding.[102] In the meantime, the Gulf Coast of Texas presents a suitable hub for development—with unique features that have the potential to make it the most advantageous area for offshore wind development in the United States.[103]

## IV. THE LONE STAR ADVANTAGE: TEXAS'S OFFSHORE REGULATORY FRAMEWORK

### *A. Historical Development*

Long before Texas was extracting its natural resources for public use, it was fighting to retain the jurisdiction it held as a sovereign: the Republic of Texas.[104] In a series of decisions known as the *Submerged Lands Cases*, the United States Supreme Court articulated the doctrine of "equal footing" and recognized paramount federal rights in defining federal and state

98. *See* Federal Aviation Act of 1958, 49 U.S.C. § 44718 (2006); 14 C.F.R. § 77 (2005).

99. *See* National Historic Preservation Act of 1966, 16 U.S.C. § 470 (2006); Archaeological and Historical Preservation Act of 1974, 16 U.S.C. §§ 469-69(c)(2) (2006) (authorizing the Secretary of the Interior to consider the effects of the permitting on historic properties and to salvage and archaeological data deemed significant); *supra* notes 62-64 and accompanying text.

100. *Regulatory Update on Wind Energy Permitting and Development*, *supra* note 85, at 10977-79.

101. *See* Press Release, U.S. Dep't of the Interior, Salazar Launches 'Smart from the Start' Initiative to Speed Offshore Wind Energy Development off the Atlantic Coast (Nov. 23, 2010), *available at* www.doi.gov/news/pressreleases/Salazar-Launches-Smart-from-the-Start-Initiative-to-Speed-Offshore-Wind-Energy-Development-off-the-Atlantic-Coast.cfm.

102. *See id.*; Danielle Murray, *Riding the Wave: Confronting Jurisdictional and Regulatory Barriers to Ocean Energy Development*, 5 GOLDEN GATE U. ENVTL. L.J. 159, 193 (2011); *Report of the Renewable Energy Committee*, 32 ENERGY L.J. 405, 417 (2011).

103. *See* discussion *infra* Parts IV.B-C.

104. *See* United States v. Texas, 339 U.S. 707, 709 (1950).

control off the coasts of the United States.[105] In *United States v. Texas*, Justice Douglas stipulated that Texas presented novel arguments before the Court, arguments not presented in the similar cases of *California* and *Louisiana*.[106] Those arguments rested largely on the "preadmission history of Texas."[107] Texas asserted several defenses in its favor, including that (1) as the Republic of Texas, it was a sovereign nation and the owner of the sea bed, at which point it acquired an interest in it, and that (2) as an independent nation it "had open, adverse, and exclusive possession and exercised jurisdiction and control over the land, minerals, etc., underlying that part of the Gulf of Mexico . . . three marine leagues from shore . . . ."[108] Texas, like California and Louisiana, was denied on the premise that states may not extend their sovereignty beyond that which other states were excluded, i.e., the "equal footing" doctrine.[109] Just three short years later, however, Congress responded with the Submerged Lands Act of 1953, which superseded *United States v. Texas*.[110] In fact, the Committee passing the resolution remarked that "[t]he purpose of this legislation is to write the law for the future as the Supreme Court believed it to be in the past . . . ."[111] Section 1301 limits "boundaries" to three geographical miles from the coastline, and three marine leagues (nine geographical miles) from the states surrounding the Gulf of Mexico.[112] Two months later, Congress passed the Outer Continental Shelf Land Act (OCSLA) to refine the Submerged Lands Act and expressly declared federal sovereignty over the outer continental shelf beyond the States' respective territories.[113] Soon after, the Supreme Court recognized Texas's retention of jurisdiction under the Acts, stating that "pursuant to the Annexation Resolution of 1845, Texas'[s] maritime boundary was established at three leagues from its coast for domestic purposes . . . . Accordingly, Texas is entitled to a grant of three leagues from her coast under the Submerged Lands Act."[114]

Within their offshore jurisdictions, states retain the right to develop and use the land and its underlying resources, so that coastal states

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105. *See* United States v. California, 332 U.S. 19, 29-30 (1947); United States v. Louisiana, 339 U.S. 699, 703 (1950); *Texas*, 339 U.S. at 716; *see also* Aaron L. Shalowitz, *Boundary Problems Raised by the Submerged Lands Act*, 54 COLUM. L. REV. 1021, 1022-24 (1954) (describing the *Submerged Lands Cases*).

106. *See Texas*, 339 U.S. at 712.

107. *Id.* at 712-13.

108. *Id.* at 711.

109. *See id.* at 719.

110. *See* Submerged Lands Act, 43 U.S.C. § 1301 (2006).

111. S. REP. NO. 133, at 8 (1953); *see also* Shalowitz, *supra* note 105, at 1026 (discussing the effect of the new law).

112. 43 U.S.C. § 1301; Shalowitz, *supra* note 105, at 1027.

113. *See* Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1331-1356a (2006); David W. Robertson, *The Outer Continental Shelf Lands Act's Provisions on Jurisdiction, Remedies, and Choice of Law: Correcting the Fifth Circuit's Mistakes*, 38 J. MAR. L. & COM. 487, 495 (2007).

114. United States v. Louisiana, 363 U.S. 1, 65 (1960).

developing and extracting resources within their waters are able to regulate their own development.[115] Thus, Texas has six additional miles within which to develop offshore wind energy; combined with the added benefit of the shallow nature of the Gulf of Mexico, Texas has at least two key advantages over the majority of the United States.[116] Upon closer analysis, it becomes clear that the state holds many more.[117]

### *B. Drill Baby Drill*[118]

Texas and the coastal states surrounding the Gulf of Mexico generally have a strong and unprecedented history of offshore oil drilling in the United States.[119] The history is not spotless, however, and has been the source of great controversy at many points in history,[120] as well as subject to several moratoria on drilling on the Outer Continental Shelf.[121] Additionally, the permitting and leasing process for offshore drilling is likewise not yet ideal.[122] As recently as March of 2011, Congress introduced legislation that would streamline the permitting process and shorten the time frame for development significantly.[123] Currently, the offshore oil permitting and leasing process consists of four stages: a five-

115. *See* 43 U.S.C. § 1301; ADAM VANN, OFFSHORE OIL AND GAS DEVELOPMENT: LEGAL FRAMEWORK, CONG. RESEARCH SERV., RL 33404, 3 (2011), *available at* www.fas.org/sgp/crs/misc/RL33404.pdf.

116. *See* 43 U.S.C. § 1301; Francis J. Gonyor, *Beyond All Boundaries?—A Study of Marine Jurisdiction of the State of Texas—Past History and Current Issues*, 17 HOUS. J. INT'L L. 253, 255 (1994). *But see* Jim Lanard & Daron Threet, *Federal and State Measures Expedite Offshore Permitting*, N. AM. WINDPOWER 1 (2011), http://www.dicksteinshapiro.com/files/News/efab40b5-c2c4-4bda-a68d-c4b6e5c527f3/Presentation/NewsAttachment/2125a721-aa4f-4250-80fc-c61fda678d78/Federal_State__Measures_Offshore_Permitting.pdf ("Regardless of where a project is located, both federal and state approvals are needed.").

117. *See infra* Part IV.C.

118. Jennifer Larson, *Challenges Under OCSLA and the Future of Offshore Drilling Under the Obama Administration*, 13 SMU SCI. & TECH. L. REV. 55, 55 (2009) (explaining the oft exclaimed presidential campaign slogan of Arizona Senator John McCain and former Governor Sarah Palin in 2008).

119. *See* JOSEPH PRATT ET AL., OFFSHORE PIONEERS: BROWN & ROOT AND THE HISTORY OF OFFSHORE OIL AND GAS 7 (1997).

120. *See generally* Lindsay K. Scaief, *Upping the Ante in the Oil Industry: Why Unlimited Liability for Oil Companies Will Deal America a Bad Beat*, 43 TEX. TECH L. REV. 1319 (2011) (discussing the history of oil spills in the United States, the recent Deepwater Horizon spill, and the ramifications of unlimited liability for offshore oil companies).

121. VANN, *supra* note 115, at 4 (explaining that President George H.W. Bush issued the first of these moratoria in 1990, which President Bill Clinton extended in 1998).

122. *See generally id.* (explaining the extensive regulations affecting offshore oil and gas development).

123. Putting the Gulf of Mexico Back to Work Act, H.R. 1229, 112th Cong. §§ 101-102 (2011); *Cong. Flores: Reform Drilling Permit Process, Reduce Delays, End Uncertainty*, TEX. INSIDER (March 18, 2011, 12:01 PM), http://www.texasinsider.org/?p=44100; VANN, *supra* note 115, at 5.

year planning process,[124] leasing,[125] exploration,[126] and development and production.[127]

Nevertheless, Texas has remained an offshore drilling hub, due in part to its proximity to the Gulf of Mexico with its deepwater resources that led to an offshore oil boom in the early 1990s.[128] Additionally, the existing infrastructure used to develop offshore oil, such as industrial fabricators and service companies, can be used for turbines as well, and will reduce operation and maintenance costs for offshore wind across the board.[129] It follows that Texas and Texas's companies' involvement and experience in the offshore drilling phenomenon posture it perfectly to emerge as the leader of offshore wind development.[130]

### *C. The Shift to Wind: How Being an Onshore Leader Helps Texas Get in the Water First*

The year 2006 marked an important point in history for Texas: it overtook California as the leader in wind energy.[131] Add together Texas's success in oil, both on and offshore, and its recent advances in onshore wind production, and the result is a true energy pioneer.[132] Perhaps most unique to Texas is its independent transmission grid.[133] The Energy Reliability Council of Texas (ERCOT) operates exclusively within Texas, a stark contrast with most states, which rely upon interconnection with fragmented intrastate transmission.[134] In 2007, the Public Utility Commission of Texas instructed ERCOT to study and develop options for building transmission lines—the infamous Competitive Renewable Energy

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124. *See* Submerged Lands Act, 43 U.S.C. § 1344 (1978); VANN, *supra* note 117, at 5.

125. *See* 43 U.S.C. §§ 1337, 1345; Vann, *supra* note 115, at 5.

126. *See* Outer Continental Shelf Lands Act of 1953, 43 U.S.C. § 1340 (1985); VANN, *supra* note 115, at 5.

127. *See* Outer Continental Shelf Lands Act of 1953, 43 U.S.C. § 1351 (1978); VANN, *supra* note 115, at 5.

128. *See* LESLEY D. NIXON, MINERALS MGMT. SERV., DEEPWATER GULF OF MEXICO 2009: INTERIM REPORT OF 2008 HIGHLIGHTS 22 (May 2009), *available at* http://www.gomr.boemre.gov/PDFs/2009/2009-016.pdf.

129. Tim Breen, *Texas Offshore Wind Project Eyes Test Turbine by End of 2011*, OFFSHORE WIND WIRE (May 17, 2011), http://offshorewindwire.com/2011/05/17/texas-test-turbine-by-end-of-2011.

130. *See id.*

131. *See AWEA Quarterly Market Report: Texas Overtakes California as Top Wind Energy State*, ALL AMERICAN PATRIOTS (submitted on July 30, 2006, 9:54 AM), http://www.allamaericanpatriots.com/node/15564.

132. *See* TOWER Conference 2011, *supra* note 13.

133. *See About ERCOT*, ERCOT, http://www.ercot.com/about (last visited Oct. 7, 2012).

134. John Shelton, Comment, *Who, What, How, & Wind: The Texas Energy Market's Future Relationship with Wind Energy and Whether It Will Be Enough to Meet the State's Needs*, 11 TEX. TECH ADMIN. L.J. 401, 403 (2010); *see also* ERCOT, *supra* note 133 (detailing ERCOT's independent role in Texas as carrying eighty-five percent of the state's electricity across seventy-five percent of Texas land).

Zone lines, or CREZ lines—for delivering renewable energy.[135] As of 2011, the CREZ lines are under construction and are poised to transmit power by 2013 with the potential to double the state's wind capacity.[136] The efficiency and sovereignty of Texas over the interconnection process is yet another advantage the Lone Star State has over its sister states in developing offshore wind.[137] The eminence of Texas's entry into the offshore market prompted a press release by the 2nd Annual Texas Offshore Wind Energy Roundtable Conference to note Texas's unique advantages:

> Offshore wind has undoubtedly benefited from the state's distinctive business environment. With stable, long-term policies, and its own transmission network, Texas offers unrivaled business opportunities for the offshore wind industry. Furthermore, the state offers an exceptional combination of laws and conditions due to its unique history as an independent nation . . . . Because of this, any project located within 10 miles off the coast of Texas does not have to deal with federal regulators. Project developers only have to obtain leases from the Texas General Land Office.[138]

While Texas's statutory outlook is certainly promising, offshore development is still subject to a grant of permit by the Army Corps of Engineers.[139] In fact, Coastal Point Energy's Galveston Wind Project, the project poised to commence within the year, has but one "permitting hurdle to clear" for the Army Corps.[140] Additionally, projects in state waters remain subject to U.S. Fish and Wildlife Service authority as well as the Departments of Defense, Homeland Security, and Transportation, meaning that a project in Texas's waters would not be wholly independent of federal regulations.[141] A project in Texas's waters would, however, have an incredible advantage over federal projects due to the stark reduction in

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135. Press Release, Energy Reliability Council of Texas, ERCOT Files Wind Transmission Options with Commission (Apr. 2, 2008), *available at* http://www.ercot.com/news/press_releases/print/255; Shelton, *supra* note 134, at 404.

136. *See* Kate Galbraith, *Wind Power Transmission Lines Rise Across Texas*, THE TEX. TRIBUNE (Oct. 21, 2011), http://www.texastribune.org/texas-energy/energy/wind-power-transmission-lines-rise-across-texas/.

137. *See* Shelton, *supra* note 134, at 403.

138. TOWER Conference 2011, *supra* note 13. The TOWER Conference combines a consortium of leading policymakers, developers, and influential industry leaders in Texas with the experience of Europe's offshore success. *Id.* The TOWER Conference also supports the Offshore Wind Law (OWL) panel to analyze the unique laws affecting Texas. *Id.*

139. Lanard & Threet, *supra* note 116, at 1.

140. *See* Breen, *supra* note 129 (noting that even though Texas projects remain subject to grants from the Corps and the Rivers and Harbors Act, the pared down process is much faster than the entire federal process).

141. *See* Jensen, *supra* note 75, at 8-10.

federal hurdles it must cross.[142] From a pure policy standpoint, there is no reason why Texas as a whole should not capitalize upon this inimitable advantage.

## V. THE TIP OF THE ICEBERG?

The splintered regulatory scheme is undoubtedly the greatest obstacle to offshore wind development in the United States. As one commentator noted, "[i]t manages to be fragmented and redundant, prescriptive and vague, authoritarian and leaderless."[143] Unfortunately, it is not the only hurdle developers face.[144] Environmental opposition, aesthetic opposition, and cost-benefit concerns persist after developers cross the initial regulatory barriers.[145]

### *A. Environmental Concerns*

Contributing to the regulatory mess but independent of the permitting process are statutes such as the National Environmental Policy Act, the Migratory Bird Treaty Act, and the Endangered Species Act, discussed previously.[146] Additionally, environmentalists remain skeptical that even those projects that meet existing statutory requirements are satisfactory.[147] The expectation that the first offshore project deployed in the United States would be in Texas prompted the Sierra Club, a well known environmental action group, to outline their concerns to the Army Corps of Engineers during their review of the Galveston projects permit application.[148] Despite praise of the projects proactive handling of environmental issues, the Sierra Club remains worried about bird deaths throughout the Gulf of Mexico.[149] The lower Gulf Coast sees more than 200 species of birds annually due to the convergence of three migratory bird corridors, many of which are on national and state endangered lists.[150] So Texas, unlike other coastal areas

142. *See id.*

143. *Id.* at 2.

144. *See* Schroeder, *supra* note 5, at 1653.

145. *Id.* at 1640-41.

146. *See* National Environmental Policy Act of 1969, 42 U.S.C. § 7401 (2011); Migratory Bird Treaty Act, 16 U.S.C. §§ 703-712 (2006); Endangered Species Act of 1973, 16 U.S.C. § 1531 (2006); discussion *supra* text accompanying notes 94-99.

147. Mark Collette, *Sierra Club Raises Concerns About South Texas Offshore Wind Farm (USA)*, CALLER.COM (Aug. 17, 2011, 6:00 PM), http://www.caller.com/news/2011/aug/17/sierra-club-raises-concerns-about-south-texas.

148. *See id.*

149. *Id.* Interestingly, European scientists generally do not consider the death of birds a significant threat to bird populations due to the low ratio of deaths to number of birds flying through wind farms. *See* M.L. MORRISON, NAT'L RENEWABLE ENERGY LAB., BIRD MOVEMENTS AND BEHAVIORS IN THE GULF COAST REGION: RELATION TO POTENTIAL WIND ENERGY DEVELOPMENTS 4 (2006), http://www.nrel.gov/wind/pdfs/39572.pdf.

150. MORRISON, *supra* note 149, at 4.

such as the Atlantic Coast, for example, may have a heightened obstacle regarding pacifying environmental concerns to offshore wind development due to the sheer volume of birds flying through the Gulf on an annual basis.[151] On the other hand, offshore wind developments in general have the potential to pose a greater environmental threat because, unlike onshore wind developments, they are usually introduced into pristine environments.[152] But this is not the case with Texas due to its history of offshore drilling.[153] As a result, even though the Gulf Coast sees a greater amount of migratory birds, the waters have been disrupted for many years due to the presence of offshore oil rigs in the area, and the heightened risk associated with offshore wind does not apply to the Gulf Coast, notwithstanding the increased amount of migratory bird traffic.[154]

In an effort to synthesize and give credibility to the patchwork of environmental studies done in Europe to date, the EU sponsored a compilation of environmental findings.[155] The findings, though difficult to quantify, show minimal impact to birds as a result of offshore wind turbines.[156] High mortality rates tended to occur among poorly sited facilities.[157] In short, regardless of a known major risk to migratory birds, simple steps can be taken to avoid any potential negative impact, such as siting developments away from bird migratory paths.[158] Conversely, not all environmental impacts are necessarily problematic, as studies show that some developments may support new marine habitats that could shelter animals in areas that are off-limits to fishing and navigation, as well as encourage micro-ecosystem development under the water's surface.[159] Moreover, any adverse effects caused by offshore wind energy are still much less dramatic than those caused by extraction of traditional fossil fuels.[160]

### *B. Aesthetic Opposition: The NIMBYs and Beyond*

As Cape Wind developers can testify, aesthetic opposition may pose a formidable threat to development as well.[161] Nuisance claims against the

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151. *See id*.

152. *Id.* at 10.

153. *See generally* Scaief, *supra* note 120 (discussing the history of offshore drilling in the United States).

154. *Compare* MORRISON, *supra* note 149, at 10, *with* Scaief, *supra* note 120 (analyzing the United States' offshore drilling industry's blemished record).

155. MORRISON, *supra* note 149, at 13.

156. *Id.*

157. *Id.*

158. *See id.*; MUSIAL & RAM, *supra* note 1, at 8, 10.

159. *See* Schaumberg & Grace-Tardy, *supra* note 33, at 6.

160. *See* Schroeder, *supra* note 5, at 1641.

161. *See* MARTIN, *supra* note 70, at 446 (describing NIMBY as a term to refer to those who fight against the siting of developments that may adversely affect the community in some way).

development of wind farms have generally not been successful in the United States, and particularly not in Texas.[162] They do, however, cause extremely costly delay.[163] In Texas, nuisance is defined as "a condition that substantially interferes with the use and enjoyment of land by causing unreasonable discomfort or annoyance to persons of ordinary sensibilities."[164] According to a Texas appellate court, successful nuisance claims involve invasions of plaintiff's property by "light, sound, odor, or foreign substance."[165] Claims based purely on aesthetic reasons have not been recognized as causes of action in Texas: "[T]he law will not declare a thing a nuisance because it is unsightly or disfigured . . . or because it is unpleasant to the eye . . . ."[166] But unsightliness is not the only reason for public outcry against wind farm developments.[167] Loss of property value due to the perceived undesirability of close proximity to turbines is a common fear held by many property owners.[168] Once again, Texas is fortunate in this regard because it has had the most amenable reception to wind development throughout the state than any other state.[169] Both environmental and aesthetic opposition may be preempted, however, by addressing stakeholders' interests at the outset of development.[170] When two private firms negotiated the purchase of TXU Energy in 2008, they partnered with the Environmental Defense Fund and the Natural Resources Defense Council in order to structure the proposed buyout.[171] The negotiations successfully avoided anticipated litigation and satisfied constituents.[172] Developers and manufacturers can achieve this same end by engaging constituents and special interest groups, and the legislature can require input to the same extent to help avoid likely litigation.[173]

### *C. It Takes Green to Go Green*

Lastly, wind energy, as a whole, and offshore wind in particular, is still not entirely economical and is largely dependent on federal subsidies.[174]

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162. *See* Stephen Harland Butler, *Headwinds to a Clean Energy Future: Nuisance Suits Against Wind Energy Projects in the United States*, 97 CALIF. L. REV. 1337, 1354-63 (2009).

163. Kristina Culley, *Has Texas Nuisance Law Been Blown Away by the Demand for Wind Power?*, 61 BAYLOR L. REV. 943, 972 (2009).

164. Rankin v. FPL Energy, LLC, 266 S.W.3d 506, 509 (Tex. App.—Eastland 2008, pet. denied) (quoting Schneider Nat'l Carriers, Inc. v. Bates, 147 S.W.3d 264, 269 (Tex. 2004)).

165. *Id.*

166. *Id.* at 510.

167. *See* MARTIN, *supra* note 70, at 431; Schroeder, *supra* note 5, at 1641.

168. MARTIN, *supra* note 70, at 431; Schroeder, *supra* note 5, at 1641.

169. *But cf.* Rose v. Chaikin, 453 A.2d 1378, 1384 (N.J. Super. Ct. Ch. Div. 1982) (enjoining development of a wind farm based on a nuisance claim).

170. *See* Nussdorf, *supra* note 17, at 31-32.

171. *See id.*

172. *Id.*

173. *Id.*

174. *See* Schaumberg & Grace-Tardy, *supra* note 33, at 17.

The cost of installation and transmission of offshore wind farms is notably higher than onshore farms—an estimated 50% higher than their onshore counterparts.[175] Shortly after the passage of the Energy Policy Act in 2005, which only began to clarify the jurisdictional murkiness of offshore development, price was determined the greatest factor in the speed and scale of development, not policy.[176] To curb this effect, industry-wide efforts to reduce costs and achieve supportable economies of scale included using larger turbines to increase energy output while using fewer platforms and proposing larger wind farms to create even more jobs and manufacturing potential to offset the high cost of development.[177]

## VI. WINDS OF CHANGE

No single member of the EU that has developed offshore wind farms relied entirely upon EU legislation and policymaking to spur wind farm development.[178] Comparatively, no single state in the United States would be wise to rely entirely upon federal legislation and incentives to drive development. Setting a mandatory national goal for renewable energy that allows state individualization is essential to an effective national strategy.[179] With its unique legal and social landscape, Texas should go further by taking matters into its own hands and capitalizing upon its advantages. The following analysis draws upon the varying aspects of relevant offshore wind policies previously discussed and synthesizes their strengths and weaknesses into a comprehensive plan for both the United States and Texas moving forward.

### *A. It Takes Two to Tango—Texas Needs the United States to Be on Board with Offshore Wind Development*

A look back to successful European countries in the trade is instructive regarding successful policy implementation. In 2007, the EU set a clear order of a 20% boost in renewable energy use by the year 2020.[180] This is similar to the United States' goal, set by President Bush in 2007, of 20%

175. *See* Schroeder, *supra* note 5, at 1641; Lanard, *supra* note 25, at 3. Mr. Lanard notes that in response to this contingency, policy arguments, such as job creation and manufacturing, must be emphasized in order to justify offshore wind development. *See* Lanard, *supra* note 25, at 5-6. A continued emphasis on the proximity of offshore wind production to the majority of the population serves to bolster this argument. *See* Schroeder, *supra* note 5, at 1642.

176. *See* Jensen, *supra* note 75, at 3.

177. *See* Lanard, *supra* note 25, at 3.

178. *See* Reiche & Bechberger, *supra* note 53, at 843.

179. *See* Nussdorf, *supra* note 17, at 29.

180. *EU Agrees Renewable Energy Target*, BBC NEWS (Mar. 9, 2007, 4:59 PM), http://news.bbc.co.uk/2/hi/europe/6433503.stm.

renewable energy use by the year 2017.[181] The difference with the EU's mandate is that it is mandatory.[182] As a demonstration of its commitment to meeting its own order, the EU gives preferential treatment to renewable energy, ensures access to the grid, and helps to defray interconnection costs to ensure countries meet the energy mandate.[183]

The contrast in the level of commitment between the EU and the United States is easily seen in comparing the ratification of climate change treaties between the EU member states and the United States.[184] The U.S. commitment pales in comparison.[185] Approaching the issue from a different, less environmentally charged perspective, China is also demonstrating a firm commitment to renewable energy.[186] This show of support is likely in response to the accepted notion that whoever leads the renewable energy transition will lead the world in the twenty-first century.[187] China's commitment has been so astonishing that stalwart environmentalist Robert F. Kennedy, Jr. stated, "the Chinese are treating the energy technology competition as if it were an arms race."[188] Whatever the motive—be it environmental or economic—a demonstrated commitment to offshore wind development is an indispensable threshold that must be crossed to be successful in the offshore wind arena.[189]

Within the United States, individual states can be, and are, firmly committed to a renewable energy goal independent of the federal government.[190] California led a renewable energy revolution in the 1980s, and states such as New Jersey, Virginia, and New Hampshire are creating innovative policies to aid in offshore development.[191] Most helpful among these pieces of legislation will be simplifying and centralizing the regulatory minefield that developers have to navigate.[192] One way Virginia Governor Mike McDonnell proposes funding offshore wind projects is by

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181. President Bush, *supra* note 20.

182. *See* Nussdorf, *supra* note 17, at 29, 31 (noting that the United States commitment has largely consisted of meaningless policy proclamations).

183. *Id.* at 29-30.

184. *See* Timothy P. Duane, *Greening the Grid: Implementing Climate Change Policy Through Energy Efficiency, Renewable Portfolio Standards, and Strategic Transmission System Investments*, 34 VT. L. REV. 711, 723-35 (2010).

185. *See generally* Snyder & Kaiser, *supra* note 9, at 1854-55 (stating that only a few states have implemented policies to address clean energy issues).

186. *See* Joel B. Eisen, *China's Renewable Energy Law: A Platform for Green Leadership?*, 35 WM. & MARY ENVTL. L. & POL'Y REV. 1, 3 (2010).

187. *See, e.g.*, President Obama, *supra* note 24, at 5 ("[T]he nation that leads the clean energy economy will be the nation that leads the global economy.").

188. Eisen, *supra* note 186, at 3.

189. *See* Snyder & Kaiser, *supra* note 9, at 1855.

190. *See* Steve Szkotak, *Va. Gov. McDonnell Outlines 2012 Energy Agenda*, BLOOMBERG BUSINESSWEEK (Jan. 6, 2012, 10:16 AM), http://www.businessweek.com/ap/financialnews/D9S3H0IO0.htm; Aaron Nathans, *New Jersey Seen as Future in Wind Projects*, GOVERNORS' WIND ENERGY COALITION (Dec. 25, 2011), http://www.governorswindenergycoalition.org/?p=756.

191. *See* Szkotak, *supra* note 190; Nathans, *supra* note 190.

192. *See* Reiche & Bechberger, *supra* note 53, at 843-45.

funding research and development projects to aid in private development.[193] Alternatively, New Jersey's Offshore Wind Development Act requires power sold in New Jersey to include a mandated amount of offshore wind generation and sets a power purchase price.[194] The New Jersey Act presents a solution to what has been the downfall to several proposed projects in the United States thus far—finding buyers for expensive power.[195] New Jersey's approach is similar to Germany's use of the feed-in tariff to guarantee offshore wind prices for utility companies.[196] Although both of these methods have been criticized for the mandatory purchase of offshore wind power that is admittedly more expensive than traditional forms of electricity, amidst the push for renewable energy, they are effective ways of securing risk to developers and utility companies that their investments will be returned.[197] These methods, in turn, ease the development process as a whole as lower risk increases the ability to obtain loans and to acquire lower interest rates.[198] Denmark's approach serves as an example of a powerful, centralized approach to encouragement of renewable energy.[199] By 2006, Denmark had already achieved 20% energy from wind—the goal the United States set for itself in 2009.[200] The Danish Energy Authority serves as a "one stop shop" for interested parties and works to bolster support from stakeholders as well as consumers.[201]

The second constant that is clear from analyzing policy of those nations with successful offshore wind developments is the necessity of ample funding from the governing body.[202] The United States federal government has tried to mirror this policy by offering extremely attractive tax cuts to developers but has yet to deliver the type of funding provided by its European counterparts.[203] The production tax credit undoubtedly gave a boost to the American wind industry, but alone is not sufficient to stimulate offshore wind.[204] Although the Coastal Zone Management Act indicates that it will encourage development through "financial assistance," in order to be successful, clear and compulsory requirements must be stated.[205]

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193. Szkotak, *supra* note 190.

194. Nathans, *supra* note 190.

195. *Id.*

196. *See* Snyder & Kaiser, *supra* note 9, at 1850; Reiche & Bechberger, *supra* note 53, at 843-45.

197. *See generally* Duane, *supra* note 184, at 711 (advancing the benefits of an integrated regulatory approach to renewable energy).

198. *Id.* at 763.

199. *See* Schroeder, *supra* note 5, at 1659.

200. *Id.*

201. *Id.*

202. *See* Snyder & Kaiser, *supra* note 9, at 1934; Eisen, *supra* note 186, at 33.

203. *See* 20% WIND ENERGY BY 2030, *supra* note 1, at 6.

204. Duane, *supra* note 184, at 763.

205. Coastal Zone Management Act of 1972, 16 U.S.C. § 1451(j) (2006); *see* Schroeder, *supra* note 5, at 1664.

It is also important to note that successfully developing offshore wind is not a zero-sum game. The benefits seen by local and state economies resonate throughout the industry and have positive effects upon the economy, the environment, and global relations.[206] Likewise, the competition among the several states, Europe, China, and other players that may emerge should remain friendly.[207] For example, the United States can benefit from European and Chinese manufacturers' prior experience overseas.[208] As the industry continues to grow and develop, prices will inevitably fall and benefit everyone from developers of energy to consumers of the electricity it produces.[209] Thus, cooperation among key players cannot be overlooked or understated.

### *B. The Lone Star Strategy*

Ultimately, Texas policymakers have a lot to learn from their predecessors' successes and shortcomings in developing offshore wind. Like the Danish, Texas must capitalize on its unique jurisdictional position and create a streamlined and centralized permitting process for developers.[210] There should be one governing body (presumably, the General Land Office, which already handles much of the permitting process), and standards that must be met to obtain the proper permits should be high enough to satisfy both state and federal requirements to avoid unnecessary overlap and delay.[211] For example, environmental studies and tests should satisfy both Texas statutory requirements and federal statutory requirements. The United Kingdom has implemented a successful strategy that establishes a siting process, guides the pattern and scale of development along the coastline, ensures evaluation of environmental impacts, monitors environmental impacts, and delivers consistent regulatory rulings.[212] Consideration of a broader development scheme as the United Kingdom has done is essential to efficient development in the Gulf as offshore wind energy becomes more and more viable.[213]

To take a page out of the EU's book, Texas should market offshore wind development as beneficial to local economies and as able to create

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206. *See generally* Duane, *supra* note 184, at 763 (explaining the desirability of integrated regulatory systems for the development of renewable energy).

207. *See id.* at 719-21.

208. *See* Erin Huggins, *Wind Energy Leaders Eye U.S. Expansion*, THE LOCAL (Dec. 14, 2011, 7:04 AM), http://www.thelocal.de/sci-tech/20111214-39485.html (quoting the vice president of the German-American Chamber of Commerce, stating that "I think what's good for Europe is also good for the US").

209. *See* Schroeder, *supra* note 5, at 1664 (noting that long-term financial incentives may bring more significant increases in investments).

210. *See id.* at 1659.

211. *See id.*; Morrison, *supra* note 147, at 4.

212. Morrison, *supra* note 149, at 25-26.

213. *Id.* at 26.

long-term local jobs along the coastline and into central Texas.[214] This will serve to bolster support among local citizens who will likely pay for part of the development, as well as local policymakers who can either do great harm or good to local construction projects depending on their stance on the matter.[215] While opposition will likely always be present, Texas's jurisprudence thus far has given wind (both on-and-offshore) a guard against frivolous nuisance claims.[216] With their rulings, the Texas courts have given the state yet another form of relief from obstacles that barred the Cape Wind project for over a decade.[217]

To aid in overcoming financial hurdles, the Texas Legislature should encourage cooperation between offshore developers and the Public Utility Commission of Texas to address the need of markets for the power generated by wind farms.[218] For example, New Jersey requires a cost-benefit analysis for all proposals of offshore wind farms off its coasts, which analyzes the benefits of the project and weighs those against the costs, with approval contingent upon the justification.[219] In doing so, the strong policy arguments for offshore wind development are included, instead of a purely financial analysis that would almost certainly favor traditional forms of energy in every case.[220] To contrast, the unfavorable regulatory scheme of Massachusetts contributed to the project's decade long gridlock.[221] The state's Coastal Zone Management Plan was a decentralized plan "based on 'at least seven memoranda of understanding between . . . state agencies . . . .'"[222] To avoid Cape Wind's pitfalls, Texas must create a centralized, clear, and efficient plan to develop offshore wind off its coasts.

In conjunction with centralized planning, the legislature would be wise to seriously consider providing sustainable and lucrative economic incentives for manufacturers to attempt not only to reduce costs, but also to bring business into the state.[223] Texas General Land Office Commissioner, Jerry Patterson, has already indicated that his sights are in fact set on attracting supply chain and manufacturing for offshore wind, much as the

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214. *See* Reiche & Bechberger, *supra* note 53, at 846.

215. *See* Schroeder, *supra* note 5, at 1651-52; Spinelli, *supra* note 8, at 748.

216. *See* Rankin v. FPL Energy, LLC, 266 S.W.3d 506, 508 (Tex. App.—Eastland 2008, pet. denied) (citing Schneider Nat'l Carriers, Inc. v. Bates, 147 S.W.3d 264, 269 (Tex. 2004)).

217. *See id.* at 512-13.

218. *See* Lanard, *supra* note 25, at 6.

219. *Id.* at 3-4.

220. *See id.* Proponents of fossil fuels have relied on a similar theory to overcome environmental concerns, which they argue are outweighed by the communities dependent on the jobs provided by the fossil fuels. *See* Nussdorf, *supra* note 17, at 32.

221. *See* Schroeder, *supra* note 5, at 1655.

222. *Id.* Massachusetts has since amended its plan under the Ocean Management Plan, which lays out the state's process for ocean development. *Id.*

223. *See* Lanard, *supra* note 25, at 3.

oil and gas industry brought the industry to the state.[224] The EU has encouraged investment from manufacturers in practice through favorable policies and a demonstrated commitment to, and prioritization of, renewable energy.[225] Texas can and should do the same through similar legislation.

## VII. "THE ANSWER, MY FRIEND, IS BLOWIN' IN THE WIND"[226]

Victor Hugo may have had it right: "Madame, bear in mind that princes govern all things—save the wind."[227] Reigning in the wind is difficult to conceptualize and even more difficult to effectuate. The State of Texas has always been a leader in innovative and complex energy structures and should not shy away from the small window of opportunity it has to capitalize on the abundant resources just miles off of its coast. To do so would be to sacrifice distinct and valuable advantages unique to the state itself. Instead, Texas should continue in its tradition of energy leadership and commit to becoming the "first in the water."[228]

224. Breen, *supra* note 129.

225. *See* Nussdorf, *supra* note 17, at 30-31.

226. BOB DYLAN, BLOWIN' IN THE WIND (Columbia Records 1963).

227. VICTOR HUGO, THE INQUISITION, 178, *available at* http://www.archive.org/stream/victor hugosworks19hugouoft/victor hugosworks19hugouoft_djvu.txt.

228. Breen, *supra* note 129.

# SUBSURFACE TRESPASS BY HYDRAULIC FRACTURING: ESCAPING *COASTAL V. GARZA*'S DISPARATE JURISPRUDENCE THROUGH EQUITABLE COMPROMISE

## Comment

*Levi Rodgers**

## I. TRESPASS AND HYDRAULIC FRACTURING

> Drainage! Drainage, Eli, you boy. Drained dry. I'm so sorry. Here, if you have a milkshake, and I have a milkshake, and I have a straw. There it is, that's a straw, you see? You watching? And my straw reaches acroooooooss the room, and starts to drink your milkshake. . . I. . . drink. . . your. . . milkshake![1]

*There Will be Blood*, the 2007 film based on Upton Sinclair's novel *Oil!*, dramatically depicts a ruthless oil tycoon's insatiable quest for wealth during the late nineteenth century.[2] In the preceding excerpt, the old oilman—drunk on whiskey, power, and the bitterness of his own sins—indignantly explained to a young man the fruitlessness of his leasing desires.[3] Eli had postponed leasing for an extended period after oil was discovered on adjoining property, during which time the land surrounding his tract was leased and produced.[4] In the foregoing exchange, Eli learns the extent of his strategic blunder.[5] Much to his chagrin, the oil from beneath his property had been drained by the oil baron's nearby wells, thus rendering the mineral estate worthless.[6] Oil possesses fungible qualities, traveling along areas of low pressure much like a milkshake through a straw. Though the old oilman's acrimonious mannerisms are in no way representative of the modern petroleum industry, the essence of

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1. THERE WILL BE BLOOD (Paramount Vintage, Miramax Films 2007).
2. *There Will Be Blood*, WIKIPEDIA.COM, http://en.wikipedia.org/wiki/There_will_be_blood (last modified Sept. 23, 2012).
3. *See supra* text accompanying note 1.
4. *See* THERE WILL BE BLOOD, *supra* note 1.
5. *See id.*
6. *See id.*

the foregoing theatrical interaction implicates founding legal principles of the oil and gas industry, such as the rule of capture, trespass, and mineral ownership theories—legal principles still in use to this day.[7]

In *Coastal Oil and Gas Corporation v. Garza Energy Trust*, the Texas Supreme Court at last specifically considered whether hydraulically fracturing across property lines constitutes a subsurface trespass.[8] There, Salinas owned the mineral estate of a 748-acre tract called Share 13, which they had leased to Coastal.[9] Coastal was also the lessee and mineral estate owner of adjacent tracts Share 12 and Share 15.[10] All properties shared a common natural gas formation called the Vicksburg T, lying between 11,000 and 13,000 feet below the surface.[11] Coastal drilled four wells on Share 13, three of which were productive.[12] The dispute arose when, in 1996, Coastal drilled the well Coastal Fee No. 1 on Share 12, 467 feet from the boundary shared by the Salinas's Share 13.[13] Situating the Coastal Fee No. 1 as close as possible to the Salinas tract placed the well too near to one of Coastal's existing producers, the Pennzoil No. 1.[14] Because both wells would drain from Share 13, the Railroad Commission refused Coastal's application for an exception.[15] Electing to operate as proximate to Share 13 as permitted, Coastal kept the Coastal Fee No. 1 well and shut in Pennzoil Fee No. 1.[16]

Concerned that Coastal was using Coastal Fee No. 1 on Share 13 to drain gas from Share 12—thereby avoiding the Salinas's royalty obligation—Salinas brought suit for subsurface trespass, bad faith pooling, and breach of implied covenants to develop, market, and prevent drainage.[17] The Coastal Fee No. 1 well's fracing operation was designed to create fractures over 1,000 feet in length, well beyond the farthest distance from this well and Share 13.[18] While both parties agreed "the hydraulic and propped lengths exceeded this distance," whether the effective length of the fractures accomplished the same

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7. *See id.*

8. *See* Coastal Oil & Gas Corp. v. Garza Energy Trust, 268 S.W.3d 1, 4 (Tex. 2008).

9. *Id.* at 6.

10. *Id.*

11. *Id.* "The Vicksburg T is a 'tight' sandstone formation, relatively imporous and impermeable, from which natural gas cannot be commercially produced without hydraulic fracturing stimulation . . . ." *Id.*

12. *Id.*

13. *Id.*; *see* 16 TEX. ADMIN. CODE § 3.37(a)(1) (West 2010) (R.R. Comm'n of Tex) ("(1) No well for oil, gas, or geothermal resource shall hereafter be drilled nearer than 1,200 feet to any well completed in or drilling to the same horizon on the same tract or farm, and no well shall be drilled nearer than 467 feet to any property line, lease line, or subdivision line; provided the commission, in order to prevent waste or to prevent the confiscation of property, may grant exceptions to permit drilling within shorter distances than prescribed in this paragraph when the commission shall determine that such exceptions are necessary either to prevent waste or to prevent the confiscation of property.").

14. *Coastal*, 268 S.W.3d at 6.

15. *Id.*

16. *Id.*

17. *Id.* at 6-9. Salinas's subsurface trespass claim alleged that Coastal's fracing operation on "Coastal Fee Well No. 1 invaded the reservoir beneath Share 12, causing substantial drainage of gas." *Id.* at 7.

18. *Id.*

remained in dispute.[19] An expert for Salinas testified that production from Coastal No. 1 consisted of 25% to 35% of gas drained from Share 13.[20] Coastal, however, provided an expert of its own who testified that no gas was drained from Share 13 as a result of the hydraulic fracturing operation.[21] Trial was to the jury, and a sizeable reward of approximately $14 million was ultimately entered in Salinas's favor.[22] The court of appeals affirmed in part, remanding for a redetermination of attorney's fees.[23] Thus, the stage was set for the Texas Supreme Court's long-awaited decision in *Coastal*.

In Part II, this Comment will provide a framework of oil and gas history, terms, and procedure. Next, Parts III and IV discuss theories of mineral ownership and subsurface trespass jurisprudence, each to their varying degrees and applicatory extent. Part V shifts away from the applicable background material and provides a summary of the Texas Supreme Court's decision in *Coastal*.[24] Finally, Part VI will analyze potentially problematic results associated with *Coastal* while discussing the ongoing discourse concerning the similitude of hydraulic fracturing to other hydrocarbon recovery operations. In Part VII, this Comment will ultimately conclude that although oil and gas recovery operations have significantly advanced over the past century, the Texas Supreme Court's decision in *Coastal* was arguably not in lock step with industry progression.[25] Such a determination will explore whether the decision in *Coastal* was a step backward or whether it created a type of jurisprudential purgatory in oil and gas law concerning subsurface trespass issues. Hydraulic fracture subsurface trespass issues are certainly not foreclosed. In order to make this area of oil and gas law more equitable, the Texas Legislature, courts, and regulatory authority should consider revising existing subsurface trespass law to more closely resemble pre-*Coastal* trespass jurisprudence—but subject to necessary modifications in accordance with the rights and interests of both the industry and individual interest holders.[26]

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19. *Id.*

20. *Id.* at 8.

21. *Id.*

22. *See id.*; Mission Res. Inc., v. Garza Energy Trust, 166 S.W.3d 301, 309 (Tex. App.—Corpus Christi 2005), *rev'd sub nom. Coastal*, 268 S.W.3d 1.

23. *Mission Res. Inc.*, 166 S.W.3d at 330-31.

24. *See infra* notes 219-46 and accompanying text.

25. *See Coastal*, 268 S.W.3d at 4-5.

26. *See infra* notes 291-319 and accompanying text.

## II. AN OVERVIEW OF THE OIL AND GAS INDUSTRY

### *A. Beginnings: The Rise of Black Gold*

Colonel Edwin Drake drilled the first successful oil well near Titusville, Pennsylvania, in 1889.[27] Unlike the dramatic gushers so iconic of the petroleum industry's early days, Colonel Drake's oil had to be manually pumped out of the earth.[28] The Titusville well utilized the cable tool drilling method, which punctured a hole through rock formations by repeatedly striking the ground with a large chisel-shaped weight.[29] Apart from the slow and methodical process, the dangers associated with cable tool drills became apparent in highly pressurized reservoirs that, once punctured, blew out in fantastic geysers of oil.[30] In 1901, a significant quantity of oil was discovered at Spindletop, the now famous landmark just outside Beaumont, Texas.[31] During the frenzied production of this historic play, the development of three technological advances—rotary drilling, drilling mud, and blowout preventers—revolutionized the petroleum industry.[32] A rotary drill enabled the operator to efficiently reach greater depths, while the drilling mud lubricated the bit and prevented wasteful blowouts.[33] Thus "began the mad rush for oil that would engulf the nation in a new era of industrial achievement," comparable only to the California Gold Rush.[34]

### *B. Industry Evolution: Waste and Associated Regulation*

Spurred in large part by the rule of capture, oil and gas resources were vastly over exploited during the early days of the oil industry.[35] The promise of wealth and "the relatively open market allowed for just about anyone to set up their own production facility."[36] The lack of regulatory restrictions resulted in overproduction, causing frequent price fluctuations.[37] The proliferation of new oil-producing locations only partially accounted for the burgeoning surplus oil.[38] Flush production, "the true father of overproduction," involved

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27. *See* CHARLES F. CONAWAY, THE PETROLEUM INDUSTRY: A NONTECHNICAL GUIDE xi-xiv (1999); MARTIN S. RAYMOND & WILLIAM L. LEFFLER, OIL AND GAS PRODUCTION IN NONTECHNICAL LANGUAGE 1-4 (2006).

28. *See* CONAWAY, *supra* note 27, at xi-xiv; RAYMOND & LEFFLER, *supra* note 27, at 1-4.

29. RAYMOND & LEFFLER, *supra* note 27, at 82-85.

30. *See* CONAWAY, *supra* note 27, at 98; RAYMOND & LEFFLER, *supra* note 27, at 12.

31. *See* CONAWAY, *supra* note 27, at xiii.

32. *See* RAYMOND & LEFFLER, *supra* note 27, at 14.

33. *See id.* (observing that drilling mud and blowout preventers have contained "countless volumes of oil and gas . . . that would otherwise have been vented to the environment").

34. CONAWAY, *supra* note 27, at xii.

35. *See* RAYMOND & LEFFLER, *supra* note 27, at 14.

36. CONAWAY, *supra* note 27, at xii.

37. *See id.* at xii-xiii.

38. *Id.* at xiii.

franticly producing the greatest volume of oil from a well as possible, "due to the close competition of other producers pumping out of the same location."[39] This system was furthered by the pervasive lack of geological knowledge combined with the equally ubiquitous incomprehension of oil well dynamics.[40] Thus, oil producers of the time were compelled to endlessly draw hydrocarbons from their wells for fear that adjacent producers would extract more oil from the common reservoir.[41]

Early industry production practices manifested into a type of race causing rampant overproduction which, in turn, resulted in price instability and wasted resources.[42] In response, the federal and state governments issued regulations that eventually curtailed the oil frenzy.[43] Such regulations typically encouraged unitization and involved proration orders (mandatory production limits) and well-spacing limits.[44]

### *C. A Golden Era of Advancements: The Birth of Modern Petroleum*

Just as regulations evolved to quell the days of hard and fast production, industry technological advances progressed to satisfy the growing demand for oil.[45] Notably, "in the 1930's, innovation and consolidation of intellectual and practical knowledge permeated the upstream industry in a production renaissance."[46] The fruits of industry progression during this era, many of which are still used today, solidified a foundation for the modern petroleum industry.[47]

#### *1. The Development of Critical Drilling Technologies*

Encouraged by a persistent application of the rule of capture, petroleum operators of the late nineteenth and early twentieth centuries customarily produced wells at maximum output levels.[48] The science of petroleum geology remained at its infancy, and "[l]ittle thought was given to the prevention of waste or the depletion of reservoir energy by this full-throttle approach to production."[49] As resources were extracted, production slowed

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39. *Id.*
40. *Id.*
41. *Id.*
42. *Id.*
43. RAYMOND & LEFFLER, *supra* note 27, at 14.
44. *Id.*
45. *See id.* at 14-17.
46. *Id.* at 17.
47. *See id.*
48. John W. Broomes, *Wrestling with a Downhole Dilemma: Subsurface Trespass, Correlative Rights, and the Need for Hydraulic Fracturing in Tight Reservoirs*, 53 ROCKY MTN. MIN. L. INST. §§ 20.01, .02, at 20-3 (2007); *see* RAYMOND & LEFFLER, *supra* note 27, at 14.
49. Broomes, *supra* note 48, § 20.02, at 20-3.

due to declining reservoir pressures.[50] Signs of an aging reservoir, drops in production were often accompanied with an influx of subterranean water.[51] Water loomed as the production operator's nemesis, gradually increasing until levels made the well uneconomical.[52] A creature of happenstance, the notion of using water to increase decaying production levels was discovered in 1865 atop Pennsylvania's Bradford Field.[53] There, operators realized production increased after surface water had been inadvertently introduced through contiguous dormant wells.[54] Inspired, they purposefully replicated the process using the perimeter wells of a nearby field, achieving the same desired results.[55] Now referred to as waterflooding, the method uses injection wells drilled along the edge of an aging reservoir to drive the remaining oil toward centrally located producing wells.[56] By the mid-twentieth century, this enhanced recovery method had become an indispensible industry component, increasing the amount of domestically recoverable oil.[57]

Utilizing vertical drilling methods to produce hydrocarbons from horizontally oriented reservoirs proved troublesome for production engineers.[58] The majority of reservoirs are wider than they are deep causing vertical wellbores to interface with the horizontal pay zone at an inefficient juncture.[59] Rotary drilling provided operators with the ability to drill directional wells.[60] Initially developed for the offshore industry, directional drilling allows an operator to curve or bend the pipe at a gradual angle beneath the earth in order to reach a reservoir.[61] To change the direction of the well, a device called a whipstock is placed at the bottom of the hole and angles the drill in the desired direction.[62]

Horizontal drilling, a relatively modern industry advancement, was not possible in the past because rotating the drill pipe during the turn from vertical to horizontal caused drillpipe failure, such as buckling.[63] Unlike rotary wells, which operate by turning the entire drill string, horizontal drilling incorporates a downhole motor, powering only the drill bit.[64] With the development of downhole motorized drill bits, this drilling technique has become viable and

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50. *Id.*
51. *Id.*
52. RAYMOND & LEFFLER, *supra* note 27, at 9-10.
53. *Id.* at 11.
54. *Id.*
55. *Id.*
56. PATRICK H. MARTIN & BRUCE M. KRAMER, THE LAW OF OIL AND GAS 13 (Patrick C. Clark et al. eds., 9th ed. 2011); RAYMOND & LEFFLER, *supra* note 27, at 11; Broomes, *supra* note 48, § 20.02, at 20-3 to 20-4.
57. *See* Broomes, *supra* note 48, § 20.02, at 20-3 to 20-4.
58. *See* RAYMOND & LEFFLER, *supra* note 27, at 16.
59. *See id.*
60. *Id.* at 109-10.
61. CONAWAY, *supra* note 27, at 118-19.
62. RAYMOND & LEFFLER, *supra* note 27, at 109.
63. *See id.* at 16.
64. *See id.*

increasingly popular.[65] Horizontal drills are typically employed in low-permeability reservoirs in order to maximize production by exposing the wellbore to a greater area of the formation.[66]

Geophysical mapping and seismic surveys have progressed significantly, along with the rest of the industry. During the industry's infancy, petroleum geology was unheard of as a science.[67] The pervasive belief was "that oil discovery was based on luck combined with a natural talent for 'sniffing out' oil."[68] This "natural talent" for sniffing out oil simply involved locating an oil seep, then drilling exploratory wells until they hit pay dirt.[69] "Modern drilling techniques now permit operators to accurately place a wellbore within a few inches of a predetermined subsurface location."[70]

### *2. Well Stimulation Processes Increase Amounts of Domestically Recoverable Oil*

Some oil and gas reservoirs are highly permeable, achieving commercially viable production rates without the need for stimulation.[71] Many formations, however, have such limited porosity and permeability that viable production requires stimulation treatment.[72] Stimulation is accomplished by creating fractures in the formation through which hydrocarbons can more freely flow to reach the wellbore, thereby increasing production rates.[73] Modern well operators typically employ acidizing or hydraulic fracturing for well stimulation—the latter being the most common.[74] Hydraulic fracturing

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65. *See id.*; CONAWAY, *supra* note 27, at 120.

66. CONAWAY, *supra* note 27, at 120.

67. *Id.* at xiii.

68. *Id.*

69. *See id.* at 43. An oil seep is created when migrating oil fills up the underground reservoir beyond its geological potential. *Id.* The excess oil then spills over and travels to the surface. *Id.* "In the early days of the oil industry, very little was understood about geology, but wildcatters found that drilling near seeps sometimes discovered reservoirs of oil." *Id.*

70. Terry D. Ragsdale, *Hydraulic Fracturing: The Stealthy Subsurface Trespass*, 28 TULSA L.J. 311, 319 (1993).

71. CONAWAY, *supra* note 27, at 159; Laura H. Burney, *Hydraulic Fracturing: Stimulating Your Well or Trespassing?*, 44 ROCKY MTN. L. INST. §§ 19.01, 19.02(1)-.02(2)(b), at 19-4 to 19-8 (1998). "Permeability . . . is a measure of the ease in which fluid can flow through a rock. . . . The greater the permeability of the rock, the easier it is for the fluids to flow through the rock." *Id.* at 19-6.

72. CONAWAY, *supra* note 27, at 159. "Porosity . . . is a measure of the pore spaces in a rock. Pores are the holes or voids between the solid particles in a sedimentary rock . . . . Because fluids (water, gas, and oil) occur in pore spaces, porosity is a measure of that rock's storage capacity for fluid." Burney, *supra* note 71, § 19.02(2)(a), at 19-4.

73. CONAWAY, *supra* note 27, at 159; Burney, *supra* note 71, § 19.02(3), at 19-10.

74. CONAWAY, *supra* note 27, at 159; Burney, *supra* note 71, §§ 19.02(3)(a)-(c), at 19-10 to 19-11. Explosive fracturing, dating back to the 1860s, is precursor to acidizing and hydraulic fracturing. Burney, *supra* note 71, §§ 19.02(3)(a)-(c), at 19-10 to 19-11 ("The technique originally used nitroglycerine in a tin container called a torpedo. The torpedo was lowered down the well to reservoir level and then exploded. This produced a large cavity in the reservoir around the wellbore . . . . This method has declined since the 1940s with the introduction of acidizing and hydraulic fracturing and is very infrequently used today.").

has enabled operators to develop low permeability reservoirs once neglected in preference of better prospects.[75] In fact, a 2005 report to Congress revealed that greater than 90% of current wells in the United States were undergoing fracture treatments.[76]

Hydraulic fracturing "is most effective when applied to hard rock as opposed to soft sand. The producing formation must be solid enough to split, rather than to be squeezed like a sponge."[77] During hydraulic fracturing, fluid is pumped down the well and into the formation at tremendous pressure, creating large fissures emanating away from the wellbore.[78] Once fracturing is accomplished, proppants—typically sand or small plastic pellets—are forced into the reservoir to hold the newly formed fractures open.[79] Without proppants, "the frac fluid tends to bleed off into the formation, allowing the fracture to heal completely."[80] By increasing the wellbore's effect on the reservoir from less than one foot to several hundred feet, production rates may increase up to fifty times.[81]

Depending on formation type, unit size, well and wellbore location, and type of well, a fracing operation may create vertical or horizontal fractures within the reservoir.[82] Commonly used in conjunction with horizontal wells, vertical fractures are "largely limited by the rock formations that lie above and below the reservoir rock," making predictions concerning the extent and direction of these fractures relatively accurate.[83] In comparison, the extent of lateral fractures cannot generally be controlled or limited.[84] "While the pressure at which the fluids are injected can be measured and controlled, the effect of that pressure and injection on the reservoir rock at any particular location can only be estimated."[85] Thus, situations arise when a fracing operation pushes fluids, proppants, and the resulting fractures beyond unit boundary lines.[86] The influx of fracing fluid across boundary lines is temporary, as it withdraws after proppant introduction.[87] Proppants injected across unit lines, however, maintain a continuing presence, hold the fracture

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75. Broomes, *supra* note 48, § 20.01, at 20-2.

76. *Id.* (citing *The Energy Policy Act of 2005: Ensuring Jobs for Our Future with Secure and Reliable Energy: Hearing Before the H. Subcomm. on Energy and Air Quality*, 109th Cong. 111 (statement of Victor Carrillo, Chairman, Texas Railroad Commission representing the Interstate Oil and Gas Compact Commission)).

77. RAYMOND & LEFFLER, *supra* note 27, at 217.

78. *Id.* at 218-19.

79. *Id.* at 218.

80. *Id.* at 219.

81. *Id.* at 218.

82. *See* Owen L. Anderson, *Subsurface Trespass After* Coastal v. Garza, 60 INST. ON OIL & GAS L. & TAX'N 65, 75 (2009).

83. *Id.*

84. *See id.* at 75-76.

85. *Id.* at 75.

86. *See id.* at 74-75.

87. *See id.*

open, and facilitate the flow of hydrocarbons to the wellbore.[88] Once a fracing operation is completed, "the lateral extent of fractures, fluids, and proppants can only be estimated."[89] Methods of obtaining more precise measurements are quite uncommon and cost intensive.[90] From a legal perspective, hydraulic fracturing implicates theories of mineral ownership—set forth fundamentally via the rule of capture and its subsequent modifications—and the debate concerning the relative trespassory nature of such operations.[91]

## III. THEORIES OF MINERAL OWNERSHIP

Understanding the basis of mineral ownership provides an integral backdrop for a proper understanding of the corresponding causes of action. While formerly absolute, property ownership has seen the removal of sticks from its bundle to accommodate modern societal needs.[92] In tracing an analysis of the mineral estate's evolution, an important point to recognize is the distinction between the ownership and nonownership theories and the relationship of these theories to the *ad coelum* doctrine.[93]

### *A. The Ad Coelum Doctrine*

At common law, real property ownership was based upon Lord Coke's maxim: "[*C*]*ujus est solum, ejus est usque ad coelum et ad inferos* (to whomsoever the soil belongs, he owns also to the sky and to the depths)."[94] Real property ownership was thus defined by the principle of absolute ownership.[95] Over time, the need for limitations to the *ad coelom* doctrine became an apparent necessity for modern society, most notably in accordance with commercial flight.[96] In context of the oil and gas industry, the courts utilized the rule of capture to limit the *ad coelum* doctrine, as subjecting operators to liability for drainage would have impeded industry development.[97] Thus, the only remedy available to a mineral owner who feared the drainage of the oil and gas beneath his land was to drill more wells.[98]

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88. *See* Anderson, *supra* note 82, at 74-75.

89. *See id.* at 75.

90. *See generally* Burney, *supra* note 71, § 19.02(3)(c)(v), at 19-15 to 19-16 (describing three methods that could be used to measure the length of induced fractures from the surface).

91. *See id.* § 19.03, at 19-17.

92. Ragsdale, *supra* note 70, at 313.

93. *Id.* at 313-15,

94. RESTATEMENT (SECOND) OF TORTS § 159 cmt. g (1965); JOHN S. LOWE, OWEN L. ANDERSON, ERNEST E. SMITH & DAVID E. PIERCE, CASES AND MATERIALS ON OIL AND GAS LAW 21 (5th ed. 2008).

95. *See* Anderson, *supra* note 82, at 68.

96. United States v. Causby, 328 U.S. 256, 260-61 (1946). In determining the upper air to be a public highway not susceptible to private rights, the Court noted that the *ad coelum* "doctrine has no place in the modern world." *Id.* at 261.

97. Ragsdale, *supra* note 70, at 313.

98. *See* CONAWAY, *supra* note 27, at xiii; *supra* Part II.B.

### *B. The Rule of Capture*

The rule of capture defines the rights of a landowner or mineral owner to oil and gas in place.[99] Rooted in ancient Greek and Roman law, the rule of capture was originally applied to groundwater.[100] The Exchequer Chamber Court set forth what is thought to be the first judicial declaration of the rule in *Acton v. Blundell*.[101] There, the court held that an owner who extracted groundwater via a well was not liable to adjoining landowners if the extracted water migrated from beneath that adjoining property.[102] This decision resulted in the formation of the ownership-capture doctrine, a corollary to the *ad coelum* doctrine.[103] A landowner's property right still reached from the center of the earth to the heavens; however, if water drawn from that landowner's well migrated from his neighbor's, it was loss without injury.[104] Adopted from English common law and premised upon approximately 1600 years of property law, "[t]he rule of capture is one of the most well-developed areas of law of any kind in Texas."[105]

The rule states that a mineral owner acquires title to the hydrocarbons produced from wells on his land, regardless of whether part of the oil or gas migrated from beneath the lands of another.[106] Upon production, the mineral owner reduces the oil or gas to possession.[107] The rule of capture in "pure form" is universally accepted as a negative rule of liability.[108] This means a mineral owner on a common pool has no liability if hydrocarbons produced from his well happen to drain from beneath the land of another.[109] "[N]on-liability provided by the [r]ule of [c]apture influences property rights" in both ownership-in-place and nonownership jurisdictions and was originally applied regardless of whether hydrocarbons were analogized to subterranean water or wild animals.[110] Under an unlimited or unqualified approach to the rule of capture, "[e]very owner of a right to the common pool has a right to produce

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99. *See* 6 MARLA E. MANSFIELD, JAMES B. WADLEY, & DAVID A. THOMAS, THOMPSON ON REAL PROPERTY, THOMAS EDITIONS § 49.02(b) (2012).

100. Anderson, *supra* note 82, at 67; *see* Dylan O. Drummond, Lynn Ray Sherman & Edmond R. McCarthy, Jr., *The Rule of Capture in Texas—Still So Misunderstood After All These Years*, 37 TEX. TECH L. REV. 1, 16-29, 41-52 (2004).

101. *See* Acton v. Blundell, 152 Eng. Rep. 1223, 1235 (1843); Drummond et al., *supra* note 100, at 37.

102. *See Acton*, 152 Eng. Rep. at 1235.

103. Anderson, *Subsurface Trespass*, *supra* note 82, at 67-69.

104. *See id.* at 68-71.

105. Drummond et al., *supra* note 100, at 15-16.

106. *See* Halbouty v. R.R. Comm'n of Tex., 357 S.W.2d 364, 375 (Tex. 1962); 6 MANSFIELD ET AL., *supra* note 99, § 49.02(a).

107. *See* Elliff v. Texon Drilling Co., 210 S.W.2d 558, 582 (Tex. 1948).

108. *See* 6 MANSFIELD ET AL., *supra* note 99, § 49.02(b); Anderson, *Subsurface Trespass*, *supra* note 82, at 71.

109. *See Elliff*, 210 S.W.2d at 582; 6 MANSFIELD ET AL., *supra* note 99.

110. Bruce M. Kramer & Owen L. Anderson, *The Rule of Capture – An Oil and Gas Perspective*, 35 ENVTL. L. 899, 906 (2005); 6 MANSFIELD ET AL., *supra* note 99, § 49.02(a).

the oil or gas and cannot prevent others from exercising similar rights."[111] As discussed in Part II, such an approach often creates economic and physical waste, which led to modifications of the rule.[112] Though relatively simple in definition, application of the rule of capture is often quite complex.[113]

Several principles limit the operation of the rule of capture.[114] First, a mineral estate owner's recovery operations must be reasonable and legitimate, as opposed to reckless, lawless, or irresponsible.[115] Second, one may reduce to possession only oil and gas legally recovered.[116] The relative legality of oil and gas recovery depends upon the recovery's compliance with controlling statutes, conservation regulations, and the Doctrine of Correlative Rights.[117]

### *C. The Doctrine of Correlative Rights*

Correlative rights are a judicially created limit on the rule of capture recognizing that mineral owners sharing a "common reservoir have reciprocal rights and duties."[118] These rights are not statutory, but rather, "held to exist because of the peculiar physical facts of oil and gas."[119] The laws and regulations set forth by the Texas Railroad Commission and conservation statutes are designed to allow mineral owners of a common reservoir the opportunity to extract a proportionate share from the entire reservoir, while preventing "operating practices injurious to the common reservoir."[120] Thus each mineral owner shares a like interest that must be exercised with regard to the other common mineral owners.[121] This right to extract a fair share of the minerals is further qualified by reasonable and legitimate operations, and drainage resulting from such operations is not actionable.[122] In sum, the Doctrine of Correlative Rights—a common law right under the theory of ownership of minerals in place—qualifies the rule of capture in that a landowner's extraction of minerals must be lawful, proportionate, and not injurious to the source of supply.[123]

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111. 6 MANSFIELD ET AL., *supra* note 99, § 49.02(b).

112. *See id.* § 49.02(d)(2); *supra* Part II.

113. *See infra* Part IV.C-D.

114. *See* Theresa D. Poindexter, Comment, *Correlative Rights Doctrine, Not the Rule of Capture, Provides Correct Analysis for Resolving Hydraulic Fracturing Cases [*Coastal Oil & Gas Corp. v. Garza Energy Trust*, 268 S.W.3d 1 (Tex. 2008)]*, 48 WASHBURN L.J. 755, 765-66 (2009).

115. Elliff v. Texon Drilling Co., 210 S.W.2d 558, 582 (Tex. 1948).

116. *See* Halbouty v. R.R. Comm'n of Tex., 357 S.W.2d 364, 375 (Tex. 1962); Poindexter, *supra* note 114, at 765-66.

117. *See* Poindexter, *supra* note 114, at 765-66

118. *Id.* at 767.

119. *Elliff*, 210 S.W.2d at 562 (quoting 1 NANCY SAINT-PAUL, SUMMERS OIL AND GAS § 63 (3d ed. 2011)).

120. *Id.*

121. *See id.* at 562-63.

122. *See id.*

123. *See id.* at 582; *see* SAINT-PAUL, *supra* note 119, § 3:8.

### *D. The Ownership in Place Theory*

Water law and wild animal law provide the two sources for the rule of capture's application.[124] Conceptually, "[t]his dual origin of the rule of capture helps explain the two basic oil-and-gas ownership theories": the non-ownership and ownership-in-place doctrines.[125] In *Houston and Texas Central Railway Co. v. East*, the Texas Supreme Court held that the ownership-capture doctrine applied to groundwater.[126] In 1915, less than ten years after its decision in *East* and during the height of the Texas oil boom, the court determined that the ownership-capture doctrine applied to oil and gas.[127] As a result, Texas law pertaining to mineral ownership retained some semblance of the *ad coelum* doctrine, construing oil and gas as a part of the real property estate.[128]

> According to the ownership-in-place theory, the landowner owns all substances, including oil and gas, which underlie his land. Such ownership is qualified, however, in the case of oil and gas, by the operation of the law of capture. If the oil and gas depart from beneath the owned land, ownership in such substances is lost.[129]

According to the ownership-in-place theory, the right to develop and reduce the oil and gas to possession rests exclusively with the mineral owner.[130] "Due to the fugacious nature of oil and gas, however," the rule of ownership is subject to the rule of capture.[131]

### *E. The Exclusive Right to Take Theory*

In contrast, many states analogized oil and gas to wild animals in their formulation of the rule of capture.[132] The exclusive right to take theory, or nonownership theory, is strikingly similar to the rule of capture portrayed in *Pierson v. Post*.[133] Unlike the ownership-in-place theory that operates as a corollary to the *ad coelum* doctrine, the nonownership theory—by likening hydrocarbons to *ferae naturae*—stands as an exception.[134] According to the

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124. Anderson, *supra* note 82, at 68-69; *see, e.g.*, Pierson v. Post, 3 Cai. 175 (N.Y. Sup. Ct. 1805) (establishing the famous rule that the act of capturing a wild animal accords possessory ownership).

125. Anderson, *supra* note 82, at 68-71 (citations omitted).

126. See *id.* at 68; *see* Houston & Tex. Cent. Ry. Co. v. East, 81 S.W. 279, 280-82 (Tex. 1904).

127. Anderson, *supra* note 82, at 69; *see* Texas Co. v. Daugherty, 176 S.W. 717, 719-21 (Tex. 1915); *supra* Part II.A-B.

128. *See Elliff*, 210 S.W.2d at 561; Ragsdale, *supra* note 70, at 314-15.

129. LOWE ET AL., *supra* note 94, at 26.

130. *See* Bender v. Brooks, 127 S.W. 168, 170 (Tex. 1910); Ragsdale, *supra* note 70, at 314-15.

131. Ragsdale, *supra* note 70, at 315. *See Elliff*, 210 S.W.2d at 561-62.

132. Anderson, *supra* note 82, at 69.

133. *Id. See generally* Pierson v. Post, 3 Cai. 175 (N.Y. Sup. Ct. 1805) (discussing the rule of capture).

134. Anderson, *supra* note 82, at 69.

nonownership theory, a landowner does not own the minerals beneath the land.[135] Instead, an owner possesses an exclusive right—as a profit a prendre—to capture the hydrocarbons by operations on his land.[136] Once reduced to possession, the minerals "become the object of absolute ownership."[137] "Thus, the lawful exercise of this right to capture and actual capture confers possessory ownership to oil and gas as the personal property of the capturer."[138] Although trespass liability has been diminished per public policy concerns, such a determination in terms of the subsurface estate stands in opposition to the ownership-in-place theory of mineral ownership in Texas.

## IV. THE LAW OF TRESPASS AND THE DEVELOPMENT OF ITS SUBSURFACE COUNTERPART

During the early days of the petroleum industry, little care or attention was paid to subsurface trespass issues.[139] Encouraged by the rule of capture, a mineral owner was compelled to construct at least as many wells as his neighbor for fear of drainage.[140] At the Spindletop oil field, for example, wells were situated so densely that one could walk from oil derrick to oil derrick without ever stepping foot on the ground.[141] Certainly, though concededly inadvertent, subsurface trespass had occurred.[142] Not until the 1930s, with the development of whipstocks and surveying equipment, did the subsurface trespass conception begin to develop.[143]

The conceptual roots of subsurface trespass law developed from traditional surface trespass.[144] The discovery of oil in Texas and California during the early 1900s "caused a massive surge in the transfer of property rights that affected the ability to explore for oil," often leading to drilling rights disputes.[145] Applying ordinary trespass principles, courts typically found that "one who unlawfully entered the land of another to drill for and produce oil was a trespasser, and was therefore not entitled to the oil severed from the land."[146] The severity of this rule was mollified where the trespasser acted in

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135. LOWE ET AL., *supra* note 94, at 26.

136. *Id.*; Anderson, *supra* note 82, at 69; Ragsdale, *supra* note 70, at 314.

137. LOWE ET AL., *supra* note 94, at 26.

138. Anderson, *supra* note 82, at 69.

139. Ragsdale, *supra* note 70, at 317-18.

140. *See id.*

141. F.J.S. Sur, *The Petroleum Industry: Condition of the Spindletop Oil Field*, 111 ENG'G & MINING J. 273 (1921).

142. *See* Ragsdale, *supra* note 70, at 317-18.

143. *Id.* at 318-19. "[S]urveying instruments were developed which could measure the direction and angle of deviation of a wellbore from the vertical. This technological advance provided a defense mechanism to landowners suspicious of questionable drilling practices by neighboring operators." *Id.* at 319.

144. *See* Robert P. Thibault et al., *A Modern Look at the Law of Subsurface Trespass: Does it Need Review, Refinement, or Restatement?*, 54 ROCKY MTN. L. INST. § 24.01, § 24.02(1), at 24-4 (2008); Broomes, *supra* note 48, § 20.03, at 20-7.

145. Broomes, *supra* note 48, § 20.03, at 20-7.

146. *Id.* (citing Bender v. Brooks, 127 S.W. 168, 170 (Tex. 1910)).

good faith by permitting recovery of drilling and production costs.[147] On the other hand, an interloper acting in the absence of good faith recouped no expenses, leaving the lawful owner a free producing well.[148] The subsurface trespass tort logically extended from surface trespass law.[149] Generally, "an unlawful physical entry onto the mineral estate of another" constitutes subsurface trespass.[150] Trespassory intent need not be shown, except as a measure of damages, as long as the trespasser's breach of another's property boundary was direct and volitional.[151] While the application of subsurface trespass law during the early days of the oil and gas industry was relatively straightforward, technological advancements have complicated determinations of whether or not certain subsurface operations are a trespass.[152]

### *A. Subsurface Trespass: Deviated, Directional, and Horizontal Wells*

Just as an interloper was restricted from openly drilling on the land of another, courts refused to permit clandestine invasions from below.[153] The most conclusive instance of actionable trespass manifests when an operator drills a directional well that unlawfully bottoms beneath another's property.[154] The Texas Supreme Court considered such a situation in *Hastings Oil Co. v. Texas Co.*, one of the earliest reported cases in Texas involving directional well subsurface trespass.[155] There, Hastings and Texas owned adjoining oil and gas leases.[156] Hastings drilled a well that deviated from its vertical path and bottomed beneath lands owned by Texas, which sought injunctive relief.[157] The court upheld the injunction, noting that in equity, courts are allowed greater latitude in instances of trespass to mining property than trespass to real property because "the injury goes to the immediate destruction of the minerals

147. *See* OWEN L. ANDERSON ET AL., HEMINGWAY OIL AND GAS LAW AND TAXATION § 4.2(B)(1), at 153 (4th ed. 2004); Broomes, *supra* note 48, § 20.03, at 20-7.

148. Broomes, *supra* note 48, § 20.03, at 20-7.

149. *Id.*

150. Thibault et al., *supra* note 144, § 24.02(1), at 24-4; Ragsdale, *supra* note 70, at 320-23.

151. *See* Thibault et al., *supra* note 144, § 24.02(1), at 24-4.

152. *See id.* § 24.02(1)(a)-(b), at 24-5 ("The earliest cases establishing the law of subsurface trespass arose from intentional or inadvertent slant wells (wells that do not have a perfectly vertical wellbore); these early slant wells often resulted in completion on and production from another party's mineral estate. Off-lease bottoming is the conceptually simplest type of subsurface trespass.").

153. Broomes, *supra* note 48, at 4.

154. *See* Ragsdale, *supra* note 70, at 320; Thibault et al., *supra* note 144, § 24.02(1), at 24-4*; see also* Owen L. Anderson, *Subsurface "Trespass": A Man's Subsurface Is Not His Castle*, 49 WASHBURN L.J. 247, 256 (2010) (noting that actionable trespass exists assuming that the neighboring property is not part of that well's lease pool or drilling unit).

155. *See* Hastings Oil Co. v. Tex. Co., 234 S.W.2d 389, 398 (Tex. 1950); Ragsdale, *supra* note 70, at 320 (noting that *Hastings* is one of the earliest reported cases of deviated "well subsurface trespass in an ownership in place jurisdiction").

156. *Hastings*, 234 S.W.2d at 390.

157. *See id.* at 390-91.

which constitute the chief value of this species of property."[158] As *Hastings* shows, courts are quite eager to apply a straightforward subsurface trespass analysis in cases involving a slant well completed without authorization beneath an adjoining parcel.[159] Such actions may occur by accident (good faith), or purposefully (bad faith).[160] While a court's relative determination of an alleged trespasser's intent is not a necessary element of the tort, it is required for damage calculations.[161] In contrast to other subsurface operations, like hydraulic fracturing, no beneficial public utility is derived from allowing deviated wells to occur without liability.[162]

Unlike deviated wells that unintentionally or nefariously bottom on another's mineral estate, modern directional wells purposefully target areas of the reservoir great lateral distances from the drilling pad.[163] In order to reach a predetermined pay zone or avoid certain obstacles, necessity may require the wellbore to pass through another owner's mineral estate.[164] In *Browning Oil Co. v. Luecke*, the Lueckes executed several leases containing pooling clauses restricted by anti-dilution provisions that required any pooled unit contain a minimum percentage of the Lueckes' land.[165] Utilizing their pooling power, the lessees formed two units—each in violation of the Lueckes' anti-dilution provisions—then commenced two horizontally drilled wells.[166] The first well, situated on the Lueckes' land, traversed through one Luecke tract and seven other separately owned tracts.[167] The second well was not installed on Luecke surface property, although the horizontal wellbore passed through two of their tracts.[168]

In response to the anti-dilution provision violation, the Lueckes filed suit, claiming royalties on all production from the first well and double royalties on all production from the second.[169] The court of appeals rejected the Lueckes' claim to royalties on all production, in part, due to "the geophysical

158. *Id.* at 398 (quoting 1 JAMES L. HIGH, A TREATISE ON THE LAW OF INJUNCTIONS § 730 (4th ed. 1905)); *see also* Ragsdale, *supra* note 70, at 321 ("Implicit in the court's holding is the notion that a directional well subsurface trespass, if proved, constitutes an actionable tort . . . .").

159. *See Hastings*, 234 S.W.2d at 396-97; Broomes, *supra* note 48, at 4 (citing Bender v. Brooks, 127 S.W. 168, 170 (Tex. 1910)); David E. Pierce, *Trespass Issues in a Shale Play*, 5 ROCKY MTN. MIN. L. INST. 7, 3-4 (2010); *see also* Ragsdale, *supra* note 70, at 321 (noting in ownership-in-place jurisdictions, like Texas, directional well subsurface trespass "raises few issues as to whether the elements of the [trespass] tort are satisfied").

160. *See* Ragsdale, *supra* note 70, at 321-23; Thibault et al., *supra* note 144, at 12.

161. *See* Ragsdale, *supra* note 70, at 321.

162. *See* Anderson, *supra* note 154, at 256 (noting that trespassory wells are "not necessary for the exploitation of oil and gas resources because a non-trespassing well could be drilled to exploit the same resources"); Pierce, *supra* note 159, at 5.

163. Thibault et al., *supra* note 144, § 24.02(1)(b), at 24-5 to 24-8.

164. *See id.*

165. Browning Oil Co. v. Luecke, 38 S.W.3d 625, 638-39 (Tex. App.—Austin 2000, pet. denied).

166. *Id.*

167. *Id.*

168. *Id.*

169. *Id.* at 639.

characteristics of the formation [that] actually inhibit the natural drainage underlying the rule of capture . . . ."[170] The Austin Chalk—the formation then at issue—possesses low porosity and low permeability, is highly fractured, and is suitable for only horizontal wells.[171] Because of these unique reservoir characteristics, the court concluded that "the migratory nature of oil and gas that supplies the rationale for the rule of capture and the Lueckes' claim to all production from neighboring tracts does not apply to horizontal wells drilled in highly fractured formations."[172] Therefore, each separate perforation point along the horizontal wellbore extracts hydrocarbons from isolated fractures, with no drill naturally draining minerals from all tracts.[173] The rule of capture would, however, permit the Lueckes claim to royalties on all production in the instance of a vertical well situated upon their land.[174]

### *B. Geophysical and Perforation Trespass*

Hydrocarbon recovery operations not involving a physical invasion of the wellbore may also be trespassory. Obtaining geophysical information about another's mineral estate unlawfully is a form of subsurface trespass.[175] Generally, Texas courts deny recovery for geophysical trespass unless a physical invasion of some "thing" has occurred.[176] For example, in *Kennedy v. General Geophysical Co.*, the plaintiff alleged that vibrations—resulting from the defendant's adjacent geophysical blasting operations—that entered into his mineral estate were trespassory.[177] The court concluded no actionable trespass had occurred because the influx of vibrations into the plaintiff's mineral estate caused no physical damage and did not provide the defendant with information concerning the plaintiff's mineral estate.[178] In *Villarreal v. Grant Geophysical, Inc.*, the court of appeals considered similar circumstances raising the issue of geophysical trespass.[179] Specifically, the court considered whether three-dimensional mapping that collected information from non-consenting mineral owners constituted a trespass without the occurrence of a physical entry.[180] Denying the plaintiff recovery in trespass, the court

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170. *Id.* at 645.
171. *Id.*at 645-46.
172. *Id.* at 646.
173. *Id.*
174. *Id.*
175. *See* Thibault et al., *supra* note 144, § 24.02(1)(e)(ii), at 24-15.
176. *See id.* § 24.02(1)(e)(ii), at 24-15 to 24-16.
177. *See* Kennedy v. Gen. Geophysical Co., 213 S.W.2d 707, 708 (Tex. Civ. App.—Galveston 1948, writ ref'd n.r.e.); Thibault et al., *supra* note 144, at 6-7.
178. *See Kennedy*, 213 S.W.2d at 709, 712-13. The court noted, "Trespass may also be committed by shooting onto or over the land, by explosions, by throwing inflammable substances, by blasting operations, by discharging soot and carbon, but not by mere vibrations." *Id.* at 711.
179. *See* Villarreal v. Grant Geophysical, Inc., 136 S.W.3d 265, 267 (Tex. App.—San Antonio 2004, pet. denied).
180. *See id.* at 266-67.

reluctantly recognized that the physical entry requirement of trespass is settled Texas law.[181]

Subsurface trespass may also occur during the perforation of the well casing.[182] Perforation is the practice of puncturing holes in the steel and concrete liner of a well within the reservoir, facilitating the influx of hydrocarbons.[183] Often, different reservoirs exist atop one another separated by layers of impermeable rock.[184] Deeper lease operators must drill through the shallow leases in order to reach their area of the reservoir.[185] These deep lease operators hold a right of access, "allowing drilling through the mineral interest of another."[186] The operator does not possess the right to perforate the well casing in areas not within its lease.[187] Called "off-lease perforating," such actions are "a form of subsurface trespass because it allows an operator to unlawfully produce from a vertically neighboring mineral estate."[188] Off-lease perforating is rare in practice.[189] Usually, all perforation locations must be reported to the state regulatory authority and require a great amount of specialized technical expertise, making "unscrupulous perfing a difficult prospect, especially where the division between estates is a bright-line . . . between well-differentiated reservoir rock types."[190] The foregoing demonstrates instances of subsurface operations that may be trespassory, depending on the factual circumstances; however, not all hydrocarbon recovery operations involving physical invasions that transcend property lines are considered a trespass.[191]

### *C. Secondary Recovery Operations*

Secondary or enhanced recovery operations are designed to maintain or increase production of an existing well once a reservoir's natural production energy has decreased.[192] These operations involve the injection of salt water, carbon dioxide, chemicals, natural gas, or other substances into a reservoir.[193] Unlike the unauthorized deviation of a well across ownership boundaries, which courts affirmatively recognize as trespassory, secondary recovery operations have "given pause to the courts in the evolution of this subsurface

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181. *See id.* at 270 ("Although it appears that Texas law regarding geophysical trespass has not kept pace with technology, as an intermediate court we must follow established precedent.").
182. *See* Thibault et al., *supra* note 144, § 24.02(1)(c), at 24-9 to 24-10.
183. *See id.* at 24-10.
184. *See id.*
185. *See id.*
186. *Id.* at 24-9.
187. *Id.* at 24-10.
188. *Id.* at 24-9.
189. *Id.*
190. *Id.* at 24-9 to 24-10.
191. *Id.*; *see* Broomes, *supra* note 48, § 20.03(2)(a), at 20-8.
192. *See* Thibault et al., *supra* note 144, § 24.02(1)(d), at 24-10.
193. *See id.*

tort."[194] In *Railroad Commission of Texas v. Manziel*, Manziel sought to set aside and cancel a waterflood permit issued by the Railroad Commission to Whelan, owners of an adjoining tract, arguing that the injected water would constitute a trespass and result in the destruction of their own well.[195] The Railroad Commission posited that permitting the location of injection wells was necessarily within its authority to prevent drainage and protect correlative rights.[196] The court upheld the Commission's order, finding persuasive the social utility derived from secondary recovery operations, despite the fact that such operations result in a physical invasion much greater than a wellbore.[197]

### *D. Trespass: Hydraulic Fracturing*

Trespass issues concerning hydraulic fracturing are more convoluted than that of a deviated well. Unlike enhanced recovery operations and directional drilling, the Texas Railroad Commission does not regulate hydraulic fracturing through a permitting process.[198] Though the Texas Supreme Court now appears to favor a departure from the view that subsurface rights are synonymous with that of the surface, such was not always so.[199] In *Gregg v. Delhi-Taylor*, the court held that allegations of hydraulic fracture subsurface trespass are for the courts to decide, rather than the Texas Railroad Commission.[200] There, Gregg was the owner of an oil and gas lease, while Delhi-Taylor owned the surrounding mineral estate.[201] Gregg drilled and planned to fracture a well thirty-seven and a half feet from the boundary line with Delhi-Taylor, who subsequently brought suit to enjoin the impending subsurface trespass.[202] The court ultimately determined Delhi-Taylor's allegations sufficiently raised the issue of trespass.[203] Specifically, the court

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194. Broomes, *supra* note 48, § 20.03(2)(a), at 20-8.

195. *See* R.R. Comm'n of Tex. v. Manziel, 361 S.W.2d 560, 561 (Tex. 1962). Waterflooding is a secondary recovery method "in which water is injected into an oil reservoir for the purpose of washing the oil out of the reservoir rock and into the bore of a producing well." PATRICK H. MARTIN & BRUCE M. KRAMER, WILLIAMS & MEYERS MANUAL OF OIL AND GAS TERMS 1049 (14th ed. 2009).

196. *See Manziel*, 361 S.W.2d at 565.

197. *See id.* at 568-69 ("The technical rules of trespass have no place in the consideration of the validity of the orders of the Commission."); *see* Broomes, *supra* note 48, § 20.03(2)(a), at 20-8 to 20-9.

198. *See* Coastal Oil & Gas Corp. v. Garza Energy Trust, 268 S.W.3d 1, 15 (Tex. 2008); Anderson, *supra* note 154, at 258.

199. *See Coastal*, 268 S.W.3d at 11, 17; Gregg v. Delhi-Taylor Oil Corp., 344 S.W.2d 411, 412 (Tex. 1961); Hastings Oil Co. v. Texas Co., 234 S.W.2d 389 (Tex. 1950); Elliff v. Texon Drilling Co., 210 S.W.2d 558, 561 (Tex. 1948).

200. *See Gregg*, 344 S.W.2d at 412-16; Delhi-Taylor Oil Corp. v. Holmes, 344 S.W.2d 420 (Tex. 1961), *rev'g*, 337 S.W.2d 479 (Tex. Civ. App.—San Antonio 1960, writ granted). *Holmes* is a companion case to *Gregg*. *Gregg*, 344 S.W.2d at 420. Both cases involved nearly identical fact patterns concerning the judicial nature of subsurface trespass claims arising from hydraulic fracturing. *See id.* In *Holmes*, the Texas Supreme Court reinstated a temporary injunction issued by the trial court against the defendant Holmes, as evidence showed that sand fracing operations instituted by Holmes would be trespassory. *Id.* at 420-21.

201. *Gregg*, 344 S.W.2d at 412.

202. *Id.*

203. *Id.*

dictated that Gregg's actions were direct, intentional, and constituted a physical invasion.[204]

> While the drilling bit of Gregg's well is not alleged to have extended into Delhi-Taylor's land, the same result is reached if in fact the cracks or veins extend into its land and gas is produced therefrom by Gregg. To constitute a trespass, 'entry upon another's land need not be in person, but may be made by causing or permitting a thing to cross the boundary of the premises.'[205]

While the preceding commentary from the court in *Gregg* is merely dicta, it remained "the only reported judicial pronouncement on hydraulic fracture subsurface trespass" for three decades.[206]

Then, in 1991, the Texas Supreme Court encountered *Geo Viking, Inc. v. Tex-Lee Operating Co.* in which it specifically held for the first time that "fracing under the surface of another's land constitutes a subsurface trespass."[207] There, Tex-Lee sued Geo Viking for breach of contract, alleging an improperly performed fracture operation.[208] Evidence suggested that the hydraulic fractures extended beyond lease boundaries more that 2,500 feet from the wellbore.[209] These fractures failed to establish communication with the natural fractures of the formation, prompting Tex-Lee's breach of contract suit.[210] On appeal, Geo Viking contested the sizeable jury award, arguing that it should have been liable only for the recoverable oil within the lease boundaries.[211] As a result, Geo Viking complained, Tex-Lee did not have the recovery rights to some of the oil as a result of the hydraulic fractures.[212] The appellate court rejected this argument as "in direct opposition to the rule of capture."[213] Per the rule of capture, self-help—the drilling of offset wells—stood as the proper remedy.[214]

The Texas Supreme Court reversed, holding that "the rule of capture would not permit Tex-Lee to recover for a loss of oil and gas that might have been produced as the result of fracing beyond the boundaries of its tract."[215] The court specifically expressed criticism that the court of appeals, through

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204. *Id.*

205. *Id.* at 416 (quoting Glade v. Dietert, 295 S.W.2d 642, 645 (Tex. 1956)).

206. Ragsdale, *supra* note 70, at 340.

207. Geo Viking, Inc. v. Tex-Lee Operating Co., No. D-1678, 1992 WL 80263, at *2 (Tex. Apr. 22, 1992), *opinion withdrawn and superseded on overruling of reh'g*, 839 S.W.2d 797 (Tex. 1992) (citing Elliff v. Texon Drilling Co., 210 S.W.2d 558, 561 (1948); Amarillo Oil v. Energy-Agri Products, 794 S.W.2d 20, 27 (Tex. 1990)).

208. *Id.* at *1.

209. *Id.*

210. *Id.*

211. Geo Viking, Inc. v. Tex-Lee Operating Co., 817 S.W.2d 357, 363-64 (Tex. App.—Texarkana 1991), *writ denied*, 839 S.W.2d 797 (Tex. 1992) (per curiam).

212. *Id.*

213. *Id.* at 364 (citing Brown v. Humble Oil & Ref. Co., 83 S.W.2d 935, 940 (Tex. 1935)).

214. *Id.*

215. *Geo Viking*, 1992 WL 80263, at *2.

reliance on the rule of capture, held Geo-Viking liable for oil production losses from extra-lease reservoirs.[216] In an interesting wrinkle, the Texas Supreme Court withdrew its opinion as improvidently granted six months later in a memorandum opinion, letting stand the previously reversed court of appeals's decision.[217]

## V. HYDRAULIC FRACTURING AND TRESPASS: THE COURT'S DECISION IN *COASTAL V. GARZA*

In *Coastal v. Garza*, the Texas Supreme Court finally considered the hydraulic fracture subsurface trespass issue directly on point.[218] The decision, with a single concurrence and three dissenting justices, was set to clarify a long-anticipated jurisprudential determination concerning hydraulic fracture subsurface trespass.[219] Indeed, at the case's outset an affirmative modern pronouncement toward trespassory concerns arising from fracturing operations had not been given.[220]

### *A. The Majority Concludes the Rule of Capture Precludes the Trespass Tort*

Justice Hecht delivered the opinion of the Texas Supreme Court, addressing first Salinas's claim that the influx of "hydraulic fracturing fluid and proppants into another's land two miles below the surface constitutes a trespass for which the minerals owner can recover damages equal to the value of the royalty on the gas thereby drained from the land."[221] Coastal argued that Salinas, as lessor, had no possessory right to the minerals, and therefore, no standing in trespass.[222] The court disagreed, viewing Salinas's reversion interest as similar to the reversion interest of a landlord.[223] Combined with the allegations of actual concrete harm, the standing requirement was fulfilled.[224]

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216. *See id.*

217. *See Geo Viking*, 839 S.W.2d at 798 ("In denying petitioner's application for writ of error, we should not be understood as approving or disapproving the opinions of the court of appeals analyzing the rule of capture or trespass as they apply to hydraulic fracturing."). *See generally* Ragsdale, *supra* note 70, at 340 (providing a thorough analysis of the *Geo Viking* cases).

218. *See* Coastal Oil & Gas Corp. v. Garza Energy Trust, 268 S.W.3d 1, 4 (Tex. 2008).

219. *See, e.g.*, Respondents' Brief on the Merits at 10, Coastal Oil & Gas Corp. v. Garza Energy Trust, 268 S.W.3d 1 (Tex. 2008) (No. 05-0466), 2005 WL 3775561 (commenting on the "wide notoriety" this case received from the industry).

220. *See supra* Part IV.D.

221. *Coastal*, 268 S.W.3d at 9.

222. *Id.*

223. *See id.* at 9-10.

224. *See id.* Justice Hecht noted that Salinas could recover nominal damages on this claim of trespass, but rather, "[h]e must prove actual injury." *Id.* at 11.

The court then turned to the hydraulic fracture subsurface trespass issue and ultimately concluded that the rule of capture precluded Salinas's claim.[225]

The majority gave four reasons for its holding.[226] First, an aggrieved mineral owner seeking recovery for drainage is already provided full recourse under the law.[227] An aggrieved property owner in such a situation may find recourse by drilling his own wells to offset the drainage, seeking drainage prevention regulation from the Texas Railroad Commission, suing the lessee for violating the implied covenant to prevent drainage, or seeking to pool.[228] Second, allowing recovery for drainage induced by hydraulic fracturing "usurps to courts and juries the lawful and preferable authority of the Railroad Commission to regulate oil and gas production."[229] Third, the court reasoned that the judicial system is ill equipped in making determinations of the value of the hydrocarbons drained.[230] Finally, the court found persuasive the numerous industry participants that strongly opposed hydraulic fracture liability.[231] Thus, the court decided—without deciding—that Salinas could not recover in trespass.

### *B. Justice Johnson Finds Holes in the Majority Opinion*

Justice Johnson delivered a separate opinion, criticizing the majority's refusal to address the trespass issue.[232] Though the rule of capture finds its basis in the fugitive nature of oil and gas, the gas here migrated as a result of hydraulic fracturing, not because of naturally occurring reservoir pressure changes.[233] Had the drainage occurred as a consequence of natural hydrocarbon migration, the dissent observed, the rule of capture would undoubtedly operate to insulate Coastal from liability.[234] Furthermore, the jury found the fracing operation trespassory, a conclusion Coastal declined to contest and, instead, advocated that "subsurface trespass by hydraulic fracturing is not actionable."[235] Justice Johnson found dispositive the issue concerning the legality of Coastal's fracing operation.[236] If illegal, the rule of

225. *Id.* at 12-13, 17. "The rule of capture is a cornerstone of the oil and gas industry and is fundamental both to property rights and to state regulation." *Id.* at 13.
226. *Id.* at 14.
227. *Id.*
228. *Id.*; *see* Anderson, *supra* note 82, at 87.
229. *Coastal*, 268 S.W.3d at 14-15.
230. *Id.* at 16.
231. *See id.* at 16-17.
232. *See id.* at 42-44 (Johnson, J., concurring in part and dissenting in part).
233. *Id.* at 42-43.
234. *Id.* at 42.
235. *Id.* at 42-43.
236. *Id.* at 43-44.

capture was inapplicable.[237] The majority refused Salinas's subsurface trespass claims because Coastal's operations did not violate a statute or regulation, nor did Salinas allege Coastal's fracing operation caused damage to his wells or reservoir.[238] In effect, the majority surmised, Salinas failed to claim recoverable damages.[239] Despite these determinations, the issue whether hydraulic fracturing across lease lines constitutes a subsurface trespass was left unanswered.[240]

Limiting the rule of capture to legally recoverable hydrocarbons stands as established precedent.[241] For example, in *Elliff v. Texon Drilling Co.* the court noted that "each owner of land in a common source of supply of oil and gas has legal privileges as against other owners of land therein to take oil or gas therefrom by *lawful* operations conducted on his own land."[242] Over a decade later in *Gregg*, the court clarified that the issue became ultimately a "question of trespass and whether the law of capture includes the right to capture by artificial means or capture by trespass."[243] Without the lawful requirement, "the rule of capture becomes only a license to obtain minerals in any manner, including unauthorized deviated wells . . . and whatever other method oilfield operators can devise."[244] Therefore, by holding that the rule of capture precluded Salinas's trespass claims, the majority neglected this crucial element of the rule of capture.[245] As Justice Johnson aptly noted, the issue regarding subsurface trespass by hydraulic fracturing remains dubitable.[246]

## VI. *COASTAL* USHERS IN DISPUTE CONCERNING SUBSURFACE RIGHTS AND PROTECTIONS

The majority opinion in *Coastal* was not persuaded that subsurface property rights should be equivalent to surface rights, a position that finds favor with many academics and commentators.[247] Indeed, there appears to be

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237. *Id.* at 43 (noting that, "[i]n the face of this record and an uncontested finding that Coastal trespassed on Share 13 by the manner in which it conducted operations on Share 12, I do not agree that the rule of capture applies").

238. *Id.* at 13 (majority opinion).

239. *See id.* at 12-13 (holding that "the gas [Salinas] claims to have lost simply does not belong to him").

240. *See id.* at 12-13, 17 (stating that the broader issue did not need to be decided here).

241. *See id.* at 43 (Johnson, J., concurring in part and dissenting in part).

242. *Id.* (quoting Elliff v. Texon Drilling Co. 210 S.W.2d 558, 561 (Tex. 1948)).

243. Gregg v. Delhi-Taylor Oil Corp., 344 S.W.2d 411, 418 (Tex. 1961). The dicta in *Gregg* concerning hydraulic fracture subsurface trespass remained the only judicial determination on this specific issue until *Coastal* as a result of the court's withdrawal of its opinion in *Geo Viking*. *See* Ragsdale, *supra* note 70, at 340-42.

244. *Coastal*, 268 S.W.3d at 43 (Johnson, J., concurring in part and dissenting in part).

245. *See id.* at 43-44.

246. *See id.* at 44.

247. *See id.* at 11 (majority opinion); Anderson, *supra* note 154, at 253-54. *See generally* Owen L. Anderson, *Lord Coke, The Restatement, and Modern Subsurface Trespass Law*, 6 TEX. J. OIL GAS &

a common thread among those who argue for diminished subsurface property rights.[248]

### *A. The Battle of Analogies—Searching for Applicable Jurisprudence Among Counterpart Recovery Operations*

Hydraulic fracturing operations are often compared to other oil and gas recovery operations in the quest to find the most applicable existing legal principles. As the following discourse reveals, analogizing trespass jurisprudence among hydraulic fracturing and counterpart industry operations presents no simple endeavor.[249] Characteristically, fracing is an amalgam of its counterparts, sharing in the indispensability and popularity of waterfloods while incorporating physical and functional attributes that make deviated wells prohibitively trespassory.[250] In light of these disparities, equity may best be served by abandoning comparative reliance, forging more suitable hydraulic fracture trespass jurisprudence from the lessons gleaned from those concomitant operations.[251]

#### *1. Enhanced Recovery Operations: Waterfloods and Social Utility*

Hydraulic fracturing has been compared to enhanced recovery operations that maintain reservoir pressure, such as waterfloods.[252] While both recovery operations share the same general purpose, stark differences arise in both the treatment given by the courts and the repercussions to the mineral estate's viability.[253] For instance, "a waterflood inflicts catastrophic damage to mineral owners who are not included in the secondary recovery unit."[254] The injected water drives the hydrocarbons from the reservoir's periphery towards the producing wellbore, irreversibly destroying any production potential from the inundated mineral estates.[255] Mineral owners not participating in the unit are left with nothing.[256] Comparatively, hydraulic fracturing does not permanently devastate the adjoining mineral estate into which it invades, but rather facilitates unauthorized mineral extraction.[257] Though instances of extra-boundary fracturing may fundamentally satisfy all trespassory elements, an

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ENERGY L. 203 (2010) (presenting an argument that the Second Restatement of Torts should be amended whereby subsurface trespass is likened to airspace trespass law).

248. *See* Anderson, *supra* note 154, at 253-54; Anderson, *supra* note 247; Anderson, *supra* note 82, at 69.

249. *See infra* part VI.A.1.

250. *See infra* part VI.A.1-2.

251. *See infra* part VI.A.3.

252. *See* Broomes, *supra* note 48, §§ 20.01-.02, at 20-3 to 20-5.

253. *See id.* § 20.04, at 20-23 to 20-25.

254. *Id.* § 20.04, at 20-23.

255. *Id.* § 20.04, at 20-23 to 20-29.

256. *Id.* § 20.04, at 20-24.

257. *See id.* § 20.04, at 20-23.

aggrieved party possesses options to mitigate any damages not available to parties on the wrong side of a waterflood.[258] For all practical purposes, however, had a waterflood not occurred, the owner likely would not have been able to extract those hydrocarbons originally due to deteriorating reservoir pressure.[259] Unlike modern hydraulic fracturing, which operators commonly employ as a primary recovery operation to foster production from an otherwise nonviable formation, waterfloods are a secondary recovery method developed to rejuvenate production from aging reservoirs.[260]

Notwithstanding the glaring discrepancy between the purpose and damaging characteristics of waterfloods and hydraulic fracturing, the Texas judiciary historically has more readily embraced the inherent social utility of waterflooding.[261] Citing public policy concerns and the precedent set forth in *Manziel*, Justice Willett's concurrence in *Coastal* showed favor to the waterflood-fracturing analogy, writing that the court should reject trespass liability for hydraulic fracturing.[262] Indeed, hydraulic fracturing has become indispensable for recovery in low permeability reservoirs, like Texas's Barnett Shale, once considered uneconomical before fracing's development.[263]

If hydraulic fracturing is as necessary an industry component as waterflood operations, why did the court negate the opportunity to do the same in *Gregg* as it did in *Manziel*? The court's past disparate treatment of hydraulic fracturing and waterfloods may simply be explained by historical comparison. During the late 1950s and early 1960s, waterflood operations were wildly popular, rejuvenating aging reservoirs and effectively increasing domestically recoverable petroleum reserves.[264] Hydraulic fracturing, however, had yet to achieve such indispensable notoriety.[265] Today it seems that hydraulic fracturing has assumed a vital role in the petroleum industry, analogous to waterfloods during the days of the *Manziel* decision.[266]

### *2. Unauthorized Directional or Deviated Wells: Functional and Physical Perspectives*

While hydraulic fracturing's indispensability to the petroleum industry may be synonymous with secondary recovery operations, construing the

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258. *See id.*; *see, e.g.*, Coastal Oil & Gas Corp. v. Garza Energy Trust, 268 S.W.3d 1, 14-17 (Tex. 2008) (providing four remedies available for a drainage claimant in the hydraulic fracture subsurface trespass context).

259. *See* Broomes, *supra* note 48, § 20.02, at 20-3 to -4.

260. *See* Poindexter, *supra* note 114, at 774.

261. *See, e.g.*, R.R. Comm'n of Tex. v. Manziel, 361 S.W.2d 560, 568 (Tex. 1962) (noting that waterflood operations should be encouraged, as the reservoir pressure driving production declines, the public need for secondary recovery inversely increases); Burney, *supra* note 71, § 19.03(1)(c), at 19-29 to -30.

262. *See Coastal*, 268 S.W.3d at 30-33 (Willett, J., concurring).

263. *See id.*

264. *See* Broomes, *supra* note 48, §§ 20.02, .04, at 20-4, 20-24.

265. *See id.* § 20.04, at 20-24.

266. *See id.*

fractures in terms of their function—increasing formation permeability and providing an avenue for greater hydrocarbon capture—allows one to easily conclude that the wellbore and fractures are functionally synonymous.[267] Hydraulic fracturing generates artificially propped fissures within the formation, induced by an operator's intentional actions, protruding into an adjacent mineral estate, facilitating hydrocarbon capture, and thus, accomplishing the same results as a directionally drilled well.[268] In both instances, the unauthorized subsurface entry procures oil and gas from the neighboring mineral estate "in a manner not contemplated by the rule of capture."[269] But for the propped fractures or deviated well, the hydrocarbons within an adjacent mineral estate could not be captured.[270] In *Coastal*'s dissent, Justice Johnson elucidated the court's recognition of this similitude between deviated and fractured wells.[271] For instance, in *Gregg*, the court found sufficient subsurface trespass allegations to enjoin a sand fracing operation, utilizing the deviated well subsurface trespass set forth in *Hastings* in a comparative analysis.[272]

The *Coastal* majority, however, rejected the similarity between a deviated well and fracing operation exhibited in *Gregg*, giving two reasons why deviated wells are not subject to the rule of capture.[273] First, a complaining adjacent mineral owner cannot protect from drainage by drilling his own well, and second, "there is no uncertainty that the deviated well is producing another owner's gas."[274] Justice Johnson failed to find the court's logic persuasive, noting that the neighbor can protect against either a deviated well or an intruding fracture.[275] The two share the same function of drawing hydrocarbons through areas of low pressure to ultimate capture on the operator's property.[276] In such a situation, "[t]he only difference is the degree of drainage that can be prevented by offset wells, and a fracture's exposure to the reservoir may be greater than that of the deviated well and thus drain more gas."[277]

Justice Johnson also extended his critique to the majority's second reason for distinguishing deviated and hydraulically fractured wells.[278] Just like a deviated well, he observed, there also exists no uncertainty that the fractured

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267. *See Coastal*, 268 S.W.3d at 44-45 (Johnson, J., concurring in part and dissenting in part); Gregg v. Delhi-Taylor Oil Corp., 344 S.W.2d 411, 416 (Tex. 1961); Ragsdale, *supra* note 70, at 339.

268. *See Coastal*, 268 S.W.3d at 44; Ragsdale, *supra* note 70, at 339.

269. Ragsdale, *supra* note 70, at 339.

270. *See Coastal*, 268 S.W.3d at 42.

271. *See id.* at 44-45.

272. *See Gregg*, 344 S.W.2d at 416-17.

273. *See Coastal*, 268 S.W.3d at 14-15 (majority opinion).

274. *Id.* at 44 (Johnson, J., concurring in part and dissenting in part).

275. *See id.* at 44-45.

276. *Id.* at 44

277. *Id.*

278. *See id.* at 44-45.

well is draining another's gas, at least in the case at hand.[279] Both deviated and fraced wells are purpose-built to gather distant minerals, and in *Coastal*, the jury found that part of the gas captured by Coastal's well originated beneath Salinas's tract.[280]

### *3. Aircraft Trespass Law—Navigating Considerations of Blanket Subsurface Trespass Reform*

Instead of attempting to analogize hydraulic fracturing with seemingly similar petroleum industry operations, one position suggests a complete reexamination of the trespass tort, associating subsurface trespass with that of the airspace.[281] In *Coastal*, the court found favor in the aircraft analogy and the corresponding limit to the *ad coelum* doctrine.[282] Lord Coke, father of the *ad coelum* doctrine, "did not consider the possibility of airplanes. But neither did he imagine oil wells. The law of trespass need no more be the same two miles below the surface than two miles above."[283] Such a position embraces the presumption that, because the trespass is occurring at substantial depth—like an aircraft traveling at thirty thousand feet—it negates the relative harmful effects of the trespass.[284] Subsuming subsurface trespass law with aircraft trespass jurisprudence would necessitate a showing of actual and substantial harm.[285] Industry activities exempted from "harmful" demarcation include instances of deep subsurface trespass: waste injection (carbon dioxide sequestration, saltwater injection, and injection of other nonhazardous materials), gas storage, enhanced recovery operations, and hydraulic fracturing.[286] In contrast, shallow subsurface impingements would likely remain oriented in accordance with surface trespass law.[287] Such a transformation is further predicated upon the societal necessity of "efficient and utilitarian use of the subsurface."[288]

Minimizing subsurface trespass liability to these ends fails to recognize the critical discrepancy in value between the two mediums. Very often the monetary gain derived from oil and gas greatly surpasses the value of the

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279. *Id.* at 44.

280. *See id.*

281. *See* Anderson, *supra* note 247, at 204-07.

282. *Coastal*, 268 S.W.3d at 11 (majority opinion); *see* Anderson, *supra* note 247, at 204 (noting that Lord Coke's *ad coelum* doctrine is essentially embraced by the Second Restatement of Torts).

283. *Coastal*, 268 S.W.3d at 11 (citation omitted).

284. *See* Anderson, *supra* note 247, at 209-10.

285. *Id.* at 205-07.

286. *See id.* at 209-10.

287. *See id.* Professor Anderson observed, "[M]any shallow subsurface intrusions directly affect the surface and are thus essentially surface trespasses." *Id.* at 209.

288. *Id.* at 206 (citing injunctive relief and ejectment as examples of serious threats to efficient subsurface usage).

surface.[289] Herein lies the problem the airplane analogy leaves unanswered. An aircraft traveling at thirty thousand feet takes no value from the "owner" of that airspace because there, nothing exists to convert for exchange.[290] In contrast, a mineral owner possesses a profoundly lucrative material, and drainage resulting from unauthorized subsurface encroachments, such as hydraulic fracturing, may cost in the millions of dollars.[291] If one bases the scope of one's property rights in the three zones—air, surface, and subsurface—on their respective monetary yield, then necessity negates limits on subsurface trespass claims in order to protect the mineral estate.[292] Despite the utility of more efficient hydrocarbon exploration and production to fuel this country's petroleum driven economy, dispatching subsurface trespass liability fashions problems of its own.[293]

### *B. Pre-*Coastal *Trespass Law Combined with Equitable Principles, Not Trespass Preclusion, Provides a More Balanced Alternative to Public Necessity Hyperbole*

Concededly, *Coastal* presented the court with an onerous quandary implicating two contrasting extremes.[294] A determination that extra-lease hydraulic fracturing is always trespassory could inundate the petroleum industry with windfall litigation, stagnating necessary production.[295] Conversely, adjudging fracing never trespassory would conceivably destroy individual mineral rights by empowering uncompensated confiscation of property.[296] Reluctant to instigate perceived changes to the rule of capture, the court sought middle ground, confining its holding to drainage injuries.[297] In

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289. *See, e.g.*, Coastal Oil & Gas Corp. v. Garza Energy Trust, 268 S.W.2d 1, 12-13 (Tex. 2008) (noting that Salinas's expert testified that the value of gas lost due to drainage caused by Coastal's hydraulic fracturing operation was approximately valued between $388,00 and $544,000; furthermore, the jury, as evidenced by its award, determined Salinas's compensation for lost royalties to be greater than $1 million).

290. *See* United States v. Causby, 328 U.S. 256, 260-61 (1946) (determining the upper air to be a public highway not susceptible to private rights, and noting that the *ad coelum* "doctrine has no place in the modern world"); RESTATEMENT (SECOND) OF TORTS § 159(2)(a)-(b) (1965); Anderson, *supra* note 154, at 253-54.

291. *See supra* note 289 and accompanying text.

292. The Texas Supreme Court in *Hastings*, and later *Gregg*, referred to James L. High's treatise on injunctions. Hastings Oil Co. v. Texas Co., 234 S.W.2d 389, 398 (Tex. 1930); Gregg v. Dehli-Taylor Oil Corp., 344 S.W.2d 411, 416 (Tex. 1961). "In the case of trespass to mining property greater latitude is allowed courts of equity than in restraining ordinary trespasses to realty, since the injury goes to the immediate destruction of the minerals which constitute the chief value of this species of property." HIGH, *supra* note 158, § 730; *accord Hastings*, 234 S.W.2d at 391-92; *Gregg*, 344 S.W.2d at 412.

293. *See Coastal*, 268 S.W.3d at 44-46 (Johnson, J., concurring in part and dissenting in part).

294. *See* Mark E. Vandermeulen, Casenote, *The Texas Supreme Court Holds Hydraulic Fracturing Trespass Claim Is Precluded by the Rule of Capture*, 62 SMU L. REV. 835, 840 (2009).

295. *See id.*

296. *See Coastal*, 268 S.W.3d at 45-46 (Johnson, J. concurring in part and dissenting in part); Vandermeulen, *supra* note 294, at 840.

297. *See Coastal*, 268 S.W.3d at 17 (majority opinion).

effect, these conclusions have adverse ramifications for individual mineral owners.[298]

Though the court delineated four remedies available to aggrieved property owners, a closer analysis reveals their insufficiencies.[299] Foremost, while these alternatives are generally available, all Texas property owners cannot feasibly possess the knowledge, experience, and resources to effectuate those remedial benefits.[300] More critically, the court's holding reduces an operator's incentive "to lease from small property owners because they can drill and hydraulically fracture to 'capture' minerals from unleased and unpooled properties that would otherwise not be captured."[301] Further still, *Coastal* indubitably permits a lessee to forego contract negotiations with a lessor and expand existing lease boundaries unilaterally through hydraulic fracturing operations.[302] As Justice Johnson aptly noted, such circumstances now enabled by the majority are paradigmatic of the facts and circumstances encountered in *Gregg* half a decade ago.[303]

Granted, utilization of hydraulic fracturing has become preeminent in modern petroleum industry procedure since *Gregg*, making arguments concerning its necessary social utility persuasive.[304] The foregoing discussion, however, reveals that a blanket moratorium on hydraulic fracture subsurface trespass liability analogous to waterflood operations adversely impinges upon property rights due to disparate circumstances and characteristics existing between the two.[305] In essence, such an approach reverts oil and gas jurisprudence to the strict rule of capture era, "allowing operators to purposefully fracture onto adjacent property with impunity, thereby violating their neighbor's correlative rights and leaving the adjacent interest owner with little recourse."[306] Arguably, because of the unique functional and physical properties hydraulic fracturing shares with deviated wells, complete preclusion of trespass liability would empower an operator to conduct stimulation operations on both his land and the land of another.[307] A practice with such interloping properties has never been endorsed by the industry.[308] Likewise,

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298. *See id.* at 44-46 (Johnson, J., concurring in part and dissenting in part); Vandermeulen, *supra* note 294, at 840.

299. *See Coastal*, 268 S.W.2d at 45-46 (Johnson, J., concurring in part and dissenting in part).

300. *See id.* at 45.

301. *Id.*

302. *See id.*

303. *See id.*; Gregg v. Delhi-Taylor Oil Corp., 344 S.W.2d 411, 412 (Tex. 1961).

304. Broomes, *supra* note 48, § 20.05(1), at 20-25.

305. *Id.*

306. *Id.* § 20.05(1)(a), at 20-26.

307. *Id.*

308. *Id.*

holding all unauthorized subsurface intrusions due to hydraulic fracturing to be actionable trespass places an untenable burden on the industry.[309]

The majority erred in *Coastal* by unnecessarily inflating the issue before the court. While counsel for Coastal argued—and ultimately persuaded the court—that an affirmation of the court of appeals would result in rampant trespass litigation concerning fracing, Garza advocated for an unfettered application of existing subsurface trespass law, specifically declining an inquest into "whether fracture stimulation constitutes a *per se* subsurface trespass."[310] By buying into Coastal's grandiose persuasions, the court unfortunately generated enough bad facts to make bad law.[311] Pre-*Coastal* subsurface trespass jurisprudence provided more than adequate protections for operators and property owners alike, making reinstatement of such jurisprudence a more prudent articulation of institutional oil and gas legal principles.[312]

The stark similarity fracture simulation shares with waterfloods undoubtedly dictates modifications to the pre-*Coastal* tort.[313] Utilizing those established principles of subsurface trespass, judicial analysis would necessarily inquire into the relative legality or illegality of the alleged trespassory intrusion, comporting with established Texas law that limits the rule of capture to legally recovered minerals.[314] Further examination must also balance the goals of mineral lessors, lessee operators, and societal needs—giving due weight to the respective goals of mineral owners and society.[315] Courts would then turn to relevant equitable considerations as they pertain to the facts and circumstances between the parties.[316]

In consideration of industry apprehension toward debilitating litigation, judicious compromise should consider withholding punitive damages except in the most deplorable of circumstances.[317] Because a significant number of domestic wells incorporate fracture treatment, it would likely be imprudent to foster "a legal environment in which honest mistakes, oversights, and even neglect could expose an operator to punitive sanctions."[318] Although trespass

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309. *Id.* (observing that "returning the realm of fracture stimulation to the rule of capture may well invite operators to do as they please *on someone else's land*—a practice not condoned even in the early days of the industry" (emphasis in original)).

310. Respondents' Brief on the Merits at 8-10, Coastal Oil & Gas Corp. v. Garza Energy Trust, 268 S.W.3d 1 (Tex. 2008) (No. 05-0466), 2005 WL 3775561.

311. *See Coastal*, 268 S.W.3d at 19-21.

312. *See* Broomes, *supra* note 48, § 20.05(1)(d), at 20-29.

313. *See id.*

314. *See Coastal*, 268 S.W.3d at 43 (Johnson, J., concurring in part and dissenting in part); Halbouty v. R.R. Comm'n of Tex., 357 S.W.2d 364, 375 (Tex. 1962).

315. *See Coastal*, 268 S.W.3d at 43 (Johnson, J., concurring in part and dissenting in part).

316. *See id.*; Owen L. Anderson et al., HEMINGWAY OIL AND GAS LAW AND TAXATION § 4.2(B)(1), at 401 (4th ed. 2004).

317. *See Coastal*, 268 S.W.3d at 43 (Johnson, J., concurring in part and dissenting in part); Broomes, *supra* note 48, § 20.04, at 20-25.

318. Broomes, *supra* note 48, § 20.04, at 20-25. The author suggested the following:

> In order to strike a proper balance between protecting the rights of aggrieved interest holders and

litigation arising from hydraulic fracturing operations is not a "new growth industry," exclusion of exemplary damages serves to ameliorate industry concerns and promote the continued advancement of modern hydrocarbon recovery operations while preserving the necessary safeguards of individual property owners.[319]

## VII. CONCLUSION: COMPROMISE AND THE MYTH OF MUTUAL EXCLUSIVITY

The histories of Texas and the petroleum industry have been inextricably intertwined for the better part of a century.[320] Indeed, many states with developing petroleum economies rely on Texas law in the cultivation of their own oil and gas jurisprudence.[321] Hydraulic fracturing has become crucial to modern industry development, making viable many low permeability reservoirs that were once disregarded.[322] *Coastal*'s shortcomings, however, reveal that the issue of subsurface trespass by hydraulic fracturing is perhaps best resolved by the realization that the competing interests of lessee-operators and individual property owners are not mutually exclusive.[323] Limited judicial recognition of the subsurface tort would provide property owners with the ability to protect their mineral interests.[324] In addition, requiring substantial proof of a real and continuing trespass—coupled with a stringent preclusion of exemplary damages awards—would preserve and encourage the petroleum industry's continued use and development of advanced recovery techniques.[325] A compromise of this nature would more agreeably embody the long, favorable relationship between Texas citizens and the oil and gas industry.[326]

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> preserving fracturing as an essential tool to the petroleum industry, if courts choose to allow plaintiffs to sue in tort over allegations of fracture trespass, they should require better proof that a fracture crossed a lease boundary and that it is actually draining hydrocarbons from the plaintiff's property.

*Id.* § 20.05(1)(d), at 20-29.

319. Respondents' Brief on the Merits at 10, Coastal Oil & Gas Corp. v. Garza Energy Trust, 268 S.W.3d 1 (Tex. 2008) (No. 05-0466), 2005 WL 3775561.

320. *See supra* Part II.A.

321. Broomes, *supra* note 48, § 20.05, at 20-30.

322. *See supra* notes 63-81 and accompanying text.

323. *See supra* text accompanying notes 295-303.

324. *See* Broomes, *supra* note 48, § 20.05(1)(a), at 20-26.

325. *See id.*

326. *See id.*

# INADVERTENCE OR UNFAIR ADVANTAGE: THE FIFTH CIRCUIT'S AND TEXAS SUPREME COURT'S APPLICATIONS OF JUDICIAL ESTOPPEL FOLLOWING A BANKRUPTCY NON-DISCLOSURE AND HOW A PACER SEARCH CAN SPARE THE CLEANUP

## Comment

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## I. PLAYING FAST AND LOOSE

Tom Debtor was filling his 1998 Chevy pickup at the neighborhood gas station on a frigid morning in mid December.[1] When Debtor went to replace the nozzle in the pump, he stepped on black ice. Debtor's feet slipped from under him, and he fell to the ground. Debtor was rushed to the local hospital where it was discovered that Debtor sustained severe injuries, including a broken hip. Debtor was unable to operate his business as a result of his injuries, so he consulted a local attorney. Smith Attorney told Debtor he could bring a premises liability claim against the filling station. After consulting his wife, Debtor decided filing suit was the best option. Attorney prepared the pleadings. Attorney failed to ask Debtor one important question, however, and Debtor failed to disclose one important fact. Unfortunately for Debtor, the filling station's attorney did make this inquiry. Debtor and his wife had filed a joint petition for bankruptcy two years prior. Although Attorney established each element of the premises liability claim, Debtor would never make it past the filling station's motion for summary judgment on the ground of judicial estoppel.

Judicial estoppel is a doctrine most plaintiffs' attorneys rarely consider.[2] But once the court or opposing counsel raises it, judicial estoppel

1. These facts are adapted from Phillips v. Flying J Inc., 375 S.W.3d 367 (Tex. App.—Amarillo 2012, no pet.).

2. *See* Eric A. Schreiber, Comment, *The Judiciary Says, You Can't Have It Both Ways: Judicial Estoppel—A Doctrine Precluding Inconsistent Positions*, 30 LOY. L.A. L. REV. 323, 324 (1996)

is a doctrine those attorneys will never forget.[3] Given that litigants faced with judicial estoppel risk dismissal of their case, it is a threat of which all practitioners should be aware.[4] Judicial estoppel is a common law doctrine that prevents a party from asserting a position that is inconsistent with a successful position in a prior proceeding.[5] It is formulated to prevent litigants from "playing fast and loose with the courts to suit the exigencies of self interest."[6] In short, it is a principle crafted by courts to protect themselves from gamesmanship.[7] Attorneys may be unaware of this doctrine because it does not arise in day-to-day practice, but any attorney whose case has been dismissed because of this procedural weapon will realize that it is too costly to ignore.[8]

In light of the heavy consequences of judicial estoppel, this Comment explores its development in the bankruptcy setting while focusing on its application to Texas practitioners. Bankruptcy-related judicial estoppel arises when a plaintiff, who has filed bankruptcy, pursues a civil cause of action that was not disclosed to the bankruptcy court.[9] Debtors may fail to disclose because they wish to keep any potential award away from creditors, or they may fail to disclose because of oversight, confusion, or ignorance.[10] The court may then estop the plaintiff from pursuing the civil action that was not disclosed as required by the Bankruptcy Code.[11] Specifically, this Comment analyzes the intersection of civil litigation and bankruptcy law that results in a confusing doctrine crafted by non-bankruptcy courts in an attempt to protect the bankruptcy process.

To set the scene, Part II provides a background of judicial estoppel, beginning with its emergence in the United States in the non-bankruptcy setting by focusing on the Supreme Court decision of *New Hampshire v. Maine*. Part II then narrows to the doctrine's adoption in Texas and its development in the bankruptcy context. Part III lays a foundation of the relevant provisions of the Bankruptcy Code. Part IV explores the development of judicial estoppel in the Fifth Circuit Court of Appeals, namely discussing *Reed v. City of Arlington* and *Love v. Tyson Foods*. Part V discusses the application of the doctrine in the Texas Supreme Court. Consequently, Part VI analyzes the juncture of judicial estoppel as

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("Although it is an obscure legal doctrine, judicial estoppel, like other forms of estoppel, has important strategic value at trial and shame on the poor lawyer who has a case dismissed sua sponte by a court on a grounds that the lawyer has never even heard of.").

3. *See id.*

4. *See infra* Part II.C.

5. *See* New Hampshire v. Maine, 532 U.S. 742, 749 (2001).

6. *In re* Coastal Plains, Inc., 179 F.3d 197, 205 (5th Cir. 1999) (quoting Brandon v. Interfirst Corp., 858 F.2d 266, 268 (5th Cir. 1998)).

7. *See supra* notes 5-6 and accompanying text.

8. *See* Schreiber, *supra* note 2, at 323-24.

9. *See infra* Part II.C.

10. *See infra* Part II.C.

11. *See infra* Part II.C.

developed by the Fifth Circuit and as developed by the Texas Supreme Court to provide the appropriate framework for Texas practitioners. This section points to two different formulations of judicial estoppel appearing in the United States Supreme Court, the Fifth Circuit, and the Texas Supreme Court.[12] Part VII surveys the approaches of the Seventh, Tenth, and Eleventh Circuit Courts of Appeals, which the Fifth Circuit cites in *Reed v. City of Arlington*. And lastly, Part VIII asks courts to reconsider their application of the *Reed v. City of Arlington* "inadvertence" framework outside of the Chapter 7 context and encourages practitioners to conduct a Public Access to Court Electronic Records (PACER) search before filing suit to prevent the doctrine's application altogether.

## II. DEVELOPMENT OF JUDICIAL ESTOPPEL

### *A. Emergence in the United States*

The origin of judicial estoppel can be traced to the Supreme Court of Tennessee in an 1857 opinion.[13] The purpose of this doctrine is to protect the integrity of the courts by preventing a party from manipulating the court system and prejudicing the administration of justice.[14] In *New Hampshire v. Maine*, the United States Supreme Court addressed judicial estoppel for the first time in the context of a boundary dispute between the two states concerning lobster fishing rights—notably, a non-bankruptcy setting.[15] The Court listed three factors for consideration: (1) the later position must be clearly inconsistent; (2) the party must have succeeded in persuading the court to accept the prior position; and (3) the party asserting the inconsistent position must "derive an unfair advantage or impose an unfair detriment on the opposing party."[16] The Court stated that judicial estoppel is an equitable doctrine that is invoked by courts at their discretion.[17] The Court also emphasized that it was not establishing a rigid or exhaustive standard, but rather that "[a]dditional considerations may inform the doctrine's application in specific factual contexts."[18] Therefore, while the Supreme

12. *See infra* Part VI.

13. *See* Hamilton v. Zimmerman, 37 Tenn. 39, 48 (1857) ("This doctrine is said to have its foundation in the obligation under which every man is placed to speak and act, according to the truth of the case; and in the policy of the law to suppress the mischiefs from the destruction of all confidence in the intercourse and dealings of men, if they were allowed to deny that, which by their solemn and deliberate acts, they have declared to be true."); Hon. William Houston Brown et al., *Debtors' Counsel Beware: Use of the Doctrine of Judicial Estoppel in Nonbankruptcy Forums*, 75 AM. BANKR. L.J. 197, 200 (2001).

14. *See* Roger M. Baron & Melissa M. Martin, *The Application of Judicial Estoppel in Texas*, 41 BAYLOR L. REV. 447, 447-50 (1989).

15. *See* New Hampshire v. Maine, 532 U.S. 742, 742-43 (2001).

16. *Id.* at 750-51.

17. *See id.* at 750.

18. *Id.* at 743; *see also* Robert F. Dugas, Note, *Honing A Blunt Instrument: Refining the Use of*

Court provided guidance for future judges faced with judicial estoppel, it did not provide an exhaustive test for the application of the doctrine.[19]

### *B. Emergence in Texas*

The Texas Supreme Court first applied judicial estoppel in 1956 in *Long v. Knox*.[20] The court explained, "The doctrine of judicial estoppel is not strictly speaking estoppel at all but arises from positive rules of procedure based on justice and sound public policy."[21] Within Texas, state courts developed the following elements for judicial estoppel: (1) a sworn inconsistent position made in a prior proceeding; (2) the prior position was successful; (3) the prior position was not made inadvertently or by mistake, fraud, or duress; and (4) the prior position was clear and unequivocal.[22]

In *Long v. Knox*, the court distinguished the newly applied doctrine of judicial estoppel from equitable estoppel. Unlike equitable estoppel, judicial estoppel does not require injury or reliance.[23] Further, the party invoking the doctrine is not required to be a party to the former proceeding.[24] Moreover, because of its focus on the sanctity of adjudications, judicial estoppel is solely a product of the courts.[25]

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*Judicial Estoppel in Bankruptcy Nondisclosure Cases*, 59 VAND. L. REV. 205, 213 (2006) ("Thus, *New Hampshire v. Maine* clarified the general motivation of the doctrine and provided guidance to the circuit courts in applying it but eschewed providing a strict definition.").

19. *See supra* note 18.

20. *See* Long v. Knox, 291 S.W.2d 292, 295 (Tex. 1956); Baron & Martin, *supra* note 14, at 447-48.

21. *Long*, 291 S.W.2d at 295.

22. *See e.g.*, Thompson v. Cont'l Airlines, 18 S.W.3d 701, 705 n.2 (Tex. App.—San Antonio 2000, no pet.).

23. *Long*, 291 S.W.2d at 295. The elements for equitable estoppel are as follows:

> (1) [A] false representation or concealment of material facts; (2) made with knowledge, actual or constructive, of those facts; (3) with the intention that it should be acted on; (4) to a party without knowledge or means of obtaining knowledge of the facts; (5) who detrimentally relies on the representations.

Johnson & Higgins of Tex., Inc. v. Kenneco Energy, Inc., 962 S.W.2d 507, 515-16 (Tex. 1998) (citing Schroeder v. Tex. Iron Works, Inc., 813 S.W.2d 483, 489 (Tex. 1991)); *see also In re* Estate of Loveless, 64 S.W.3d 564, 577-78 (Tex. App.—Texarkana 2001, no pet.) ("The doctrine of judicial estoppel is sometimes confused with equitable estoppel arising from inconsistent positions taken in judicial proceedings.").

24. *See Long*, 291 S.W.2d at 295.

25. *See* Baron & Martin, *supra* note 14, at 447 (explaining that the doctrine has developed independent of the legislature).

### *C. Application in the Bankruptcy Context*

The possibility for judicial estoppel is heightened in the bankruptcy context.[26] When the debtor petitions for bankruptcy, various provisions of the Bankruptcy Code require the debtor to disclose its assets.[27] The debtor may make such a disclosure but fail to list a pre-petition cause of action or fail to amend the disclosed assets to list a cause of action that accrues between the filing of the bankruptcy petition and the debtor's discharge from bankruptcy.[28] The debtor then brings the non-disclosed cause of action, and the defendant asserts that the debtor should be judicially estopped.[29] Herein lies the intersection between the Bankruptcy Code and a subsequent non-bankruptcy court; the court may judicially estop a party from bringing its cause of action if the subsequent suit was property of the bankruptcy estate and the party did not list its cause of action in a bankruptcy schedule, reorganization plan, or disclosure statement.[30]

Because the non-disclosure affects the bankruptcy court, the Fifth Circuit has instructed courts to apply federal law when addressing judicial estoppel in this context.[31] The Fifth Circuit sets out three elements for judicial estoppel to apply: (1) the position is clearly inconsistent with a prior position; (2) the court accepted the prior position; and (3) the non-disclosure was not inadvertent.[32] To show inadvertence, the party must lack knowledge of the claim or have no motive for concealment.[33] An assertion that the debtor did not know all the facts or was uncertain of the legal basis for the claim may not be sufficient to show a lack of knowledge.[34] Additionally, if the undisclosed cause of action would have increased the

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26. *See* Benjamin J. Vernia, Annotation, *Judicial Estoppel of Subsequent Action Based on Statements, Positions, or Omissions as to Claim or Interest in Bankruptcy Proceeding*, 85 A.L.R. 5th 353, 353 (2001).

27. *See* Dugas, *supra* note 18, at 219-20.

28. *See id.*

29. *See id.*

30. *See* Cricket Commc'ns, Inc. v. Trillium Indus., Inc., 235 S.W.3d 298, 304 (Tex. App.—Dallas 2007, no pet.) (citing Hamilton v. State Farm Fire & Cas. Co., 270 F.3d 778, 783 (9th Cir. 2001)).

31. *See In re* Coastal Plains, Inc., 179 F.3d 197, 205 (5th Cir. 1999). *But see* Nat'l Loan Investors, L.P. v. Taylor, 79 S.W.3d 633, 637 (Tex. App.—Waco 2002, pet. denied), *overruled by* Dall. Sales Co. v. Carlisle Silver Co., 134 S.W.3d 928 (Tex. App.—Waco 2004, pet. denied) (applying the four Texas elements of judicial estoppel to a case arising from a bankruptcy non-disclosure). Two years later, the same court overruled its prior decision by holding that federal law applies when the prior proceeding was in a bankruptcy court. *See Dall. Sales Co.*, 134 S.W.3d at 931 (reasoning that federal law should apply for two reasons: (1) "the primary purpose of judicial estoppel is to preserve the integrity of the prior judicial proceeding," which was in federal bankruptcy court; and (2) the Supreme Court has held that federal law applies when considering whether a state court cause of action is barred by a prior federal judgment). Additionally, the Texarkana Court of Appeals questioned whether federal law should apply because of inconsistencies among the federal circuits. *See In re* Estate of Loveless, 64 S.W.3d 564, 579 (Tex. App.—Texarkana 2001, no pet.).

32. *See* Kane v. Nat'l Union Fire Ins. Co., 535 F.3d 380, 385-86 (5th Cir. 2008).

33. *See id.* at 386.

34. *See Cricket Commc'ns, Inc.*, 235 S.W.3d at 306-07.

bankruptcy estate, a debtor will usually have motive to conceal the cause of action.[35] When analyzing judicial estoppel, the court and the attorneys must turn to the law that imposes the duty to disclose on the debtor—the Bankruptcy Code.[36]

## III. ENTER THE BANKRUPTCY CODE: INTERSECTION OF CIVIL COURTS AND BANKRUPTCY PROVISIONS

Non-bankruptcy judges and plaintiffs' attorneys faced with a judicial estoppel defense must acquaint themselves with potentially unfamiliar and complex provisions within the Bankruptcy Code.[37] Accordingly, to decide whether the doctrine applies and to analyze how to defeat the defense, the court and attorney must understand its requirements.

### *A. Property of the Estate and the Debtor's Duty to Disclose*

The filing of a bankruptcy petition creates a bankruptcy estate.[38] In essence, property of the debtor becomes property of the bankruptcy estate. Section 541, which is the general rule applicable to Chapters 7, 11, 12, and 13, states that property of the bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case."[39] Thus, under the general rule, a cause of action that accrues prior to the bankruptcy petition becomes property of the estate.[40] Conversely, if the cause of action is not property of the bankruptcy estate, a judicial estoppel defense may be misplaced.

The Bankruptcy Code imposes an affirmative duty on debtors to disclose all assets, including causes of action that may be unliquidated or contingent.[41] Further, debtors must disclose potential claims even if they are uncertain as to the facts or legal basis.[42] The duty to disclose is not a one-time obligation, but rather a continuing obligation.[43] Additionally,

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35. *See id.* at 307.

36. *Cf. supra* note 27 and accompanying text.

37. *See* Brown, *supra* note 13, at 197 (discussing the differing approaches of non-bankruptcy courts in applying judicial estoppel to a non-disclosure scenario).

38. *See* 11 U.S.C. § 541(a)(1) (2006).

39. 11 U.S.C. § 541.

40. *But see infra* note 67 and accompanying text.

41. *See In re* Coastal Plains, Inc., 179 F.3d 197, 207-08 (5th Cir. 1999); 11 U.S.C. § 521(a)(1) (2006). The Bankruptcy Code defines the term "claim" as: "(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured." 11 U.S.C. § 101(5) (2006).

42. *See Coastal Plains*, 179 F.3d at 207-08; Baron & Martin, *supra* note 14, at 447-50.

43. *See Coastal Plains*, 179 F.3d at 208.

Bankruptcy Schedule B requires individual debtors to list "[o]ther contingent and unliquidated claims of every nature, including tax refunds, counterclaims of the debtor, and rights to setoff claims" and to "[g]ive [an] estimated value of each."[44]

### *B. Role of the Trustee and Standing*

The bankruptcy trustee is the representative of the estate and has the capacity to sue on behalf of the estate.[45] Accordingly, the issue of standing plays a significant role in the application of judicial estoppel in the bankruptcy context.[46] While this Comment does not delve into the details and mechanics of standing, it is impossible to address bankruptcy-based judicial estoppel without mentioning standing.[47] Additionally, some courts prefer to resolve the debtor's non-disclosure on standing alone, instead of applying judicial estoppel.[48] Therefore, this Comment points to standing as a potential resource for courts faced with this dilemma.[49] Ultimately, the role of the trustee—and its subsequent effect on standing—depends on whether the debtor files under Chapter 7, 11, 12, or 13 of the Bankruptcy Code.[50]

### *C. Chapter 7, 11, 12, and 13 Filings*

Judicial estoppel may arise in the context of a Chapter 7, Chapter 11, Chapter 12, or Chapter 13 bankruptcy proceeding.[51] It is worth noting the differences among the chapters to highlight the complications of judicial estoppel in the bankruptcy context, especially in the areas of trustee standing and property of the estate.[52]

Chapter 7 is the "straight bankruptcy" setting that involves the liquidation and distribution of the debtor's assets.[53] The court appoints a trustee promptly after the filing of a Chapter 7 bankruptcy petition.[54] Additionally, the court tasks the trustee with determining what property should be considered property of the estate.[55] Generally, property acquired

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44. *See* Bankr. Official Form 6, Schedule B ¶ 21.
45. *See* 11 U.S.C. § 323(a), (b) (2006).
46. *See* Dugas, *supra* note 18, at 223; *infra* notes 198-201 and accompanying text.
47. *See* Dugas, *supra* note 18, at 223-25 (discussing standing in this context).
48. *See infra* Parts VII.A, C.
49. *See infra* Part VIII.B.1.
50. *See infra* Part III.B.
51. *See* Dugas, *supra* note 18, at 220-22.
52. *See id.* at 223-41 (discussing in detail judicial estoppel as applied to Chapters 7, 11, and 13 filings individually).
53. 28 STEPHEN G. COCHRAN, TEXAS PRACTICE SERIES: CONSUMER RIGHTS AND REMEDIES § 16.9 (3d ed. 2002).
54. *See* 11 U.S.C. § 701(a)(1) (2006).
55. *See* 11 U.S.C. § 704(a).

prior to the petition becomes property of the estate, while property acquired after belongs to the debtor.[56]

Chapter 11 primarily provides for business reorganizations, rather than liquidation.[57] In contrast to Chapter 7, an independent trustee is not appointed upon the filing of a Chapter 11 petition.[58] Under Chapter 11, "a trustee is the exception, rather than the rule."[59] The court appoints a trustee only upon showing of cause, such as dishonesty, fraud, or gross mismanagement of the debtor's affairs.[60] Therefore, in the typical Chapter 11 scenario, the debtor retains possession of the property and assumes the duties of a trustee.[61] After the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, property of the estate in a Chapter 11 filing is expanded to include the individual's post-petition earnings.[62]

Chapter 12 provides relief to family farmers and was largely modeled after Chapter 13.[63] Only the debtor may file a plan under Chapter 12.[64] Family fishermen are now also eligible to file under Chapter 12.[65] A trustee is appointed in every Chapter 12 case, but the debtor remains in possession of his property.[66] In both Chapter 12 and 13, property of the estate includes property described in § 541 that is acquired after the commencement of the case but before the case is closed, converted, or dismissed in addition to post-petition earnings.[67] Accordingly, in Chapters 12 and 13, a cause of action that accrues after the bankruptcy petition but before the bankruptcy case is closed, converted, or dismissed is property of the estate.

Chapter 13 is a mechanism for a debtor with regular income to make payments to creditors over an extended period of time.[68] Similar to Chapters 11 and 12, a Chapter 13 debtor remains in possession of his property.[69] Additionally, a Chapter 13 proceeding is voluntary, and only

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56. *See* 11 U.S.C. § 541 (2006).

57. *See* 15 J. MAXWELL TUCKER, TEXAS PRACTICE SERIES: TEX. FORECLOSURE L. & PRAC. § 15.01 (2011).

58. *See* Dugas, *supra* note 18, at 225; 5 WILLIAM L. NORTON JR., NORTON BANKR. L. & PRAC. § 91:1 (3d ed. 2012).

59. NORTON, *supra* note 58, § 91:1.

60. *See id.* (citing 11 U.S.C. § 1104(a)(1) (2006)).

61. *See id.* (citing 11 U.S.C. §§ 322, 1101, 1104, 1107, 1108 (2006)).

62. *See* 11 U.S.C. § 1115(a)(2).

63. *See* NORTON, *supra* note 58, 122:1. It does not appear that non-disclosure-based judicial estoppel has been asserted regarding a Chapter 12 filing but such a defense remains possible. *Cf.* 85 A.L.R.5th 353 (holding a "family farm corporation's representation in a reorganization plan that it would not contest the validity of the security interest a bank held in its property did not estop the farm from challenging the bank's subsequent foreclosure action").

64. 11 U.S.C. § 1221 (2006).

65. *See* NORTON, *supra* note 58, § 122:10 (citing Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, 119 Stat. 23, § 1007 (Apr. 20, 2005)).

66. *See* NORTON, *supra* note 58, § 122:10 (citing 11 U.S.C. §§ 1202(a), 1203, 1204, 1226(c) (2006)).

67. *See* 11 U.S.C. §§ 1207, 1306 (2006).

68. *See* 3 BANKR. DESK GUIDE § 29:1.

69. *See* § 1306 (2006); TUCKER, *supra* note 57, § 15.01 ("A Chapter 13 case is likewise a

the debtor may file the repayment plan.[70] In contrast to Chapter 11, a trustee is appointed under Chapter 13.[71] However, unlike Chapter 7, the trustee serves primarily as a middleman to collect monies from the debtor in order to pay the creditors.[72]

### *D. Abandonment and Reopening*

After a bankruptcy petition is filed, the trustee may "abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate."[73] Additionally, the Code provides that any property of the estate that is not abandoned or administered remains property of the estate.[74] Generally, an abandonment is irrevocable, but courts have carved limited exceptions, such as when the debtor gives the trustee false or incomplete information that prompts the abandonment.[75]

To further maintain property of the estate, a court may reopen a case even after the estate is fully administered and the trustee is discharged.[76] Section 350 provides, "[a] case may be reopened in the court in which such case was closed to administer assets, to accord relief to the debtor, or for other cause."[77] The decision to reopen a case is within the discretion of the bankruptcy court.[78] Notably, a concealed or non-disclosed asset may serve as cause to reopen.[79] Therefore, some courts turn to reopening as a potential solution when faced with a non-disclosure.[80] Procedurally, the debtor or a party in interest may move to reopen the case.[81] Additionally, the bankruptcy court may reopen a case sua sponte.[82] The court will consider the time and expense, as well as the likelihood of recovery, when deciding whether to reopen a case.[83]

Ultimately, an analysis of judicial estoppel arising out of a bankruptcy non-disclosure may seem daunting to civil judges or plaintiffs' attorneys unacquainted with the Bankruptcy Code. But with a proper foundation and

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reorganization proceeding conducted on a smaller scale and with fewer formal requirements than a Chapter 11 case.").

70. *See* 11 U.S.C. § 1321 (2006); COCHRAN, *supra* note 53, § 16.5.
71. *See* 11 U.S.C. § 1302 (2006); TUCKER, *supra* note 57, § 15.01.
72. *See* § 1302; TUCKER, *supra* note 57, § 15.01.
73. *See* 11 U.S.C. § 554(a) (2006).
74. *See id.* § 554(d).
75. *See* 4 WILLIAM J. NORTON, JR., NORTON BANKR. L. & PRAC. § 74:15 (3d. ed. 2012).
76. *See* 11 U.S.C. § 350 (2006).
77. *Id.*
78. *See* 2 WILLIAM J. NORTON, JR., NORTON BANKR. L. & PRAC. § 40:3 (3d. ed. 2012).
79. *See id.* § 40:4.
80. *See infra* Part VIII.B.1.
81. *See* NORTON, *supra* note 78, § 40:9.
82. *See id.*
83. *See id.* § 40:4.

a keen eye on its requirements, judges and attorneys can aptly address this defense.

## IV. EVOLUTION IN THE FIFTH CIRCUIT

Regardless of whether the civil suit is filed in state or federal court within Texas, federal law will apply to the application of judicial estoppel following a bankruptcy non-disclosure.[84] Therefore, Texas practitioners must first turn to Fifth Circuit precedent.[85] The following five cases are the most recent bankruptcy-related judicial estoppel decisions out of the Fifth Circuit, with each case building upon the other's development of the doctrine.

### *A.* In Re Coastal Plains

The Fifth Circuit's application of judicial estoppel in the bankruptcy context begins with *In re Coastal Plains*.[86] In the 1980s, Coastal Plains, Inc. (Coastal), an equipment distributor, faced financial problems.[87] Thus, Coastal impliedly told its creditors that it would file for bankruptcy if the creditors did not agree to a workout plan.[88] Under the plan, Coastal would return to its creditors inventory that the creditors sold to Coastal on credit.[89] The creditors would then "pay Coastal 50 percent of the inventory's cost and [would] write off Coastal's debt."[90] Coastal would then use this money to pay off its secured creditor.[91] One creditor, Browning, agreed to a workout plan, and Coastal began returning inventory.[92] Eventually, the workout plan did not occur as expected; Coastal returned its entire inventory to Browning, but Browning did not complete the transaction.[93] Thereafter, Coastal filed a Chapter 11 bankruptcy petition[94]

Coastal filed an adversary proceeding against Browning, requesting an injunction against the disposition of the returned inventory and an order directing its transfer to Coastal.[95] Coastal also asserted claims against Browning for conversion, interference with contracts and business relationships, violation of the automatic stay, and punitive damages.[96] The

84. *See supra* note 31 and accompanying text.
85. *See supra* note 31 and accompanying text.
86. See *In re* Coastal Plains, 179 F.3d 197, 201-16 (5th Cir. 1999).
87. *Id.* at 202.
88. *See id.*
89. *Id.*
90. *Id.*
91. *Id.*
92. *Id.*
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.*

bankruptcy court found that Browning violated the automatic stay and ordered the return of the inventory to Coastal.[97] The court did not discuss the other claims.[98]

Subsequently, Coastal's CEO executed the sworn bankruptcy schedules and Statement of Financial Affairs for Coastal but omitted the claims against Browning.[99] Eventually, the automatic stay was lifted, and Coastal's secured creditor purchased the inventory at an auction.[100] The secured creditor then sold the assets to a corporation formed by Coastal's CEO, Industrial Clearinghouse, Inc. (IC).[101] The assets purchased by IC expressly included the undisclosed claims against Browning.[102] Ultimately, Coastal's bankruptcy case was converted to a Chapter 7, and "[a]fter the [t]rustee filed a no-asset report," the case was closed.[103]

Thereafter, the bankruptcy case was reopened for issues not related to Browning, and IC substituted for Coastal in the adversary proceeding against Browning.[104] The case was set for trial in district court when the trustee intervened asserting that Coastal's bankruptcy estate owned the claims.[105] The district court sent the case back to the bankruptcy court, which determined that the estate owned the tort claims and that IC owned those in contract.[106] Further, the bankruptcy court approved an agreement between IC and the trustee whereby IC and the trustee would share any recovery against Browning, with IC receiving 85%.[107] Ultimately, the jury found favorably for the plaintiffs on all claims except for fraud, and Browning appealed to the Fifth Circuit.[108]

The Fifth Circuit panel held that judicial estoppel applied.[109] The panel found the first prong—inconsistent statements—was met because the omission from the schedules and statement was tantamount to an assertion that the claim did not exist.[110] The next prong—acceptance—was not disputed because the stay was lifted because of Coastal's asserted value of assets.[111] As to the third prong, the panel explained that inadvertence in the bankruptcy context means the debtor had no knowledge of the claims or

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97. *Id.* at 203.
98. *See id.*
99. *Id.* (noting that Coastal's claims against Browning were worth up to $10 million).
100. *Id.*
101. *Id.*
102. *Id.*
103. *Id.* (explaining that in between the initiation of the adversary proceeding and the closing of the case, no mention was made of the claims against Browning).
104. *Id.*
105. *Id.* at 204.
106. *Id.*
107. *Id.*
108. *Id.*
109. *Id.* at 209.
110. *Id.* at 210 (explaining that even though the adversary proceeding stated the claims, the parties involved believed the adversary proceeding to be finished).
111. *Id.*

had no motive to conceal.[112] The panel found that Coastal had knowledge of the claim at the time the schedules and statement were prepared and had motive to conceal because had the claims been disclosed, the unsecured creditors might have opposed lifting the stay or creditors may have placed higher bids at the auction.[113] Thus, the three prongs were met, and judicial estoppel applied.[114]

### *B.* In Re Superior Crewboats

The next Fifth Circuit case brought a new issue to the table—abandonment of the asset by the trustee.[115] In August 1999, Arthur Hudspeath was allegedly injured while disembarking a vessel owned by Superior Crewboats (Superior).[116] A year later, Mr. "Hudspeath and his wife . . . filed a Chapter 13 bankruptcy petition in the Eastern District of Louisiana."[117] In January 2001, while their bankruptcy case was pending, "the Hudspeaths filed a state court lawsuit against Superior" regarding Mr. Hudspeath's disembarking incident.[118] The original documents prepared by the Hudspeaths for the bankruptcy court did not reflect the cause of action.[119] Moreover, the Hudspeaths did not amend their bankruptcy schedules to reflect the filed suit.[120]

In July 2001, the Hudspeaths disclosed the lawsuit at the creditors' meeting; however, the Hudspeaths told the trustee that the statute of limitations had run on the case.[121] Later, the Hudspeaths alleged confusion as to whether maritime or Louisiana limitations applied.[122] Thereafter, the "trustee filed a Petition of Disclaimer and Abandonment" regarding the lawsuit against Superior.[123] The Hudspeaths received a "no asset" discharge from bankruptcy in October 2001.[124]

Shortly thereafter, in January 2002, "Superior filed an admiralty limitation proceeding in" the Eastern District of Louisiana, and the Hudspeaths responded with a complaint to recover damages arising out of the disembarking incident.[125] Six months later, Superior told the

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112. *Id.*
113. *Id.* at 212-13.
114. *Id.* at 216.
115. *See infra* notes 121-23 and accompanying text.
116. *See In re* Superior Crewboats, Inc., 374 F.3d 330, 333 (5th Cir. 2004).
117. *Id.* The Hudspeaths' bankruptcy was later converted to a Chapter 7. *See id.*
118. *Id.*
119. *See id.*
120. *See id.*
121. *See id.* at 333 n.1.
122. *See id.* at 333.
123. *See id*.
124. *Id.* The usual Chapter 7 case is one where the debtor has no assets for distribution to the creditors. *See* 8 WILLIAM J. NORTON, JR., NORTON BANKR. L. & PRAC. § 160:2 (3d. ed.2012).
125. *Superior Crewboats*, 374 F.3d at 333. For an explanation of an admiralty limitation

bankruptcy trustee that the Hudspeaths were continuing to pursue their claim.[126] Subsequently, the trustee moved to reopen the bankruptcy case, and the Hudspeaths amended their schedules to include the claim.[127] Additionally, Superior filed a motion to dismiss, and the trustee moved to substitute as the plaintiff in the limitation proceeding.[128]

Superior asserted two arguments in the motion to dismiss: (1) judicial estoppel barred the claim and (2) the suit was not brought by the real party in interest under Federal Rules of Civil Procedure Rule 17(a).[129] The district court rejected the judicial estoppel argument, reasoning that it was not a matter to be decided summarily, but rather at trial.[130] Additionally, the court rejected the 17(a) argument.[131] Consequently, Superior filed an appeal to the Fifth Circuit.[132]

The Fifth Circuit panel recognized three requirements for judicial estoppel to apply: (1) a clearly inconsistent position, (2) accepted by the previous court, and (3) the non-disclosure must not have been inadvertent.[133] First, the panel found that the positions were clearly inconsistent because an omission of a claim is tantamount to a representation that it does not exist.[134] Second, the panel reasoned that the bankruptcy court accepted the prior position because the trustee abandoned the claim.[135] Third, the non-disclosure was not inadvertent because it was made with knowledge of the claim and with motive to conceal.[136] The panel dismissed the Hudspeaths' alleged confusion as to the statute of limitations because the Hudspeaths knew of the facts giving rise to the claim and were aware of their continuing duty to disclose.[137] Further, the debtors had motive to conceal because they stood to reap a windfall if they received a judgment without disclosure to the creditors.[138] The Hudspeaths were not allowed to reopen their bankruptcy case to amend because the panel said judicial estoppel prevents parties from believing they only have

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proceeding, see 1 ROBERT FORCE, THE LAW OF MAR. PERS. INJURIES § 15:11 (5th ed. 2011).

126. *Superior Crewboats*, 374 F.3d at 333.

127. *Id.*

128. *Id.* at 334.

129. *Id.*

130. *Id.* at 333.

131. *Id.*

132. *Id.*

133. *Id.* at 335.

134. *Id.*

135. *Id.* Acceptance only requires "that the first court has adopted the position urged by the party, either as a preliminary matter or as part of a final disposition." *In re* Coastal Plains, 179 F.3d 197, 206 (5th Cir. 1999) (quoting Reynolds v. Comm'r of Internal Revenue, 861 F.2d 469, 473 (6th Cir. 1988)).

136. *Superior Crewboats*, 374 F.3d at 335.

137. *Id.* ("The Hudspeaths certainly had knowledge of the undisclosed claim, initiating the suit only months after filing for bankruptcy and requesting service of process during the pendency of the bankruptcy petition.").

138. *Id.* at 336.

to disclose if they are caught.[139] The panel disposed of the 17(a) argument and motion to substitute in one sentence, stating that the judicial estoppel holding obviates the need to address both.[140]

### *C.* Kane v. National Union Fire Insurance Co.

Four years later, the Fifth Circuit had the opportunity to explain its *Superior Crewboats* holding. The Kanes brought a personal injury lawsuit in a Louisiana state court arising out of a car accident.[141] Three years later, while the state court lawsuit was pending, the Kanes petitioned for a Chapter 7 bankruptcy.[142] The Kanes did not list their lawsuit on their bankruptcy schedules or inform the trustee of the claim; the Kanes received a discharge, and the trustee closed the case as a no-asset case.[143] The state court defendants filed a motion for summary judgment on judicial estoppel, and then the Kanes filed a motion in the bankruptcy court to reopen the proceedings so the trustee could administer the claim.[144] The bankruptcy court granted the motion to reopen.[145]

The defendant removed the case to federal court and again moved for summary judgment on judicial estoppel.[146] Additionally, the trustee moved to substitute himself as the real party in interest in order to pursue the claim on behalf of the bankruptcy estate.[147] Applying *Superior Crewboats*, the federal district court granted summary judgment on judicial estoppel and summarily dismissed the trustee's motion to substitute as moot.[148]

The Fifth Circuit panel disagreed, stating that *Superior Crewboats* did not control the case at bar.[149] The panel distinguished the prior decision by stating that the trustee in *Superior Crewboats* formally abandoned the claim.[150] Because the trustee in *Kane* did not abandon the claim, he was still the real party in interest.[151] The panel did not address the Hudspeaths' misstatement of the statute of limitations that prompted the *Superior Crewboats* trustee to abandon the claim.[152] Further, the Fifth Circuit panel noted that, unlike the Hudspeaths, the Kanes stood to gain only if there was

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139. *Id.*
140. *Id.*
141. Kane v. Nat'l Union Fire Ins. Co., 535 F.3d 380, 383 (5th Cir. 2008) (per curiam).
142. *Id.*
143. *Id.*
144. *Id.*
145. *Id.*
146. *Id.*
147. *Id.*
148. *Id.* at 383-84.
149. *Id.* at 386.
150. *Id.* at 386-87.
151. *See id.* at 387.
152. *See id.* at 386-87; *supra* notes 121-24 and accompanying text.

a surplus after debts and fees were paid to the bankruptcy creditors.[153] This left open the possibility that a judgment could be awarded in excess of the debts owed.

### *D.* Reed v. City of Arlington

The Fifth Circuit again had the opportunity to explain its application of judicial estoppel in a 2011 en banc rehearing, *Reed v. City of Arlington*.[154]

#### *1. District Court*

Kim Lubke received a judgment in excess of one million dollars against the City of Arlington under the Family Medical Leave Act (FMLA).[155] During the city's appeal, Mr. Lubke and his wife filed a Chapter 7 bankruptcy petition, but the Lubkes did not disclose the FMLA judgment.[156] Subsequently, the Lubkes received a discharge, and the trustee closed the case as a no-asset case.[157]

A Fifth Circuit panel affirmed the FMLA judgment but remanded for a damages recalculation.[158] Thereafter, the plaintiff's attorney in the FMLA case learned of the Lubkes' bankruptcy petition and notified the bankruptcy trustee of the judgment.[159] The bankruptcy case was reopened, and the trustee substituted herself in the FMLA action as the real party in interest.[160] The city filed a petition for rehearing.[161] The panel denied the petition but ordered the district court to determine whether judicial estoppel applied.[162] The district court held judicial estoppel barred Lubke but crafted what it perceived to be an equitable remedy for the trustee.[163] The trustee could pursue the claim on behalf of the bankruptcy creditors, but any portion of the judgment in excess after distribution to the creditors would revert to the city.[164]

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153. *Kane*, 535 F.3d at 387.
154. *See* Reed v. City of Arlington, 650 F.3d 571 (5th Cir. 2011) (en banc).
155. *Id.* at 572-73.
156. *Id.* at 573 (noting that the Lubkes also did not inform their FMLA attorney of the bankruptcy petition).
157. *Id.*
158. *Id.*
159. *Id.*
160. *Id.*
161. *Id.*
162. *Id.*
163. *Id.*
164. *Id.*

### *2. Panel Decision*

A panel of the Fifth Circuit reversed.[165] The panel noted that the district court applied "this court's" requirements for judicial estoppel—(1) the position is clearly inconsistent with a prior position; (2) the court accepted the prior position; and (3) the non-disclosure was not inadvertent[166]—but later, in its own analysis, listed the Supreme Court's *New Hampshire v. Maine* non-exhaustive factors—(1) the later position must be clearly inconsistent, (2) the party must have succeeded in persuading the court to accept the prior position, and (3) the party asserting the inconsistent position must derive an unfair advantage or impose an unfair detriment on the opposing party.[167] The panel held that, considering the cost and consequences of Lubke's misrepresentations, equity weighed against further litigation by the trustee.[168] The panel concluded that the district court failed to engage in a fact-specific analysis regarding all parties involved.[169]

Specifically, the panel explained that the district court made two mistakes.[170] First, the debtor's misconduct could not be distinguished from the trustee because the trustee "succeeds to the debtor's claim with all its attributes."[171] Second, the balance of harm favored judicial estoppel.[172] The court found no material advantage to the creditors because only about one-sixth of the creditors timely filed claims when the case was reopened.[173] Therefore, the principal remaining claimants were the bankruptcy trustee's counsel and the FMLA attorney.[174] Further, Lubke's misrepresentations resulted in additional litigation and, thereby, increased attorney's fees that the city must statutorily bear—fees distinct from the underlying FMLA claim.[175] The panel reasoned that ultimately, the taxpayers of Arlington were forced to assume the cost of Lubke's misconduct.[176]

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165. *Id.* The panel opinion was authored by Chief Judge Edith Jones who was also the author of the *Superior Crewboats* opinion. *See* Reed v. City of Arlington, 620 F.3d 477, 480-81 (5th Cir. 2010), *rev'd en banc*, 650 F.3d 571 (5th Cir. 2011); *In re* Superior Crewboats, Inc., 374 F.3d 330, 332 (5th Cir. 2004).

166. *See Reed*, 620 F.3d at 480; *see also supra* note 32 and accompanying text (listing the factors the 5th Circuit previously applied).

167. *See Reed*, 620 F.3d at 479; *see also supra* note 16 and accompanying text (listing a different set of factors than it previously applied).

168. *Reed*, 620 F.3d at 483.

169. *Id.*

170. *Id.* at 482.

171. *Id.*

172. *Id.* at 482-83.

173. *Id.*

174. *Id.* at 483 ("[The trustee's] claim has been substantially increased because of this judicial estoppel litigation.").

175. *Id.*

176. *Id.*

### *3. En Banc Rehearing*

The Fifth Circuit granted a rehearing en banc and held the trustee was not barred by judicial estoppel.[177] The court said that allowing the trustee to pursue the claim (1) follows from bankruptcy law, (2) follows from equity, (3) is consistent with Fifth Circuit precedent, and (4) is consistent with other circuits.[178] First, the court reasoned that the FMLA claim became an asset of the bankruptcy estate at the moment the petition was filed; moreover, the trustee was the real party in interest with the authority and duty to bring the claim on behalf of the estate.[179] Additionally, the general principle that a trustee received claims subject to defenses that could be raised against the debtor did not apply because it is limited to pre-petition defenses that would have been applicable had the debtor not filed bankruptcy.[180] Second, the court said estopping the trustee would frustrate a core goal of bankruptcy law—achieving a maximum and equitable distribution for creditors.[181] Third, the court cited *Kane* and *Superior Crewboats*, stating that the facts of *Kane* are nearly identical and, again, distinguishing *Superior Crewboats* on the issue of the trustee's abandonment.[182] As in *Kane*, the Fifth Circuit did not discuss the motivation for the trustee's abandonment—the debtor's misrepresentation regarding the statute of limitations.[183] The court also noted the fact that attorneys would be the principal parties to benefit from pursuing the cause of action was not a reason to apply judicial estoppel.[184] Lastly, the court pointed to the Seventh, Tenth, and Eleventh Circuit Courts of Appeals highlighting that its opinion is in accord.[185]

Chief Judge Edith Jones authored the dissenting opinion and was joined by Judge Edith Clement and Senior Judge Harold DeMoss Jr., who were the same three members of the court that served as the panel.[186] Chief Judge Jones opined that the court should take a broader perspective in analyzing the impact of Lubke's deception.[187] Specifically, the Chief Judge emphasized the impact on the federal district and circuit courts, in addition to the interests of the bankruptcy process.[188]

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177. Reed v. City of Arlington, 650 F.3d 571, 573-79 (5th Cir. 2011) (rehearing en banc).
178. *Id.*
179. *Id.* at 575.
180. *Id.*
181. *Id.* at 576.
182. *Id.* at 577-78.
183. *Cf.* Kane v. Nat'l Union Fire Ins. Co., 535 F.3d 380 (5th Cir. 2008) (per curiam).
184. *Reed*, 650 F.3d at 578.
185. *Id.* at 578-79.
186. *Reed*, 650 F.3d at 579-81 (Jones, C.J., dissenting).
187. *Id.* at 579.
188. *Id.* at 579-80

### *E.* Love v. Tyson Foods

Less than one year later, the Fifth Circuit addressed judicial estoppel following a Chapter 13 case. In *Love v. Tyson Foods, Inc.,* Willie E. Love (Love) filed a lawsuit against his former employer, Tyson, alleging racial discrimination and retaliation.[189] Love was a debtor under a Chapter 13 proceeding when he filed the EEOC charge and lawsuit.[190] After the EEOC charge was filed, the bankruptcy court confirmed Love's plan, which did not include the cause of action.[191] Thereafter, Tyson moved for summary judgment on judicial estoppel, Love filed an amended schedule in his Chapter 13 case listing the claim, and the court granted the motion, dismissing Love's claim.[192] Love appealed to the Fifth Circuit.[193]

The Fifth Circuit panel said Love only argued the inadvertence element on appeal.[194] The panel opined that Love failed to create a fact issue as to inadvertence because the element was nowhere mentioned in his brief—noting that it only discussed "two of the three criteria that are central to this court's judicial estoppel analysis."[195] Instead, Love asserted, "Plaintiff will not derive any unfair advantage or impose any unfair detriment on any opposing party if not estopped."[196] Consequently, the panel held that Love did not raise a fact issue as to his inadvertence and thus, the application of judicial estoppel was proper.[197]

In contrast, the dissent opined that Tyson, the party asserting the judicial estoppel defense, did not carry its summary judgment burden and that even if Love was estopped, the court should have crafted a solution to allow the bankruptcy estate to benefit from the potential judgment.[198] Importantly, the dissent recognized that Love's response used the *New Hampshire v. Maine* three-factor test.[199] In short, the dissent explained that Love would not gain a legal advantage because a Chapter 13 debtor in possession essentially acts as a Chapter 7 trustee and any recovery received would be shared with Love's creditors.[200] Therefore, the dissent concluded that Love had no motive to conceal.[201]

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189. Love v. Tyson Foods, Inc., 677 F.3d 258, 260 (5th Cir. 2012).
190. *Id.* at 260-61.
191. *Id.* at 261.
192. *Id.*
193. *Id.*
194. *Id.* at 262.
195. *Id.* at 263. Love was not represented by an attorney in his lawsuit. *Id.* at 261 n.1.
196. *Id.* at 263.
197. *Id.*
198. *Id.* at 266-67 (Haynes, J., dissenting).
199. *See id.* at 269-70.
200. *See id.* at 270-75.
201. *Id.* at 264.

### *F. Synthesizing the Fifth Circuit Decisions*

In *Reed v. City of Arlington*, the Fifth Circuit reconciled its prior decisions—*Superior Crewboats* and *Kane*—as being in accord with the proposition that the innocent trustee should not be estopped from pursuing the claim on behalf of the bankruptcy estate.[202] In both *Kane* and *Reed*, however, the court overlooked the distinguishing factor in *Superior Crewboats*—the trustee's formal abandonment of the claim under the Bankruptcy Code.[203] In her dissent, Chief Judge Jones—the author of the *Superior Crewboats* opinion—points out this inconsistency.[204] Addressing the trustee's abandonment in *Superior Crewboats*, the Chief Judge stated, "Just as a closed bankruptcy case may be 'reopened' when a trustee finds hidden assets, however, an abandonment may be revoked in the best interest of creditors."[205] Given this distinction, Chief Judge Jones stated there was not support in the circuit for the *Reed* trustee's position until *Kane*.[206]

The Chief Judge may be right because the cases can be construed as inconsistent. The *Reed* en banc decision stands in contrast with *Superior Crewboats* because the trustee in *Superior Crewboats* was not allowed to revoke its abandonment in order to substitute as the real party in interest.[207] In *Superior Crewboats*, the trustee filed a motion to substitute, but the court said the Rule 17(a) motion was moot after it granted summary judgment on judicial estoppel.[208] In *Kane*, the court explained away this distinction by stating that the trustee was not the real party in interest because it abandoned the claim.[209] Again, the trustee may revoke an abandonment.[210] Having done this, the trustee would be the real party in interest, and judicial estoppel would not apply.[211] Therefore, in *Superior Crewboats*, it appears that the circuit court did not allow the debtor to succeed in its subsequent suit because of its deception but, incongruously, denied the trustee's motion to substitute because the trustee fell victim to the very same deception by the debtor. Given that *Superior Crewboats* summarily dismissed the trustee's argument, it is not clear if and how these decisions may be reconciled. Nevertheless, in the en banc *Reed* opinion, the circuit court should have stated that the *Superior Crewboats* panel was in error or explained its apparent conflict.

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202. *See* Reed v. City of Arlington, 650 F.3d 571, 577-78 (5th Cir. 2011) (en banc).
203. *See supra* notes 121, 149-52, 183 and accompanying text.
204. *See Reed*, 650 F.3d at 580 n.1 (Jones, C.J., dissenting).
205. *Id.* at 580 n.1.
206. *Id.* at 580 n.2.
207. *See infra* notes 149-52 and accompanying text.
208. *In re* Superior Crewboats, Inc., 374 F.3d 330, 336 (5th Cir. 2004).
209. Kane v. Nat'l Union Fire Ins. Co., 535 F.3d 380, 384-88 (5th Cir. 2008) (per curiam).
210. *See supra* note 205 and accompanying text.
211. *See supra* note 205 and accompanying text.

Additionally, the circuit court apparently negated the potential for a judgment in excess of the debts owed if the trustee pursued the claim on behalf of the estate.[212] *Kane* left open the possibility of an excess judgment, but the district court in *Reed* said any excess amount would revert to the defendant.[213] Although the en banc circuit court did not engage in its own discussion of the possibility of an award in excess of debts, the court affirmed the district court's judgment.[214]

In *Reed*, the en banc Fifth Circuit hinted at the possibility for judicial estoppel to bar the trustee, but it was not clear when these "unusual circumstances" would arise.[215] Some practicing bankruptcy attorneys suggest that this may occur when the debtor stands to benefit from the judgment or when the judgment is in excess of debts owed.[216] But this does not comport with the circuit court's seeming support for allowing any excess to revert to the defendant.[217] Therefore, while the Fifth Circuit hinted at the potential use of judicial estoppel against the trustee, it remains to be seen if and when this would occur.

In addition to the en banc *Reed* opinion, attorneys within the Fifth Circuit must also keep *Love v. Tyson Foods* in mind.[218] Specifically, the chapter under which the plaintiff-debtor filed should receive heightened attention. Defendants are now incentivized to raise judicial estoppel when it arises in the context of a Chapter 13 filing because, as *Love* demonstrates, the defendant will receive a complete windfall if the debtor, who essentially stands in the shoes of a Chapter 7 trustee, is estopped.[219] Because *Love* provided no recovery for the bankruptcy creditors, this decision stands in contrast with the prior decisions of the Fifth Circuit, such as *Reed* and *Kane*, in which the court allowed the bankruptcy trustee to pursue the claim on behalf of the estate.[220]

Despite these areas of confusion, attorneys can likely count on the Fifth Circuit's inadvertence standard to earn the majority vote—(1) the position is clearly inconsistent with a prior position; (2) the court accepted the prior position; and (3) the non-disclosure was not inadvertent.[221] But

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212. *See supra* notes 153, 164 and accompanying text.

213. *See supra* notes 153, 164 and accompanying text.

214. *See* Reed v. City of Arlington, 650 F.3d 571, 579 (5th Cir. 2011) (en banc).

215. *See id.* at 573 ("We now . . . state a general rule that, absent unusual circumstances, an innocent trustee can pursue for the benefit of creditors a judgment or cause of action that the debtor fails to disclose in bankruptcy.").

216. *See* George Klidonas & Regina L. Griffin, *Estoppel Does Not Extend to Innocent Trustees*, AM. BANKR. INST. J., Nov. 2011, at 44, 45.

217. *See Reed*, 650 F.3d at 579; *supra* text accompanying notes 212-14.

218. *See supra* notes 189-201 and accompanying text.

219. *See supra* notes 189-97 and accompanying text.

220. *See supra* Parts IV.B, C.

221. *See supra* note 32-33 and accompanying text.

judicial estoppel does not only arise in federal courts.[222] Texas practitioners may also need to turn to state court applications as well.[223]

## V. APPLICATION IN THE TEXAS SUPREME COURT

In 2009, the Texas Supreme Court addressed judicial estoppel in *Ferguson v. Building Materials Corp. of America*.[224] The debtors, who were under a Chapter 13 plan, listed their personal injury suit on their Statement of Financial Affairs and disclosed its existence to the bankruptcy trustee.[225] The debtors, however, omitted the suit from the bankruptcy schedules and the court-approved plan.[226] This omission was brought to the debtors' attention, and they amended their plan.[227] The Texas Supreme Court held that judicial estoppel did not apply because the debtors did not gain an advantage and the personal injury defendant and bankruptcy creditors did not suffer a disadvantage.[228]

The court was persuaded by the debtors' attempts to disclose the cause of action rather than the procedural error in omitting the cause of action from the Schedule of Personal Property.[229] While the court did not directly address what standard should apply, it did not cite to any Fifth Circuit precedent, instead relying primarily on its own decision in *Pleasant Glade Assembly of God v. Schubert*.[230] Both opinions emphasized the lack of an "unfair advantage"—language that tracks the standard set forth in the United States Supreme Court decision of *New Hampshire v. Maine*.[231] Thus, the Texas Supreme Court employs a different test than the Fifth Circuit, which may result in conflicting opinions between the two jurisdictions.

## VI. BRINGING IT TOGETHER FOR TEXAS PRACTITIONERS: TWO STANDARDS EMERGE

### *A. The United States Supreme Court and the Fifth Circuit*

Three potential standards for judicial estoppel have appeared in state and federal courts within Texas: (1) the Supreme Court's "unfair

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222. *See infra* Part V.
223. *See infra* Part V.
224. *See* Ferguson v. Bldg. Materials Corp. of Am., 295 S.W.3d 642, 643 (Tex. 2009) (per curiam).
225. *Id.*
226. *Id.*
227. *Id.* at 644.
228. *Id.*
229. *See id.* at 643.
230. *See id.* at 643-44 (citing Pleasant Glade Assembly of God v. Schubert, 264 S.W.3d 1, 6 (Tex. 2008)).
231. *See id.*; New Hampshire v. Maine, 532 U.S. 742, 750-51 (2001); *Pleasant Glade Assembly of God*, 264 S.W.3d at 6-8.

advantage" standard, (2) the Fifth Circuit's "inadvertence" standard, and (3) the Texas Supreme Court's original "bad faith" standard.[232] Because the Fifth Circuit instructed courts to apply federal law in the bankruptcy context, only the first two approaches are now applicable.[233] But the Fifth Circuit has not clarified how its three elements for bankruptcy-based judicial estoppel fit with the Supreme Court's non-exhaustive factors in *New Hampshire v. Maine*.[234] This distinction is evident in the discourse between the majority and dissent in *Love v. Tyson Foods*.[235]

The Supreme Court characterized its analysis as "several factors [that] typically inform the decision whether to apply the doctrine in a particular case."[236] In contrast, the Fifth Circuit enumerates three elements.[237] The Fifth Circuit's elements can clearly be traced to the Supreme Court's analysis.[238] But it is not apparent whether the circuit completely abandoned *New Hampshire v. Maine* given that the circuit employs the standard in non-bankruptcy cases.

### *1. Fifth Circuit Application in the Non-Bankruptcy Context*

In *Hall v. GE Plastic Pacific PTE Ltd.*, the Fifth Circuit analyzed judicial estoppel in a non-bankruptcy setting.[239] Mr. Hall brought a personal injury lawsuit against GE in Texas state court alleging that GE manufactured an extension cord that caused a fire, resulting in severe burns to Mr. Hall.[240] The case was removed to federal court and referred to a magistrate judge, at which point GE moved for summary judgment on the ground of judicial estoppel.[241] GE argued judicial estoppel applied because Mr. Hall asserted that GE was the manufacturer of the cord after asserting in an earlier lawsuit that only Woods Industries could be the

232. *See supra* notes 16, 22, 133 and accompanying text. One element of the Texas formulation of judicial estoppel is that the prior position was not made inadvertently or by mistake, fraud, or duress. *See supra* note 21 and accompanying text.

233. *See supra* notes 32-33 and accompanying text.

234. *See supra* note 18.

235. *See* Love v. Tyson Foods, Inc., 677 F.3d 258, 270 n.7 (5th Cir. 2012) (Jones, C.J., dissenting) ("The majority opinion condemns Love for framing his argument based on the Supreme Court's three-prong test, which differs slightly from that set out by our precedent. The majority opinion states that *New Hampshire*'s third prong—'whether the party seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped'—is an entirely different issue than Love's motive at the time of nondisclosure. . . . I cannot agree, however, that these issues are entirely distinct." (citation omitted)).

236. *New Hampshire*, 532 U.S. at 750.

237. *See supra* note 32 and accompanying text.

238. *Cf.* Eastman v. Union Pac. R. Co., 493 F.3d 1151, 1157 (10th Cir. 2007) (explaining that, although the Supreme Court instructed courts to resist the application of judicial estoppel when the prior position was by inadvertence or mistake, the circuit courts have evolved a much higher bar in the bankruptcy context).

239. *See* Hall v. GE Plastic Pac. PTE Ltd., 327 F.3d 391, 395-400 (5th Cir. 2003).

240. *Id.* at 393.

241. *Id.* at 394.

manufacturer.[242] The magistrate judge—applying federal law—recommended that the motion be granted.[243] After de novo review, the district court granted the motion.[244] Mr. Hall appealed claiming that judicial estoppel was inappropriate.[245]

On appeal, the Fifth Circuit panel listed the first and second *New Hampshire v. Maine* elements—(1) the later position must be clearly inconsistent and (2) the court must have accepted the prior position—as the "two bases for judicial estoppel."[246] The panel noted that the circuit primarily relies on the first two factors but went on to discuss other factors, including the third non-exclusive factor from *New Hampshire v. Maine*—(3) whether the party asserting the inconsistent position will derive an unfair advantage or impose an unfair detriment on the opposing party.[247] Notably, the court stated that detrimental reliance, privity, and intent are not required within the Fifth Circuit.[248] Further, the panel rejected a defense of mistake, pointing out that Mr. Hall did not allege that he now has new information or that he had less incentive to discover the manufacturer in the first suit.[249] The panel cited the inadvertence element for the bankruptcy context—no knowledge of the claim and no motive to conceal.[250] Concluding, the panel said the lower court was correct in judicially estopping Mr. Hall because the first two bases were met, and Mr. Hall lacked *any* defense.[251] The panel went on to note that, "it was within the court's discretion to utilize judicial estoppel and prevent Hall from playing 'fast and loose' with the court by 'changing positions based upon the exigencies of the moment.'"[252]

Five years later, the Fifth Circuit was able to reflect on its non-bankruptcy approach in *Hopkins v. Cornerstone America*.[253] The panel stated, "Generally, we have recognized at least two requirements to invoke the doctrine," referring to the "two bases" or the first two *New Hampshire v. Maine* factors.[254] Further, the panel highlighted that *New Hampshire v.*

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242. *Id*.

243. *Id*.

244. *Id.*

245. *Id.* On appeal, Mr. Hall also claimed that state law should apply. *Id.* The Fifth Circuit concluded that federal law should apply because "the application of federal law concerning judicial estoppel is appropriate in this case because both suits filed by Hall ended up in federal court and it is the federal court that is subject to manipulation and in need of protection." *Id.* at 395-96.

246. *Id.* at 396 (quoting Ahrens v. Perot Sys. Corp., 205 F.3d 831, 833 (5th Cir. 2000)); *see supra* note 16 and accompanying text.

247. *Hall*, 327 F.3d at 399-400.

248. *See id.* at 399. *Contra* Love Terminal Partners v. United States, 97 Fed. Cl. 355, 403 (Fed. Cl. 2011) (explaining that the Federal Circuit retained the privity requirement for judicial estoppel).

249. *Hall*, 327 F.3d at 399.

250. *Id.* at 399-400; *supra* note 33 and accompanying text.

251. *Hall*, 327 F.3d at 400.

252. *Id.* (quoting Ergo Sci., Inc. v. Martin, 73 F.3d 595, 598 (5th Cir. 1996)).

253. *See* Hopkins v. Cornerstone Am., 545 F.3d 338, 347 (5th Cir. 2008).

254. *See id.*

*Maine* did not create "inflexible prerequisites."[255] It explained that, in some instances, it has allowed a broader interpretation of the "acceptance" or "success" element of judicial estoppel.[256] Therefore, the panel indicated its flexibility in regard to judicial estoppel in the non-bankruptcy context.

### *2. Fifth Circuit—Supreme Court Distinction Within the Circuit*

As illustrated by the preceding cases, outside of the bankruptcy context, the Fifth Circuit favors the United States Supreme Court's unfair advantage standard. But within the bankruptcy context, the Fifth Circuit employs its inadvertence test.[257] The original panel opinion and Chief Judge Jones' dissent in *Reed v. City of Arlington* should be viewed in light of these conflicting approaches.[258] In a footnote, the panel enumerated the Fifth Circuit's "three particular requirements" but outlined the *New Hampshire v. Maine* factors in its own analysis.[259] In fact, the panel described judicial estoppel as follows: "Because it is an equitable doctrine, judicial estoppel is not rigidly defined . . . ."[260] This description demonstrates that the panel was motivated by the Supreme Court's standard, rather than its own circuit's test. The panel stated, "[t]he lowest common denominator appears to lie in a holistic, fact-specific consideration of each claim of judicial estoppel that arises from litigation claims undisclosed to a bankruptcy court."[261]

This exact distinction came to a head in *Love v. Tyson Foods*.[262] Judge Haynes dissented because she found support for the district court's decision to not apply judicial estoppel based on the pro se plaintiff's brief, while the majority found the brief lacked a required element—inadvertence.[263] Judge Haynes's dissent logically discussed the inadvertence-unfair-advantage distinction and reconciled the two tests.[264] She opined that Love's assertion that he would not gain an unfair advantage could support the inadvertence element the majority sought.[265]

In short, the Fifth Circuit formulated its own test for judicial estoppel following a bankruptcy non-disclosure based on the United States Supreme

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255. *Id.* at 348 n.2 (quoting New Hampshire v. Maine, 532 U.S. 742, 751 (2001)).

256. *Id.*

257. *See supra* notes 32-33 and accompanying text.

258. *See supra* Part IV.C.

259. *See* Reed v. City of Arlington, 620 F.3d 477, 483 n.3 (5th Cir. 2010) (quoting *In re* Superior Crewboats, Inc., 374 F.3d 330, 335 (5th Cir. 2004)), *rev'd en banc*, 650 F.3d 571 (5th Cir. 2011). The panel analyzed Fifth Circuit precedent and concluded, "What are the bankruptcy courts, which confront these problems regularly in our circuit, to make of these decisions?" *Id.* at 481.

260. *Id.* at 481 (citing New Hampshire v. Maine, 532 U.S. 742, 750-51 (2001)).

261. *Id.* at 482.

262. *See supra*, Part IV.E.

263. *See supra* notes 198-201 and accompanying text.

264. *See* Love v. Tyson Foods, Inc., 677 F.3d 258, 268-75 (5th Cir. 2012) (Haynes, J., dissenting).

265. *Id.*; *see supra* note 200 and accompanying text.

Court's non-bankruptcy application.[266] Yet, judges within the Fifth Circuit are still split as to which standard the court should employ.[267] This divide led to the dissenting opinions in *Reed* and *Love*, but the Fifth Circuit is not alone in the unfair advantage-inadvertence rift.

### *B. The Fifth Circuit and the Texas Supreme Court*

In addition to the distinction within the Fifth Circuit, the disparity is also evident between the Fifth Circuit and the Texas Supreme Court.[268] In fact, after *Love v. Tyson Foods*, the Texas Supreme Court's application of judicial estoppel in a Chapter 13 case may be in conflict with that of the Fifth Circuit.[269] In *Ferguson*, the Texas Supreme Court held judicial estoppel did not apply to the Chapter 13 debtors because the debtors attempted to disclose their cause of action and to amend their schedules to include the lawsuit once their procedural error was brought to their attention.[270] In contrast, the Fifth Circuit held judicial estoppel applied to the Chapter 13 debtor in *Love* despite his willingness to amend to include the cause of action.[271]

Because the Texas Supreme Court and the Fifth Circuit are concurrent appellate courts, Texas practitioners have no guidance as to whether *Ferguson* is still good law. Given that the Fifth Circuit instructed practitioners to apply federal law to bankruptcy-based judicial estoppel, however, the *Love* approach is the more persuasive of the two.[272] Although it is now evident that *Ferguson* may conflict with *Love*, the *Ferguson* intermediate court decision foreshadowed this issue.[273] Specifically, the El Paso Court of Appeals' decision demonstrates the significant disparity that may arise between the inadvertence and unfair advantage approaches to Chapter 13 cases.[274]

The El Paso Court of Appeals, which was reversed by the Texas Supreme Court, applied the three particular requirements of the Fifth Circuit or the inadvertence test.[275] As to the first requirement—a clearly inconsistent statement—the court of appeals noted that the debtors told the trustee only after judicial estoppel was raised and, further, that disclosure to

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266. *See supra* note 32 and accompanying text.
267. *See supra* text accompanying notes 257-66.
268. *See infra* notes 269-85 and accompanying text.
269. *See supra* notes 224-31 and accompanying text.
270. *See* Ferguson v. Bldg. Materials Corp. of Am., 276 S.W.3d 45, 50-52 (Tex. App.—El Paso 2008), *rev'd*, 295 S.W.3d 642 (Tex. 2009).
271. Love v. Tyson Foods, Inc., 677 F.3d 258, 266 (5th Cir. 2012).
272. *See supra* note 31 and accompanying text.
273. *See Ferguson*, 276 S.W.3d at 50-52.
274. *See id.*
275. *Id.*

the trustee in a creditors' meeting was insufficient.[276] The court was also not persuaded by the amended schedule stating that considering an amendment—filed only after the other party raises judicial estoppel—encourages debtors to not disclose claims unless they are caught.[277] Therefore, the subsequent disclosure and amendment were not sufficient in light of the failure to list the claim in the Schedule of Personal Property as required by the Bankruptcy Code.[278] As to the second element—acceptance of the inconsistent statement by the prior court—the appellate court quickly disposed of the issue stating that the Fifth Circuit finds acceptance when the bankruptcy court confirms a plan under a Chapter 13 proceeding.[279]

Lastly, as to the third element of inadvertence, the court analyzed the two prongs of the test: (1) knowledge of the claim and (2) motive to conceal.[280] The debtors conceded knowledge of the claim, so the court addressed motive to conceal.[281] The court found motive because, under the original confirmed plan, the creditors would have been entitled to seven cents on the dollar, while under the amended plan, the creditors would be repaid dollar for dollar.[282] Therefore, the appellate court held judicial estoppel applied.[283] Thus, under the inadvertence test, as applied by the El Paso Court of Appeals, judicial estoppel applied. Under the unfair advantage standard, however, as applied by the Texas Supreme Court, judicial estoppel did not apply.

Consequently, practitioners in Texas may be faced with the unfair advantage standard of the Texas Supreme Court or the inadvertence test of the Fifth Circuit majority.[284] As *Ferguson* indicates, this distinction can be crucial, especially in the Chapter 13 context.[285]

## VII. A LOOK OUTSIDE TEXAS

In the en banc *Reed v. City of Arlington* opinion, the Fifth Circuit cited its consistency with the Seventh, Tenth, and Eleventh Circuit Courts of

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276. *Id.* at 51-52.
277. *Id.*
278. *Id.* at 50-51.
279. *Id.* at 52 (citing Jethroe v. Omnova Solutions, Inc., 412 F.3d 598, 600 (5th Cir. 2005)).
280. *Id.*
281. *Id.*
282. *Id.*
283. *Id.* at 54.
284. *See* New Hampshire v. Maine, 532 U.S. 742, 750-51 (2001) (noting the flexible nature of the judicial estoppel inquiry); Ferguson v. Bldg. Materials Corp. of Am., 295 S.W.3d 642, 643-44 (Tex. 2009) (applying the *New Hampshire v. Maine* inadvertence standard); *see generally* Reed v. City of Arlington, 620 F.3d 477, 483 (5th Cir. 2010), *rev'd en banc*, 650 F.3d 571 (5th Cir. 2011) (explaining that the doctrine is not rigidly defined); Reed v. City of Arlington, 650 F.3d 571, 574 (5th Cir. 2011) (en banc) (enumerating three elements).
285. *See supra* notes 274-83 and accompanying text.

Appeals.[286] Accordingly, these circuit courts have allowed bankruptcy trustees to pursue non-disclosed claims on behalf of the bankruptcy estate.[287]

### *A. Seventh Circuit*

Although the *Reed* holding tracks that of prior cases in the Seventh Circuit, the Fifth Circuit overlooked differences along the way. In *Cannon-Stokes v. Potter*, the Seventh Circuit reasoned that the possibility of judicial estoppel applying to the debtor arises once the trustee abandons the claim because "as a technical matter the estate in bankruptcy, not the debtor, owns all pre-bankruptcy claims, and unless the estate itself engages in contradictory litigation tactics the elements of judicial estoppel are not satisfied."[288] Therefore, the Seventh Circuit analyzed the application of judicial estoppel to the debtor because the trustee had abandoned the claim, and the creditors were out of the picture.[289] This suggests that the Seventh Circuit would resolve the issue on standing alone, rather than judicial estoppel, if both the trustee and debtor were involved.

A subsequent decision by the Bankruptcy Court for the Eastern District of Wisconsin distinguished the Seventh Circuit's application of the doctrine.[290] In *In re FV Steel & Wire Co.*, the debtor filed an employment discrimination charge with the EEOC before filing a Chapter 7 bankruptcy

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286. *See, e.g.*, Biesek v. Soo Line R.R. Co., 440 F.3d 410 (7th Cir. 2006); Cannon–Stokes v. Potter, 453 F.3d 446, 448 (7th Cir. 2006); Eastman v. Union Pac. R.R. Co., 493 F.3d 1151 (10th Cir. 2007); Parker v. Wendy's Int'l, Inc., 365 F.3d 1268 (11th Cir. 2004). Although the *Reed* opinion primarily discussed the approaches of the Seventh, Tenth, and Eleventh Circuit Courts of Appeals, other circuit courts have addressed judicial estoppel as well. *See, e.g.*, Payless Wholesale Distribs., Inc. v. Alberto Culver (P.R.) Inc., 989 F.2d 570, 570-72 (1st Cir. 1993) (holding that former debtor was judicially estopped from bringing a pre-petition claim, which was not disclosed in Chapter 11 case); *In re* I. Appel Corp., 104 Fed. App'x 199, 201-02 (2d Cir. 2004) (noting the absence of case law to support the application of judicial estoppel to a reopening and holding that judicial estoppel would not apply anyway because the debtor's claim was adequately disclosed); Krystal Cadillac-Oldsmobile GMC Truck, Inc. v. Gen. Motors Corp., 337 F.3d 314, 319-25 (3rd Cir. 2003) (applying judicial estoppel to claims known to the debtor at the time of the bankruptcy even though the debtor attempted to amend the disclosure statement); Whitten v. Fred's, Inc., 601 F.3d 231, 241-42 (4th Cir. 2010) (concluding judicial estoppel would not bar sexual harassment suit because debtor disclosed the possibility of a lawsuit in the bankruptcy petition); Stephenson v. Malloy, 700 F.3d 265, 266-75 (6th Cir. 2012) (holding judicial estoppel did not bar trustee from pursuing claim and debtor's omission was inadvertent); Stallings v. Hussmann Corp., 447 F.3d 1041, 1047-49 (8th Cir. 2006) (concluding judicial estoppel did not apply because the bankruptcy court did not accept the inconsistent position given that the bankruptcy case was dismissed and the debtor's debts were not discharged); Hamilton v. State Farm Fire & Cas. Co., 270 F.3d 778, 782-86 (9th Cir. 2001) (holding debtor was judicially estopped from bringing claim that was not disclosed in prior bankruptcy); Moses v. Howard Univ. Hosp., 606 F.3d 789, 791-800 (D.C. Cir. 2010) (reasoning employee was judicially estopped from bringing Title VII claims against former employee because the claims were not disclosed in bankruptcy initiated after Title VII suit was filed).

287. *See Eastman*, 493 F.3d at 1155 n.3.

288. *Cannon-Stokes*, 453 F.3d at 448.

289. *Id.*

290. *See In re* FV Steel & Wire Co., 349 B.R. 181, 185-89 (Bankr. E.D. Wis. 2006).

petition.[291] The debtor did not list her claim in the bankruptcy schedules or Statement of Financial Affairs.[292] The debtor received a no-asset discharge, and thereafter, the former employer filed its own Chapter 11 petition.[293] Subsequently, the debtor filed a proof of claim with the bankruptcy court concerning her discrimination claim against the former employer.[294]

During settlement discussions, the former employer's attorney notified the debtor's attorney that the debtor failed to disclose the claim in the debtor's own closed bankruptcy case.[295] Thereafter, the debtor's Chapter 7 case was reopened, the debtor amended the schedule to include the claim, and the trustee employed an attorney to represent the bankruptcy estate in pursuing the claim.[296] The trustee became the real party in interest, with the result that any recovery in excess of the debts owed would be paid to the debtor.[297] The former employer then sought to disallow the debtor's claim on the basis of judicial estoppel, but the bankruptcy court held that the doctrine did not apply because the circumstances shifted the equities in favor of the debtor.[298]

The court reasoned that the employer failed to show how it was harmed or how the debtor was benefited from the nondisclosure and further, that the employer failed to show the "requisite intent to deceive the court."[299] Additionally, the court noted that judicial estoppel could not apply to the trustee because the trustee made no inconsistent statements.[300] Although this case does not have subsequent history, its analysis, if accepted by the Seventh Circuit, would cast doubt on its harmony with the Fifth Circuit.[301] In *Superior Crewboats*, the Fifth Circuit did not allow the debtors to reopen their bankruptcy case to amend, reasoning that such behavior would encourage non-disclosure until the debtors are caught.[302]

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291. *Id.* at 183.

292. *Id.* The debtor claimed she informed the bankruptcy attorney of the charge and also that she was unaware that the potential claim was an asset of the bankruptcy estate or that she was required to disclose it. *Id.*

293. *Id.*

294. *Id.*

295. *Id.* at 184.

296. *Compare id.* (holding that judicial estoppel is not applicable when the equities have been shifted in the debtor's favor), *with In re* Miller (Berti), 767 N.Y.S.2d 729, 729 (N.Y. App. Div. 2003) (reasoning that judicial estoppel is not applicable absent a final determination in the bankruptcy case endorsing the inconsistent position, and therefore, reopening the case nullifies a final determination).

297. *See In re FV Steel*, 349 B.R. at 189.

298. *See id.* at 184-85, 189.

299. *See id.* at 189.

300. *See id.*

301. *See infra* text accompanying note 302.

302. *See supra* note 139 and accompanying text.

### *B. Tenth Circuit*

The Tenth Circuit first applied judicial estoppel in the non-bankruptcy context in *Johnson v. Lindon City Corp.*, noting that it resisted its application until the Supreme Court's directive in *New Hampshire v. Maine*.[303] The Tenth Circuit then had the chance to address judicial estoppel following a bankruptcy non-disclosure in *Eastman v. Union Pacific*.[304] Circuit Judge Bobby Ray Baldock provided a meaningful analysis of the circuit courts' treatment of *New Hampshire v. Maine* in the bankruptcy setting.[305] He set forth the Supreme Court's flexible approach but cautioned litigants that although the Supreme Court said judicial estoppel may not be proper when the omission is by mistake or inadvertence, the circuit courts have crafted a near insurmountable bar in the bankruptcy context.[306]

This stands in contrast to the Fifth Circuit, which has not articulated its journey from *New Hampshire v. Maine* to its current application of judicial estoppel in the bankruptcy setting.[307] In *Eastman*, the debtor claimed that his attorney was to blame because he told the attorney of the cause of action and, further, that he—as a layperson—was ignorant of the law.[308] Applying the no-knowledge or no-motive-to-conceal standard, the court rejected this argument.[309] This is consistent with the inadvertence approach of the Fifth Circuit.[310]

### *C. Eleventh Circuit*

The Eleventh Circuit led the way for the Seventh and Tenth Circuits with *Parker v. Wendy's International, Inc*.[311] In *Parker*, the Chapter 7 trustee intervened in the debtor's pre-bankruptcy employment discrimination claim, which was not disclosed to the bankruptcy court.[312] The Eleventh Circuit explained that although the Supreme Court stated judicial estoppel is probably not reducible to any general formula, the Eleventh Circuit generally considers two factors: (1) whether the allegedly inconsistent statements were made under oath in a prior proceeding and

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303. *See* Johnson v. Lindon City Corp., 405 F.3d 1065, 1068-69 (10th Cir. 2005).

304. *See Eastman*, 493 F.3d at 1151.

305. *See id.* at 1157-58.

306. *See Eastman*, 493 F.3d at 1157 ("Where a debtor has both knowledge of the claims and a motive to conceal them, courts routinely, albeit at times *sub silentio*, infer deliberate manipulation."); *see also supra* note 16 and accompanying text (listing three factors for consideration).

307. *See supra* notes 236-38 and accompanying text.

308. *Eastman*, 493 F.3d at 1157.

309. *Id.* at 1158 (emphasizing the debtor's direct denial of any claim when questioned by the trustee).

310. *See supra* Part VI.A.

311. *See* Parker v. Wendy's Int'l, Inc., 365 F.3d 1268 (11th Cir. 2004).

312. *Id.* at 1269.

(2) whether the inconsistencies were "calculated to make a mockery of the judicial system."[313] In *Burnes v. Pemco Aeroplex, Inc.*, the Eleventh Circuit reasoned that these two factors are consistent with *New Hampshire v. Maine* and leave courts with sufficient flexibility: "We recognize that these two enumerated factors are not inflexible or exhaustive; rather, courts must always give due consideration to all of the circumstances of a particular case when considering the applicability of this doctrine."[314]

Faced with the argument that even if judicial estoppel applies to the debtor, it should not apply to the trustee, the Eleventh Circuit concluded, "judicial estoppel should not be applied at all."[315] The court called into question its prior application of judicial estoppel in *Burnes*, stating that the more appropriate defense would have been that the debtor lacked standing.[316] The Eleventh Circuit explained that a pre-bankruptcy petition cause of action is the property of the bankruptcy estate, and only the bankruptcy trustee has standing to prosecute causes of action belonging to the estate.[317]

Therefore, the trustee is the proper party in interest, and the debtor ceases to have an interest in the cause of action unless and until the trustee abandons it.[318] The court noted that judicial estoppel might arise in the "unlikely scenario" that the trustee recovers more money than the amount necessary to satisfy the creditors, and then, "perhaps judicial estoppel could be invoked by the defendant to limit any recovery to only that amount and prevent an undeserved windfall from devolving on the non-disclosing debtor."[319] This approach is similar to that of the Seventh Circuit, with both being distinguishable from the Fifth Circuit's approach because of the preference to resolve the defense on standing alone, rather than judicial estoppel.[320]

## VIII. PROVIDING A SOLUTION FOR TEXAS

### *A. The Mess as the Law Stands*

Judicial estoppel has greatly evolved from its initial application, but it is still plagued with inconsistencies in the bankruptcy context.[321] Some courts question the application of judicial estoppel altogether when the

313. *Id.* at 1271 (quoting Burnes v. Pemco Aeroplex, Inc., 291 F.3d 1282, 1285 (11th Cir. 2002)).
314. *Burnes,* 291 F.3d at 1285-86.
315. *Parker*, 365 F.3d at 1272.
316. *See id.*
317. *Id.* ("Section 541 of the Bankruptcy Code provides that virtually all of a debtor's assets, both tangible and intangible, vest in the bankruptcy estate upon the filing of a bankruptcy petition.").
318. *See id.* at 1272 n.2.
319. *Id.* at 1273 n.4.
320. *See supra* notes 288-89 and accompanying text.
321. *See supra* Part II.

issue can be resolved on standing alone.[322] These courts rely on the Bankruptcy Code's allocation of standing to the trustee.[323] Additionally, because judicial estoppel no longer serves as a complete bar to recovery, but rather typically resolves on substitution of the bankruptcy trustee, the defendant will not necessarily reap the same windfall by raising the defense.[324] Accordingly, the defendant may lack motivation to assert judicial estoppel.[325] Given that the Fifth Circuit appears to limit recovery to the debts owed, however, this may serve as an incentive to the defendant hoping to minimize any potential liability.[326]

And most significantly, Texas practitioners face uncertainty as to which standard the court will favor: the unfair advantage approach from *New Hampshire v. Maine* or the inadvertence test of the Fifth Circuit majority.[327] While the latter evolved from the former, the distinction may prove crucial because it turns on the willingness of the court to take a holistic approach and weigh the equities of the case.[328] The plaintiff will typically prefer the *New Hampshire v. Maine* approach by arguing that the non-disclosure was an accident or a mistake or that equity favors reopening the bankruptcy case to amend.[329] The defendant, on the other hand, will argue for the Fifth Circuit standard, which is better described as a checklist with an impossible defense of inadvertence.[330] Although these standards fit within one another, they reflect a judicial attitude or mood in regard to a bankruptcy debtor who claims he did not know any better.[331] Depending on whether the case goes up to the Texas Supreme Court or the Fifth Circuit, the debtor may have a better idea of which attitude will guide the court's decision, but in between those courts, the plaintiff-debtor can only hope for the more forgiving of the two.[332]

Despite this conflict, the Fifth Circuit reached the correct result in the en banc rehearing of *Reed v. City of Arlington*.[333] The claim belonged to the bankruptcy estate; therefore, the trustee was entitled to pursue the claim on its behalf.[334] Still, the Fifth Circuit did not explain the significance of

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322. *See supra* notes 315-20 and accompanying text.
323. *See supra* note 45 and accompanying text.
324. *See supra* notes 315-20 and accompanying text.
325. *See supra* notes 315-20 and accompanying text.
326. *See supra* notes 212-14 and accompanying text.
327. *See supra* Part VI.
328. *See supra* Part VI.B.
329. *See supra* Part VI.
330. *See supra* notes 32-35 and accompanying text.
331. *See supra* Part VI; *see also* Theresa M. Beiner & Robert B. Chapman, *Take What You Can, Give Nothing Back: Judicial Estoppel, Employment Discrimination, Bankruptcy, and Piracy in the Courts*, 60 U. MIAMI L. REV. 1, 73 (2005) ("One is left wondering whether the willingness to apply judicial estoppel, wrong as a matter of bankruptcy law and wrong as a matter of procedure, reflects judicial hostility toward discrimination plaintiffs.").
332. *See supra* Part VI.
333. *See infra* note 334 and accompanying text.
334. *See* 11 U.S.C. § 541 (2006); Reed v. City of Arlington*,* 650 F.3d 571, 574 (5th Cir. 2011) (en

the *New Hampshire v. Maine* factors in its decision.[335] This was evident in *Love v. Tyson Foods*.[336]

In contrast to *Reed*, the Fifth Circuit did not reach the correct result in *Love*.[337] The Fifth Circuit's inadvertence test should give way to the Supreme Court's unfair advantage standard outside the Chapter 7 context. The inadvertence approach is ill-suited for most scenarios outside of Chapter 7 because a Chapter 11 or 13 debtor is essentially acting as a Chapter 7 trustee.[338] In contrast to liquidation under Chapter 7, Chapters 11 and 13 primarily provide for reorganization or payment plans.[339] Given the time frame for these plans and the statutes of limitations for most causes of actions, it is likely that the Chapter 11 or 13 debtor would still be under such plan when judicial estoppel is asserted.[340] In that scenario, the court should allow the debtor to amend the plan to include this cause of action. This approach serves the primary goal the Fifth Circuit cited in *Reed*—providing maximum recovery to creditors.[341] In the unlikely event that the debtor's plan is complete, the court should proceed with its inadvertence approach. By recognizing the distinctions among the bankruptcy filings, the Fifth Circuit can fix the inconsistency that arose when it allowed the creditors to receive a portion of any recovery in *Reed* but prevented any such relief in *Love*.

### *B. Cleaning up the Doctrine: How Courts and Practitioners Can Pitch In*

#### *1. Consider the Debtor's Circumstances When Determining Which Standard Applies*

In his *Northern Pipeline* dissent, Justice White explained that Congress's perception of a lack of judicial interest in bankruptcy matters was a factor behind the establishment of bankruptcy courts.[342] Simply put, Article III judges were not that interested in bankruptcy.[343] But explaining

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banc); Klidonas & Griffin, *supra* note 216, at 44, 45.

335. *Reed,* 650 F.3d at 574.

336. *See* Love v. Tyson Foods, Inc., 677 F.3d 258, 265 (5th Cir. 2012)*; supra* Part IV.E.

337. *See* Steve Sather, *Fifth Circuit Tackles Judicial Estoppel Yet Again Resulting in a Split Decision*, A TEXAS BANKRUPTCY LAWYER'S BLOG, (Apr. 5, 2012) http://stevesathersbankruptcynews.blogspot.com/2012/04/fifth-circuit-tackles-judicial-estoppel.html (providing a critical analysis of *Love v. Tyson Foods*).

338. *See supra* Part III.C (explaining the differences between Chapters 7, 11, and 13 filings).

339. *See supra* Part III.C.

340. *See supra* Part III.C.

341. *See* Reed v. City of Arlington, 650 F.3d 571, 576 (5th Cir. 2011) (rehearing en banc).

342. N. Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 116-17 (1982) (White, J., dissenting) (citing H.R. REP. NO. 95-595, at 14 (1977)) (explaining that the Bankruptcy Act of 1978 was not an attempt by the political branches to usurp power, but rather "Congress feared that this lack of interest would lead to a failure by federal district courts to deal with bankruptcy matters in an expeditious manner").

343. *See id.*

away bankruptcy-based judicial estoppel as a lack of interest underestimates non-bankruptcy judges.[344] A better explanation is that non-bankruptcy courts are misperceiving the nature of bankruptcy courts in applying this equitable doctrine.

Technically, a bankruptcy judge does not sit as a court of equity, but rather as a statutory court of bankruptcy.[345] But cases, articles, and commentary assert otherwise.[346] In fact, § 105(a) of the Bankruptcy Code grants wide-ranging authority to bankruptcy judges:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.[347]

The United States Supreme Court recognized this "broad authority granted to bankruptcy judges" in *Marrama v. Citizens Bank of Massachusetts*.[348] While a further discussion of the statutory-equity distinction is outside the scope of this Comment, this distinction is useful in addressing the problems that arise when non-bankruptcy courts apply judicial estoppel following a non-disclosure. Non-bankruptcy courts' application of the doctrine likely stems from a misperception of bankruptcy courts.[349] But as § 105(a) demonstrates, an equitable doctrine can square with the Bankruptcy Code.[350]

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344. *See* Troy A. McKenzie, *Judicial Independence, Autonomy, and the Bankruptcy Courts*, 62 STAN. L. REV. 747, 791-92 (2010) (noting that circuit courts' procedure to refer appeals from bankruptcy matters to a magistrate judge before resolution by a district judge "suggests that the Article III courts do not view bankruptcy matters as central to the duties of the life-tenured judiciary").

345. *See generally* Alan M. Ahart, *The Limited Scope of Implied Powers of a Bankruptcy Judge: A Statutory Court of Bankruptcy, Not a Court of Equity*, 79 AM. BANKR. L.J. 1, 2 (2005) (explaining that a bankruptcy judge has no general equitable power).

346. *See, e.g.*, BANKR. L. MANUAL § 2:21 (5th ed. 2012); Lynne F. Riley & Maria C. Furlong, *The Supreme Court Restores Discretion and Enhances Jurisdiction of the Bankruptcy Courts*, ANN. SURV. OF BANKR. LAW 4 (2008) ("Bankruptcy courts are traditionally viewed as rooted in equity—possessing the discretion needed to implement a statute that incorporates social policy and to resolve the myriad situations that arise in bankruptcy cases but are not specifically addressed in the Bankruptcy Code."). *See generally* Hon. Marcia S. Krieger, "*The Bankruptcy Court Is a Court of Equity": What Does That Mean?*, 50 S.C. L. REV. 275 (1999) (discussing why bankruptcy courts are commonly referred to as courts of equity).

347. 11 U.S.C. § 105(a) (2006).

348. Marrama v. Citizens Bank of Mass., 549 U.S. 365, 374-75 (2007). *But see* Ahart, *supra* note 345, at 3 (reasoning that "these inherent powers are not truly inherent if [11 U.S.C.] § 105(a) [2006] confers these powers").

349. *Cf.* Cheng v. K&R Diversified Invs., Inc. (*In re* Cheng), 308 B.R. 448, 453 (B.A.P. 9th Cir. 2004) ("Thus, regardless of whether technical equitable rules and distinctions are controlling, the rich lore of equitable principles cannot be ignored.").

350. *See supra* notes 347-48 and accompanying text. Bankruptcy courts' equitable powers are not limited to § 105(a). *See* 11 U.S.C. § 510(c) (outlining equitable subordination); J. Stephen Gilbert, Note,

A better non-disclosure framework allows for flexibility and greater interaction with bankruptcy courts. Two professors assert that judicial estoppel in the bankruptcy context is wrong as a matter of bankruptcy policy and procedure.[351] As a solution, they argue that existing bankruptcy procedures can protect creditors and that the trustee can be joined under the Federal Rules of Civil Procedure.[352] The professors state that the bankruptcy system is designed to ensure that one of two things will occur: (1) the non-disclosure will be detected and thwarted or (2) the non-disclosure will temporarily succeed, but will be void or voidable.[353] The potential to rely solely on the Bankruptcy Code is heightened in Chapters 11 and 13 because of the extended plan periods. Chapter 7, however, also provides apt remedies for a non-disclosure, such as the loss of discharge or the revocation of discharge and reopening of the case.[354] Additionally, the court may impose criminal sanctions on a debtor who fails to disclose.[355]

Another article, authored by a bankruptcy judge and two law clerks, urges courts to consider whether the bankruptcy court may provide more appropriate remedies, other than dismissal, and to allow bankruptcy courts to consider reopening the case.[356] The authors explain that the bankruptcy courts' reluctance to reopen cases coincides with the strict application of judicial estoppel.[357] Therefore, bankruptcy judges may be hesitant to reopen cases until non-bankruptcy courts demonstrate that they will consider amendment as a potential solution.[358] While these articles do not provide a quick fix to the current state of confusion, their analysis bolsters the need for the Fifth Circuit to reconsider its approach.

A portion of the surveyed jurisdictions suggests resolution on standing alone; however, this approach does not account for the differences among Chapters 7, 11, and 13 filings.[359] A better method would provide for flexibility based on the debtor's circumstances. The need for this reformulation is illustrated in *Love* in which the Fifth Circuit's rote

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*Substantive Consolidation in Bankruptcy: A Primer*, 43 VAND. L. REV. 207, 208 (1990) (describing substantive consolidation, which is not mentioned in the Bankruptcy Code).

351. *See generally* Beiner & Chapman, *supra* note 331, at 2 (arguing that employers are getting away with discrimination, creditors are losing the chance to be repaid, and victims are not receiving their day in court because of judicial estoppel).

352. *See id.* at 37-69 ("Bankruptcy law, considered as procedure, *already* provides methods to handle a debtor's dishonesty and to prevent creditors from being deprived of the value of that civil action.").

353. *See id.* at 45-46.

354. *See* 11 U.S.C. § 727(a)(2), (4) (denial of discharge); § 727(d), (e) (revocation of discharge); § 350(b) (reopening of the case).

355. *See* 18 U.S.C. § 152 (providing for fine and imprisonment in relation to concealment of assets and false oaths); § 3284 (stating that the concealment of assets is deemed a continuing offense and the statute of limitations does not begin to run until final discharge or denial of discharge).

356. *See* Brown, *supra* note 13, at 227.

357. *See id.* at 214.

358. *See id.*

359. *See supra* Part III.C.

application of judicial estoppel faltered.[360] In *Reed*, the Fifth Circuit aimed to serve a core bankruptcy goal—maximizing recovery for creditors.[361] This same goal could have been achieved in *Love*, but it was discarded in favor of form. Based on the five prominent Fifth Circuit decisions, two apt approaches to judicial estoppel emerge: (1) the inadvertence test and (2) the unfair advantage standard.[362]

The inadvertence test is suitable for a Chapter 7 scenario, such as *Reed*. Under this approach, the court should analyze whether the debtor should be judicially estopped and, if so, allow the bankruptcy trustee to pursue the claim on behalf of the creditors. In contrast, the unfair advantage standard should be employed outside the Chapter 7 context. The inadvertence test fails to account for the distinction among the chapter filings and ultimately shortchanges the bankruptcy creditors. By viewing judicial estoppel through the broader unfair-advantage lens, the court may account for the potential to amend a bankruptcy plan that remains open. In contrast to the current state of the doctrine within the Fifth Circuit, these approaches are congruous because they both serve the interests of the bankruptcy system and provide recovery to creditors.

The Fifth Circuit reached the correct result in *Reed*. *Love*, however, demonstrated the need to limit the inadvertence test to its facts. In *Love*, the circuit court should have taken the opportunity to highlight the differences among the bankruptcy chapters and the role judicial estoppel should play therein. Unfortunately, the Fifth Circuit majority missed this opportunity. By broadening its approach to non-disclosure, the Fifth Circuit can account for these differences and respect the goals of the bankruptcy process.[363] Ultimately, bankruptcy law is not black and white, and neither should be the civil courts' approach to a non-disclosure. At the next opportunity, the Fifth Circuit should reconsider its use of judicial estoppel, but in the meantime, a protective measure exists for attorneys to spare the confusion.

### *2. Conduct a PACER Search Prior to Filing Suit*

Defense attorneys have long been encouraged to discover whether a judicial estoppel defense is available.[364] Plaintiffs' attorneys and defense

360. *See* Love v. Tyson Foods, Inc., 677 F.3d 258, 263-67 (5th Cir. 2012).

361. *See* Reed v. City of Arlington, 650 F.3d 571, 576 (5th Cir. 2011) (en banc).

362. *See supra* Part IV (evaluating and synthesizing the major Fifth Circuit decisions that shaped the application of judicial estoppel).

363. *See supra* notes 351-62 and accompanying text.

364. *See* Thomas H. Dickenson et. al, *The Bankruptcy Tainted Plaintiff's Worst Nightmare—Judicial Estoppel*, PRACTICE TIPS (June 2006) http://hdclaw.com/Publications-Seminars/Bankruptcy_Nightmare.pdf; Roman T. Galas & John P. Mueller, *Using Bankruptcy Filings to (E)stop a Plaintiff in His Tracks*, DRITODAY (Oct. 13, 2011), http://dritoday.org/feature.aspx?id=178; *see also* Anita Hotchkiss & Elizabeth M. McKeever, *Plaintiff's Bankruptcy to Summary Judgment* (Jan. 2006), *available at* http://www.pbnlaw.com/data/articles/Boon_for_Defendants_The_Road_from_Plaintiffs_

counsel alike should conduct this inquiry.[365] One attorney writes, "'[h]ave you ever filed for bankruptcy?' may be the single most important question a lawyer asks a client."[366] This seems obvious enough, but clearly, it is not being asked. It is a simple question, but it is one with a powerful, preventive effect. Most importantly, the timing of this question is key. Every plaintiff's attorney should ask this question before filing suit to short-circuit a judicial estoppel defense.[367]

At first glance, plaintiffs' attorneys may not view this approach as a solution at all, but rather as a roadblock to their potential suit; however, plaintiffs' attorneys need not fret because catching a judicial estoppel defense before filing is much better than the alternative.[368] Attorneys cannot ignore the potential for the defense out of fear of losing a claim.[369] If a judicial estoppel defense exists, the court or the defendant will likely discover it, thereby cutting short the lawsuit and wasting the attorney's time and money.[370] On the other hand, plaintiffs' attorneys that are proactive can discover the defense themselves and possibly still bring the subsequent suit.[371]

Attorneys who discover that a client has filed bankruptcy should advise the client to consult with the bankruptcy attorney or with the bankruptcy trustee if the bankruptcy case is still open.[372] The bankruptcy court may allow the client to rectify the situation, which would likely thwart any judicial estoppel defense if the client successively brings suit.[373]

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Ban.pdf ("[T]his frequently overlooked concept might prove to be just what you need to get summary judgment for your client.").

365. *See infra* notes 366-71 and accompanying text. Two online sources suggested that plaintiffs' attorneys should conduct this inquiry as well, but this approach has not been widely accepted. *See also* Tanya N. Lewis, *Bankruptcy as a Silver Bullet: Bankruptcy Actions Can Have Major Impacts on Plaintiff Personal Injury Claims* (Aug. 2006), *available at* http://www.hutchlegal.com/resources/article/Communique%20Tanya%20Lewis.pdf ("Attorneys who are knowledgeable and informed about the doctrine, whether they practice on the plaintiff or defense side, stand a better chance of being prepared for its effects on cases involving their clients."); Dickenson, *supra* note 364, at 4 ("Plaintiff's attorneys need a good client interview process to ferret out the existence of the client's bankruptcy filings.").

366. *See* Betty Ruth Fox, *Bankruptcy: Behold or Beware?*, http://www.watkinseager.com/pdfs/BRF%20Article.pdf (last visited Oct. 11, 2012).

367. If attorneys discover a bankruptcy filing before filing suit, they can wait to file until their client resolves matters with the bankruptcy court, thereby preventing any inconsistent statement made in a subsequent proceeding. *See supra* note 5 and accompanying text; *see also* Lewis, *supra* note 365, at 34, 36 (explaining how a PACER search allowed the defendant to raise a judicial estoppel defense).

368. *See supra* notes 27-30 and accompanying text (discussing the typical judicial estoppel scenario).

369. *See supra* notes 27-30 and accompanying text (discussing the typical judicial estoppel scenario).

370. *Cf. supra* note 364 and accompanying text (stating that defense attorneys frequently search for a judicial estoppel defense); *supra* note 175 and accompanying text (discussing the fees accrued in defending a judicial estoppel defense).

371. *See* infra text accompanying notes 372-73.

372. *See supra* note 367 and accompanying text.

373. *See* Dugas, *supra* note 18, at 240-41 (addressing the willingness of bankruptcy courts to reopen cases at the request of the debtor).

Therefore, it is crucial that attorneys ask their clients, "have you ever filed for bankruptcy?" Clients have no reason to answer dishonestly unless they are aware of judicial estoppel.[374] Even then, this situation is unlikely because a client who is aware of judicial estoppel should be aware of its devastating effect to the subsequent action.[375] Even if an attorney is faced with a dishonest client, however, there is one sure-fire way to answer this important question.[376]

Public Access to Court Electronic Records (PACER) allows attorneys to obtain case information from bankruptcy courts for a nominal fee.[377] Defense attorneys have used PACER to launch their judicial estoppel defense,[378] but it should be routine for plaintiffs' attorneys to conduct a search as well.[379] This should be done before the attorney files suit.[380] Similar to conflict checks, these searches should become a routine firm activity.[381] It is by no means good news to discover that a client filed bankruptcy and failed to disclose the potential claim. But it is far superior to learn this prior to filing suit than to be blindsided by a motion for summary judgment or a motion to dismiss. By adopting this procedure, attorneys can avoid a court's interpretation and adoption of judicial estoppel and, thereby, save the time and money incurred along the way.

## IX. CONCLUSION

The Fifth Circuit should reconsider its approach to judicial estoppel following a bankruptcy non-disclosure. The inadvertence test employed in *Reed v. City of Arlington* is apt for the Chapter 7 scenario.[382] As demonstrated in *Love v. Tyson Foods*, however, this approach should not be universal.[383] Under Chapters 11 and 13, when the debtor is more akin to the Chapter 7 trustee, the court should look to the unfair advantage approach for guidance.[384] This standard counsels the use of amendments to current plans rather than a complete dismissal of the suit.[385] By taking a broader view, the court may consider the creditors' interests and allow for maximum recovery—a goal the Fifth Circuit aimed to serve less than one year prior in *Reed*.

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374. *See supra* Part II.C.

375. *See supra* Part II.C. This Comment does not suggest presuming client dishonesty, but rather promotes an open discussion with a client with a PACER search as a secondary source.

376. *See infra* note 377 and accompanying text.

377. *See* PACER, http://www.pacer.gov (last visited Oct. 11, 2012).

378. *See supra* note 364 and accompanying text.

379. *See supra* notes 365-75 and accompanying text.

380. *See supra* notes 366-67 and accompanying text.

381. *See* MODEL RULES OF PROF'L CONDUCT R. 1.7 cmt. 3 (2011).

382. *See supra* Part IV.E.

383. *See supra* Part IV.E.

384. *See supra* Part VIII.B.1.

385. *See supra* Part VIII.B.1.

In the meantime, attorneys can take matters into their own hands. Rather than hoping for the most favorable approach, attorneys on both sides of the litigation can be proactive.[386] All practitioners can take the first step by cutting out any judicial estoppel defense with a pre-suit PACER search.[387] Attorneys should no longer risk dismissal on the ground of judicial estoppel now that a simple solution is at their fingertips.[388]

386. *See supra* Part VIII.B.2.
387. *See supra* Part VIII.B.2.
388. *See supra* Part VIII.B.2.