UNC SCHOOL OF LAW

NORTH CAROLINA LAW REVIEW

Volume 77 | Number 6 Article 5

9-1-1999

Survey of Developments in North Carolina Law and the Fourth Circuit 1998

North Carolina Law Review

SURVEY

Choosing Fairness over Fundamentals: How *Bailey v. North Carolina* Undermines the Constitutional Prohibition Against the State Contracting Away Its Power of Taxation

For approximately two hundred years, state governments have used tax exemptions as an integral tool in formulating public policy.[1] And for two hundred years, the United States Supreme Court has protected contracts creating permanent tax exemptions from impairment by later state actions.[2] The judicial system's protection of state-created contracts for tax exemptions is rooted in the notion of fairness.[3] Allowing a state to withdraw unilaterally from a contract for a tax exemption after a private party has relied on that exemption is simply unfair.[4] Accordingly, the Supreme Court has held that a state's failure to honor a contractual obligation promising a permanent tax exemption is a violation of the Contracts Clause of the United States Constitution.[5]

This judicial protection and its resulting limitation on a state's ability to change tax policies have led many states to adopt constitutional provisions designed to prevent their legislatures from

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1. *See* Stewart E. Sterk & Elizabeth S. Goldman, *Controlling Legislative Shortsightedness: The Effectiveness of Constitutional Debt Limitations*, 1991 WIS. L. REV. 1301, 1317 (1991) (noting that in the early nineteenth century, as state legislatures chartered private corporations, the charters commonly included tax exemptions as a means for hiding government subsidies and affording preferences to some taxpayers).

2. *See, e.g.*, United States Trust Co. of N.Y. v. New Jersey, 431 U.S. 1, 23-24 (1977) (affirming that the United States Constitution prevents states from impairing contracts for tax exemptions); New Jersey v. Wilson, 11 U.S. (7 Cranch) 164, 166-67 (1812) (recognizing for the first time that states can create contracts for permanent tax exemptions that are protected from impairment by the Constitution).

3. *See* Bailey v. North Carolina, 348 N.C. 130, 149, 500 S.E.2d 54, 65 (1998) (holding that "[t]he basis for prohibiting such action is fundamental fairness").

4. *See* Plaintiff-Appellees' Brief at 64, *Bailey* (No. 53PA96) (highlighting the unfairness that would be created if the state is not bound to honor contracts for tax exemptions where thousands of state employees have fulfilled their part of the agreement by giving "the State a lifetime of work, loyal service, and monetary considerations").

5. *See* U.S. CONST. art. I, § 10, cl. 1 ("No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . ."). *See, e.g.*, *United States Trust*, 431 U.S. at 23-24; Murray v. Charleston, 96 U.S. 432, 448-49 (1877); Washington Univ. v. Rouse, 75 U.S. (8 Wall) 439, 440 (1869); State Bank of Ohio v. Knoop, 57 U.S. (16 How.) 369, 384 (1853); *Wilson*, 11 U.S. (7 Cranch) at 166-67.

creating permanent tax exemptions in the first place.[6] Some of these provisions include language stating that "the power of taxation ... shall never be surrendered, suspended, or contracted away."[7] Under such constitutional provisions, states can still create tax exemptions, but such exemptions are merely statements of policy and are subject to repeal.[8] The purpose of these constitutional provisions is to ensure that state lawmakers maintain maximum flexibility to revise tax policies in order to meet changing economic conditions.[9] For these very reasons, the North Carolina General Assembly drafted Article V, section 2(1) to limit the state's ability to contract away its power of taxation.[10]

Inevitably, courts must decide how to mesh these constitutional provisions with the long-standing judicial tradition of recognizing and protecting state-created contracts for tax exemptions. Most state supreme courts that have addressed this issue have ruled that these constitutional provisions prevent the creation of permanent tax exemptions.[11] In the recent case *Bailey v. North Carolina*,[12] however, the North Carolina Supreme Court adopted a very different approach. The supreme court interpreted Article V, section 2(1) of

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6. *See, e.g.*, ARIZ. CONST. art. IX, § 1 ("The power of taxation shall never be surrendered, suspended, or contracted away."); GA. CONST. art. VII, § 1(1) ("The state may not suspend or irrevocably give, grant, limit, or restrain the right of taxation and all laws, grants, contracts, and other acts to effect any of these purposes are null and void."); ME. CONST. art. 9, § 9 ("The Legislature shall never, in any manner, suspend or surrender the power of taxation."); MONT. CONST. art. VIII, § 2 ("The power of taxation shall never be surrendered, suspended, or contracted away."); N.C. CONST. art. V, § 2(1) ("The power of taxation ... shall never be surrendered, suspended, or contracted away.").

7. *E.g.*, ARIZ. CONST. art. IX, § 1; N.C. CONST. art. V, § 2(1).

8. *See, e.g.*, Sheehy v. Public Employees Retirement Div., 864 P.2d 762, 765-66 (Mont. 1993) (holding that because the state constitution prohibits the state from creating contracts for permanent tax exemptions, the tax exemption in question is simply a statement of current policy that may be repealed).

9. *See* Switzer v. City of Phoenix, 341 P.2d 427, 431 (Ariz. 1959) (stating that a constitutional provision prohibiting the state from contracting away its power of taxation "was designed to leave legislators unencumbered in so far as their power to impose taxes").

10. *See infra* notes 96-113 and accompanying text.

11. *See, e.g., Switzer*, 341 P.2d at 431 (holding that an Arizona constitutional provision prohibiting the legislature from surrendering, suspending, or contracting away its taxation power left the legislature unencumbered in its ability to impose taxes); Parrish v. Employees' Retirement Sys., 398 S.E.2d 353, 355 (Ga. 1990) (holding that the Georgia Constitution prevents the creation of "irrevocable" tax exemptions); Blair v. State Tax Assessor, 485 A.2d 957, 960 (Me. 1984) (ruling that the Maine Constitution prevents the legislature from granting state retirees permanent tax exemptions); *Sheehy*, 864 P.2d at 766 (ruling that the Montana Constitution barred the state from granting permanent tax exemptions on state employee retirement benefits).

12. 348 N.C. 130, 500 S.E.2d 54 (1998).

the North Carolina Constitution[13] to allow the state to contract for permanent tax exemptions, thus re-asserting the judicial emphasis on fairness at the expense of state fiscal flexibility.[14]

This Note discusses the facts of *Bailey*, its history in the lower courts, and the North Carolina Supreme Court's unique resolution of the constitutional issue presented by the case.[15] The Note then examines the relevant United States Supreme Court cases concerning the impairment of contracts for tax exemptions.[16] Next, the Note analyzes the history and intent behind the adoption of Article V, section 2(1).[17] The Note then examines other state supreme court cases interpreting similar constitutional provisions.[18] Next, the Note analyzes the three key aspects behind the North Carolina court's constitutional interpretation: its focus on fairness; its structural and intent-based analysis; and its selective use of United States Supreme Court precedent.[19] Finally, the Note discusses the *Bailey* decision's potential impact on North Carolina public policy and concludes that the court based its approach more on concepts of fairness than on sound constitutional interpretation.[20]

The relevant facts in *Bailey* arise from a series of legislative and judicial decisions at both the state and federal levels. Beginning in 1939, the North Carolina General Assembly established a variety of retirement programs to benefit North Carolina state and local government employees.[21] For fifty years, the state granted tax

13. The full text of Article V, section 2(1) reads "*Power of taxation.* The power of taxation shall be exercised in a just and equitable manner, for public purposes only, and shall never be surrendered, suspended or contracted away." N.C. CONST. art. V, § 2(1).

14. *See Bailey*, 348 N.C. at 148, 500 S.E.2d at 64. The lack of fiscal flexibility was immediately felt by the State of North Carolina as the court's decision left the General Assembly with the difficult task of balancing the state budget while paying hundreds of millions of dollars in tax refunds to state retirees. *See* Wade Rawlins, *Budget Picture 'A Matter of Semantics,'* NEWS & OBSERVER (Raleigh, N.C.), Jan. 29, 1999, at A13. The ultimate impact of the *Bailey* decision on the finances of state government was enormous. In the end, the state was required to refund $799 million in unconstitutionally collected taxes to state and local retirees. *See* Telephone Interview with North Carolina Representative Gregg Thompson, member of the North Carolina House of Representatives Appropriations Subcommittee for General Government (Apr. 13, 1999) (transcript on file with the *North Carolina Law Review*). In addition, fiscal analysts project that the loss of tax revenue from state and local retirees will amount to approximately $125 million annually. *See id.*

15. *See infra* notes 21-67 and accompanying text.

16. *See infra* notes 68-95 and accompanying text.

17. *See infra* notes 96-113 and accompanying text.

18. *See infra* notes 114-29 and accompanying text.

19. *See infra* notes 130-83 and accompanying text.

20. *See infra* notes 184-203 and accompanying text.

21. *See* Act of Apr. 4, 1939, ch. 390, §§ 2, 11, 1939 N.C. Sess. Laws 837, 839, 856

exemptions on benefits paid to state and local government retirees.[22] In 1989, however, the United States Supreme Court in *Davis v. Michigan Department of the Treasury*[23] held unconstitutional state taxation schemes that treated federal employees differently from state and local employees.[24] Under the *Davis* ruling, North Carolina discovered that it had unconstitutionally benefited state employees for fifty years because its tax exemptions had not included federal employees.[25]

In response to the Court's decision, the North Carolina General Assembly changed the tax exemption on retirement benefits in two important ways.[26] First, the legislation expanded the tax exemption to include federal government employees.[27] Second, and most important for the *Bailey* decision, the legislation capped the state and federal annual benefits exempted from state taxation at $4000 per person.[28] As a result, North Carolina taxed state and local employee retirement benefits for the first time.

Following the partial removal of the tax exemption on retirement benefits, state and local government retirees filed a lawsuit claiming that the General Assembly's action was an unconstitutional impairment of contract.[29] The retirees' initial complaint, however, was rejected on procedural grounds because the plaintiffs failed to comply with the state's statutorily prescribed procedure for protesting

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(codified as amended at N.C. GEN. STAT. §§ 128-22, 128-31 (1999)) (creating the Local Government Employees' Retirement System and exempting its retirement benefits from state and local taxation). By 1989, when the General Assembly enacted the tax legislation in dispute in *Bailey*, there were a variety of different statutory retirement systems providing benefits to former state and local employees. *See, e.g.*, N.C. GEN. STAT. § 128-22 (1999) (creating the Local Government Employees' Retirement System in 1939); N.C. GEN. STAT. §§ 135-50 to -76 (1997) (creating the Consolidated Judicial Retirement System in 1973); N.C. GEN. STAT. § 120-4.9 (1994) (creating the Legislative Retirement System in 1983).

22. *See Bailey*, 348 N.C. at 138, 500 S.E.2d at 58; Act of Apr. 4, 1939, § 11 (creating the Local Government Employees' Retirement System and exempting its benefits from state and local taxation).

23. 489 U.S. 803 (1989).

24. *See id.* at 817.

25. *See id.* (holding that differentiated taxation between state and federal government employees violates both the constitutional doctrine of intergovernmental tax immunity and federal statutory law).

26. *See* Act of Aug. 12, 1989, ch. 792, sec. 1.1, 1989 N.C. Sess. Laws 2891, 2891 (1989) (codified as amended at N.C. GEN. STAT. § 105-134.6(b) (1997)) (amending the exemption so as to include all governmental employees and creating a cap on the amount of employee benefits exempted from state taxation); *Bailey*, 348 N.C. at 139, 500 S.E.2d at 59.

27. *See* Act of Aug. 12, 1989, sec. 1.1.

28. *See id.*

29. *See Bailey*, 348 N.C. at 135, 500 S.E.2d at 56-57.

taxes.[30] The court held that compliance with the protest and demand requirements of the statute was the exclusive method for challenging unconstitutional or invalid income taxes in North Carolina.[31] As a result of this procedural setback, the plaintiffs were forced to wait more than six years before the North Carolina Supreme Court decided their case on the merits.[32]

The retirees filed suit a second time using only named plaintiffs who had followed the requisite statutory protest requirements.[33] In 1994, the trial court certified the lawsuit as a class action.[34] Following a two-week trial in September 1995, the trial court ruled in favor of the plaintiff-retirees.[35] Essential to the trial court's decision was its determination that the 1989 legislation partially repealing the tax exemption on state and local government employee retirement benefits was an unconstitutional impairment of contract under the United States Constitution.[36] The State appealed the trial court's decision directly to the North Carolina Supreme Court.[37]

The central issue in *Bailey* was whether the plaintiffs had a contractual right to a tax exemption that was unconstitutionally

30. *See* Bailey v. North Carolina ("Bailey I"), 330 N.C. 227, 235, 412 S.E.2d 295, 300 (1991) ("When a tax is challenged as unlawful . . . the appropriate remedy is to bring suit under [N.C. GEN. STAT.] § 105-267."). Under section 105-267 of the North Carolina General Statutes, a taxpayer with a valid defense to the enforcement of a tax must first pay the tax and then demand a refund in writing within 30 days. *See* N.C. GEN. STAT. § 105-267 (1997 & 1999 Supp.). Only if the Secretary of Revenue refuses to refund the tax within 90 days may the taxpayer sue to recover the amount paid. *See id.* The plaintiffs in this case failed to follow these procedures. First, the plaintiffs filed their complaint seeking refunds prior to sending demand letters to the Secretary of Revenue, thus failing to meet the condition precedent for relief outlined in the statute. *See Bailey I*, 330 N.C. at 237, 412 S.E.2d at 301. Additionally, the plaintiffs failed to provide sufficient information about each claimant so that the Department of Revenue could determine if that person had properly filed a protest and was thus eligible for a refund. *See id.* at 237-38, 412 S.E.2d at 301-02.

31. *See id.* at 235, 412 S.E.2d at 300.

32. The first *Bailey* decision was handed down in December 1991, and the court did not decide the merits of the case until May 1998. *See Bailey*, 348 N.C. at 131, 500 S.E.2d at 54; *Bailey I*, 330 N.C. at 229, 412 S.E.2d at 296.

33. *See Bailey*, 348 N.C. at 135, 500 S.E.2d at 57.

34. *See id.* The certified class included state and local government retirees and beneficiaries who had complied with the statutory protest requirements for the tax years 1989, 1990, and 1991. *See id.*

35. *See id.* at 135, 500 S.E.2d at 56-57.

36. *See id.* at 135, 500 S.E.2d at 57. The trial court also found that the legislation was a material breach of contract and an unconstitutional retroactive tax, and that it violated judges' state constitutional rights not to have their salaries diminished during office as well as other state and federal constitutional provisions. *See id.*

37. *See id.* at 136, 500 S.E.2d at 57. The North Carolina Supreme Court designated the case as "exceptional" and granted discretionary review, thereby bypassing the North Carolina Court of Appeals. *See id.*

impaired by the State of North Carolina.[38] The court used criteria set forth by the United States Supreme Court to analyze whether the General Assembly's partial repeal of the exemption violated the Contracts Clause of the United States Constitution.[39] The key question under this analysis was whether an enforceable contract was created between the plaintiffs and the State by virtue of the original legislation exempting state employee retirement benefits from taxation.[40]

The State argued that Article V, section 2(1) of the North Carolina Constitution, which provides that "the power of taxation ... shall never be surrendered, suspended, or contracted away,"[41] prevented the state from contracting with state employees for a permanent tax exemption on their retirement benefits.[42] The State posited that, given this constitutional prohibition, the General Assembly never intended to confer contractual rights on state employees.[43] Though the North Carolina Constitution allows the state to create tax exemptions,[44] the State argued that Article V, section 2(1) prohibits the state from making such exemptions permanent.[45] Given this constitutional restriction, the state asserted that the legislation exempting retirement benefits from state taxation should be construed as a statement of state policy that the General Assembly could change at any time, rather than the creation of permanent contract rights.[46] The North Carolina Supreme Court

38. *See id.* at 140, 500 S.E.2d at 59-60.

39. *See id.* at 141, 500 S.E.2d at 60. The Supreme Court established a three-part test in *United States Trust* that "requires a court to ascertain: (1) whether a contractual obligation is present; (2) whether the state's actions impaired that contract; and (3) whether the impairment was reasonable and necessary to serve an important public purpose." United States Trust Co. of N.Y. v. New Jersey, 431 U.S. 1, 17 (1977). The plaintiffs' constitutional challenge relied on the Contracts Clause of the United States Constitution, which provides that "[n]o State shall ... pass any ... Law impairing the Obligation of Contracts." U.S. CONST. art. I, § 10, cl. 1.

40. *See Bailey*, 348 N.C. at 141, 500 S.E.2d at 60; Act of Apr. 4, 1939, ch. 390, §§ 2, 11, 1939 N.C. Public Laws 837, 839, 856 (creating the Local Government Employees' Retirement System). Section 11 of the legislation upon which the plaintiff-retirees' contractual claim is based states in pertinent part that the retirement benefits created by the Act are "exempt from any state or municipal tax." Act of Apr. 4, 1939, § 11.

41. N.C. CONST. art. V, § 2(1).

42. *See Bailey*, 348 N.C. at 147, 500 S.E.2d at 64.

43. *See* Defendant-Appellants' Brief at 45, *Bailey* (No. 53PA96).

44. *See* N.C. CONST. art. V, § 2(6) ("there shall be allowed ... exemptions").

45. *See* Defendant-Appellants' Brief at 45, *Bailey* (No. 53PA96) (arguing that the General Assembly could not have intended to make the tax exemptions contractual, and therefore permanent, because doing so would have been unconstitutional).

46. *See id.* at 51-52; *cf.* Sheehy v. Public Employees Retirement Div., 864 P.2d 762, 765 (Mont. 1993) (holding that a similar constitutional provision prevented the State of

rejected the State's argument on both equitable and substantive grounds.[47]

The court first rejected the State's interpretation of Article V, section 2(1) based on what the court viewed as the unfairness that would result from the State's position.[48] The court noted that, as a general rule, a party cannot accept benefits conferred under a statute and then question the constitutionality of that statute in order to avoid its burdens.[49] The court pointed out that the State had benefited from the tax exemption on retirement payments for many years by using it as an inducement for individuals to enter and remain in government employment.[50] The court ruled that after such a long history of accepting the benefits of the tax exemption, the State could not escape its responsibilities under the agreement.[51]

In assessing the unfairness of the State's constitutional argument, the supreme court interpreted Article V, section 2(1) as allowing the State to make permanent contracts for tax exemptions without running afoul of the North Carolina Constitution.[52] The court's narrow interpretation of Article V, section 2(1) stemmed in part from its reading of other subsections of section 2 that allowed the State to create tax exemptions.[53] The court focused its analysis on Article V, section 2(6), which provides "there shall be allowed personal exemptions and deductions so that only net incomes are taxed," and Article V, section 2(3), which deals exclusively with property taxes and establishes that "[n]o taxing authority other than the General Assembly may grant exemptions."[54] The court reasoned that, given these subsections, a tax exemption does not constitute the relinquishment of the state's taxation power.[55] In its opinion, however, the court failed to address the State's argument that Article V, section 2(1) allowed the state to grant tax exemptions, but prohibited the state from making such exemptions permanent. To

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Montana from entering into a permanent contract for a tax exemption). In *Sheehy*, the court held that given this limitation, all tax exemptions provided by the state legislature simply reflected current state policy and were repealable at any time. 864 P.2d at 765.

47. *See Bailey*, 348 N.C. at 147-50, 500 S.E.2d at 64-66.

48. *See id.* at 147, 500 S.E.2d at 64.

49. *See id.*

50. *See id.* at 150, 500 S.E.2d at 65.

51. *See id.* at 150, 500 S.E.2d at 65-66.

52. *See id.* at 148, 500 S.E.2d at 64.

53. *See id.*

54. N.C. CONST. art. V, §§ 2(3), 2(6).

55. *See Bailey*, 348 N.C. at 148, 500 S.E.2d at 64. The court, however, did not address the State's argument that the constitution allows only temporary, not permanent, tax exemptions. *See* Defendant-Appellants' Brief at 45, *Bailey* (No. 53PA96).

bolster its interpretation, the court noted that Article V, section 2(7) allows the State to enter into contracts for public purposes.[56] The court stated that the interplay of these other subsections precluded it from reading Article V, section 2(1) in isolation.[57] Instead, the court held that, when all sections are read in combination, the North Carolina Constitution allows the State to enter into contracts for tax exemptions without contracting away the power of taxation as long as the contract is for a public purpose.[58]

Following its rejection of the State's constitutional argument, the North Carolina Supreme Court ruled that the State formed a contractual relationship with its employees vested in the state retirement system.[59] The court based its decision on the premise that retirement benefits are currently earned but deferred compensation to which employees had a vested contractual right.[60] The court then determined that this contract was unconstitutionally impaired by the General Assembly's repeal of the tax exemption on retirement benefits, and that plaintiffs were thus entitled to relief.[61]

The supreme court's final task was to determine to whom the State owed tax refunds.[62] Following on the heels of its pro-taxpayer interpretation of Article V, section 2(1), the court ruled that the State

56. *See Bailey*, 348 N.C. at 148, 500 S.E.2d at 64. Article V, section 2(7) provides that the "State ... may contract with ... any person ... for the accomplishment of public purposes only." N.C. CONST. art. V, § 2(7).

57. *See Bailey*, 348 N.C. at 148, 500 S.E.2d at 64.

58. *See id.* The court supported its interpretive conclusion with an illustration of the impact that would result if the court interpreted Article V, section 2(1) differently. *See id.* at 149, 500 S.E.2d at 65. The court analogized the State's contract with state employees to the State's issuance of tax-exempt municipal bonds. *See id.* The court suggested that if Article V, section 2(1) invalidated the State's contract in *Bailey*, then the State could also "issu[e] tax-free bonds, collec[t] hundreds of millions of dollars for their purchase, and then retrospectively repea[l] investors' tax-free interest and capital gain advantages." *Id.* at 149, 500 S.E.2d at 65.

59. *See Bailey*, 500 S.E.2d at 61. This portion of the opinion does not appear in the North Carolina reporter. *See Bailey*, 348 N.C. at 141.

60. *See Bailey*, 348 N.C. at 141, 500 S.E.2d at 60 (citing Simpson v. North Carolina Local Gov't Employees' Retirement Sys., 88 N.C. App. 218, 223-24, 363 S.E.2d 90, 94 (1987)). After determining that a contractual obligation existed, the court determined that the State had impaired this contract by capping the amount of retirement benefits exempted from taxation. *See id.* at 151, 500 S.E.2d at 66. The court went on to rule that the impairment of the contract was neither necessary nor reasonable to serve an important public purpose. *See id.* at 151, 500 S.E.2d at 66-67 (holding that the State was not forced to cap the tax exemptions of state retirees following the Supreme Court's decision in *Davis*, but could have instead met its legal obligation to tax federal and state employees equally by extending full tax exemption to federal employees).

61. *See id.* at 153, 500 S.E.2d at 67 (holding that the State had unconstitutionally impaired the contractual rights of state and local retirees).

62. *See id.* at 163, 500 S.E.2d at 73.

owed refunds to all retirees unconstitutionally taxed, not simply those who followed the statutorily prescribed protest procedures.[63] This reversal of earlier precedent, including the court's decision in *Bailey I*, was opposed by two members of the court.[64] In addition, the reversal provoked widespread media coverage of the *Bailey* decision because it substantially increased the amount of money the State was forced to refund.[65]

The court's interpretation of Article V, section 2(1) of the North Carolina Constitution is likely to have similarly important, though more subtle, effects on North Carolina public policy. Although not so widely publicized at the time, the *Bailey* decision was the first explicit supreme court interpretation of Article V, section 2(1)'s prohibition on the state contracting away its power of taxation.[66] Interestingly,

63. *See id.* at 166, 500 S.E.2d at 75. The court based its decision on what it perceived as the underlying purpose of the statutory protest requirements. *See id.* The court found that section 105-267 of the North Carolina General Statutes was simply a procedural requirement designed to give the State notice of potential liabilities and allow it to budget accordingly. *See id.* The court held that once the plaintiffs followed the procedural requirements of section 105-267 and the court decided the case on its merits, the state could not use the statute to prevent those taxpayers that did not follow the statutory "protest" procedures from recovering refunds from the State. *See id.*

64. *See id.* at 167-68, 500 S.E.2d at 76-77 (Webb, J., concurring in part and dissenting in part); *id.* at 167, 500 S.E.2d at 76 (Frye, J., concurring in part and dissenting in part). Judge Webb argued that the court should not overturn contrary precedent by focusing on the purpose of the statute, but should instead follow the plain meaning of the statute and limit refunds to those taxpayers paying under protest. *See id.* at 167-68, 500 S.E.2d at 76-77 (Webb, J., concurring in part and dissenting in part).

65. *See* Rawlins, *supra* note 14, at A13 (discussing how the *Bailey* decision and its multi-million dollar, court-ordered refund to retirees contributed to "one of the toughest fiscal squeezes in a decade" for lawmakers attempting to craft a two-year state budget); *Early Look at Budget Exposes Problems: North Carolina Might Be Facing a $900 Million Shortfall*, NEWS & RECORD (Greensboro, N.C.), December 30, 1998, at B2D (noting that the *Bailey* decision would cost the state $400 million and could lead to a budget shortfall). The court's statutory interpretation of section 105-267 of the North Carolina General Statutes was an extremely important aspect of the *Bailey* decision because of its enormous impact on the state budget. *See* Rawlins, *supra* note 14, at A13. The broad fiscal implications of the court's statutory interpretation have already been felt in a subsequent lawsuit against the state. *See* Smith v. State, 349 N.C. 332, 341, 507 S.E.2d 28, 33 (1998) (holding that the State of North Carolina owed hundreds of millions of dollars in additional refunds to all state taxpayers who paid unconstitutional intangibles taxes). Unfortunately, the necessarily limited scope of this Note does not allow for a more in-depth analysis of this important statutory interpretation. Instead, the analysis of this Note focuses on the court's equally important, though less publicized, constitutional interpretation of Article V, section 2(1). *See infra* notes 130-203 and accompanying text (analyzing the *Bailey* court's constitutional interpretation).

66. Other supreme court cases have cited Article V, section 2(1), but have not explicitly interpreted its meaning. *See, e.g.*, Swanson v. State, 329 N.C. 576, 586, 407 S.E.2d 791, 796 (1991) ("It is very difficult under this section for the State to waive its right to collect taxes.").

the court's interpretation differed substantially from the interpretations adopted by other states with similar constitutional provisions.[67] Thus, to understand if the court's decision was a proper interpretation of Article V, section 2(1), it is necessary to analyze three factors: the United States Supreme Court precedent upon which the court based its decision; the legal and legislative history behind the adoption of Article V, section 2(1); and the alternative constitutional analysis favored by other state courts.

The United States Supreme Court has consistently ruled that a state may contract for tax exemptions and that such contracts are protected from impairment by the Contracts Clause of the United States Constitution.[68] As early as 1812, the United States Supreme Court recognized that a state could, consistent with the United States Constitution, properly grant a permanent tax exemption and that the Contracts Clause prohibited the impairment of such an agreement.[69] In *New Jersey v. Wilson*,[70] the State of New Jersey entered into a contract with the Delaware Indians that granted a permanent tax exemption to a tract of land used by the tribe.[71] The Court ruled that the contract affected the land itself and that, despite later being sold to a third party, the State could not levy taxes on the land without unconstitutionally impairing the contract.[72]

Forty years later, in *State Bank of Ohio v. Knoop*,[73] the Court rejected the argument that a state legislature did not have the power to make a binding contract for a tax exemption.[74] In *Knoop*, the Court examined an 1845 Ohio statute that fixed the amount of state

67. *See, e.g.*, Switzer v. City of Phoenix, 341 P.2d 427, 431 (Ariz. 1959) (holding that an Arizona Constitution provision prohibiting the legislature from surrendering, suspending, or contracting away its taxation power left the legislature unencumbered in its ability to impose taxes); Parrish v. Employees' Retirement Sys., 398 S.E.2d 353, 355 (Ga. 1990) (holding that the Georgia Constitution prevents the creation of "irrevocable" tax exemptions); Blair v. State Tax Assessor, 485 A.2d 957, 960 (Me. 1984) (ruling that the Maine Constitution prevents the legislature from granting state retirees permanent tax exemptions); Sheehy v. Public Employees Retirement Div., 864 P.2d 762, 766 (Mont. 1993) (ruling that the Montana Constitution barred the state from granting permanent tax exemptions on state employee retirement benefits).

68. *See, e.g.*, United States Trust Co. v. New Jersey, 431 U.S. 1, 23-24 (1977); State Bank of Ohio v. Knoop, 57 U.S. (16 How.) 369, 384 (1853); New Jersey v. Wilson, 11 U.S. (7 Cranch) 164, 166-67 (1812).

69. *See Wilson*, 11 U.S. (7 Cranch) at 166-67.

70. 11 U.S. (7 Cranch) 164 (1812).

71. *See id.* at 165.

72. *See id.* at 167.

73. 57 U.S. (16 How.) 369 (1853).

74. *See id.* at 384.

taxation on banks at six percent.[75] In 1851, the Ohio legislature attempted to tax banks at general property rates, thereby increasing taxation over the previous six percent limit.[76] The United States Supreme Court held that the 1851 legislation represented an impairment of a contractual obligation between the banks and the State and was thus unconstitutional under the Contracts Clause.[77] In its analysis of the case, the Court specifically rejected the notion that a contract for a tax exemption amounted to bargaining away a part of a state's sovereignty.[78] Since *Knoop*, the Court has repeatedly affirmed its position that a state may contract for a permanent tax exemption without contracting away an essential element of its sovereignty.[79]

The Court's most recent analysis of the impact of the Contracts Clause on state tax-exemption legislation reinforces the outcomes of these previous decisions. In *United States Trust Co. of New York v. New Jersey*,[80] the Court analyzed the constitutionality of repealing a New Jersey statute that provided security for holders of certain state bonds.[81] The Supreme Court held that this repeal violated the Contracts Clause of the Constitution because it impaired the contract between the bond holders and the State by removing an important

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75. *See id.* at 376-77.

76. *See id.* at 377-78.

77. *See id.* at 392; *supra* note 5 (quoting U.S. CONST. art. I, § 10, cl. 1).

78. *See Knoop*, 57 U.S. (16 How.) at 384. The Court held that:

> The assumption that a State, in exempting certain property from taxation, relinquishes a part of its sovereign power, is unfounded. The taxing power may select its objects of taxation; and this is generally regulated by the amount necessary to answer the purposes of the State.... [T]he exemption of property from taxation is a question of policy and not of power.

Id. at 384.

79. *See, e.g.*, Murray v. Charleston, 96 U.S. 432, 444 (1877) ("The constitutional provision against impairing contract obligations is a limitation upon the taxing power, as well as upon all legislation, whatever form it may assume. Indeed, attempted State taxation is the mode most frequently adopted to affect contracts contrary to the constitutional inhibition."); Washington Univ. v. Rouse, 75 U.S. (8 Wall.) 439, 440 (1869) (stating that the charter creating Washington University contained an "exemption from taxation [that] became one of the franchises of the corporation of which it [c]ould not be deprived by any species of State legislation").

80. 431 U.S. 1 (1977).

81. *See id.* at 13-14. The *United States Trust* decision did not explicitly involve a legislative contract for tax exemption. Instead, the New Jersey legislature passed a law requiring certain funds generated by the New York-New Jersey Port Authority to be used only to repay bondholders. *See id.* at 9-10. The Supreme Court held that this legislation created a contract with the bondholders that could not be impaired. *See id.* at 32. Although the case did not directly address tax exemptions, its Contract Clause analysis was derived from the previously cited cases and was cited by the North Carolina Supreme Court in *Bailey*. *See Bailey*, 348 N.C. at 148, 500 S.E.2d at 64-65.

security provision that was an essential element of the contract.[82] In its analysis, the Court distinguished between the various powers of state governments, holding that a state cannot contract away certain "reserved powers," such as its police power and the power of eminent domain.[83] In contrast, however, a state can contractually create permanent limits on the future exercise of its taxing and spending powers, including making indelible contracts for tax exemptions.[84]

Despite Supreme Court precedent affirming the ability of states to make constitutionally protected contracts for tax exemptions, the Court has stated that it will interpret tax exemption legislation in light of state constitutional restrictions that prevent the creation of contracts for tax exemptions.[85] In *Home of the Friendless v. Rouse*,[86] the State of Missouri attempted to tax a charitable organization despite a provision in the organization's charter that exempted it from state taxation.[87] The United States Supreme Court held that the organization's charter created an enforceable contract for a permanent tax exemption and was thus protected by the Contracts Clause.[88] The Court, however, noted that the contract was enforceable only because a state constitutional provision prohibiting the state from entering into such contracts was not in effect at the time the charter was adopted.[89]

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82. *See id.* at 32.

83. *See id.* at 23-24.

84. *See id.* at 14. In *Bailey*, the North Carolina Supreme Court relied specifically on *United States Trust* to support its contention that the state could enter into a contract for a tax exemption without impermissibly undermining its sovereignty. *See Bailey*, 348 N.C. at 148, 500 S.E.2d at 64-65.

85. *See* Gulf & Ship Island R.R. Co. v. Hewes, 183 U.S. 66, 71 (1901) (stating that the railroad's charter had to be "construed in subordination to the [state] constitution"); *see also* Sterk & Goldman, *supra* note 1, at 1319 n.104 (stating that the Supreme Court implicitly affirmed the ability of a state constitution to prevent the creation of contracts for permanent tax exemptions).

86. 75 U.S. (8 Wall.) 430 (1869).

87. *See id.* at 436.

88. *See id.* at 438-39.

89. *See id.* at 438. As the Court noted, "the present constitution of Missouri prohibits the legislature from entering into a contract which exempts the property of an individual or corporation from taxation, but when the charter in question was passed there was no constitutional restraint on the action of the legislature in this regard." *Id.* at 438. Both *Home of the Friendless v. Rouse* and *Washington University v. Rouse* were Missouri cases that involved state-created corporations with identical tax exemption provisions in their charters. *See* Home of the Friendless v. Rouse, 75 U.S. (8 Wall.) 430 (1869); Washington Univ. v. Rouse, 75 U.S. (8 Wall.) 439 (1869). The Supreme Court ruled against the State of Missouri in both cases on the same day. *See Home of the Friendless*, 75 U.S. (8 Wall.) at 438-39; *Washington University*, 75 U.S. (8 Wall.) at 440-41.

Similarly, in *Gulf & Ship Island Railroad Co. v. Hewes*,[90] the Supreme Court concluded that a state charter granting a railroad a tax exemption had to be construed as subordinate to the Mississippi State Constitution.[91] The Court focused its analysis on a provision of the state constitution that declared that the "property of all corporations . . . shall be subject to taxation."[92] The Supreme Court stated that in determining whether a contract exists, the Court presumes that the parties enter any agreement in contemplation of the existing state constitution.[93] Therefore, because the state constitution prevented the creation of permanent tax exemptions for corporations, the Court held that no contract existed and that the original charter was simply a statement of policy that was subject to subsequent legislative repeal.[94] Since *Hewes*, the Court has continued to affirm the ability of state constitutions to limit the creation of contracts for permanent tax exemptions.[95]

North Carolina's legal history preceding the adoption of Article V, section 2(1) highlights the impact on public policy of the United States Supreme Court's Contracts Clause analysis. In 1871, the United States Supreme Court held in *Raleigh & Gaston Railroad Co. v. Reid*[96] that the North Carolina General Assembly could not tax a railroad that the state had previously exempted from state taxation because such an action would unconstitutionally impair the obligation of contract.[97] The charter of the Raleigh and Gaston Railroad, which was granted by the General Assembly in 1852, permanently exempted

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90. 183 U.S. 66 (1901).

91. *See id.* at 71.

92. *Hewes*, 183 U.S. at 71-72 (citing MISS. CONST. art. XII, § 13 (1869)).

93. *See Hewes*, 183 U.S. at 71.

94. *See id.* at 74-75. The Court held that given the prevailing interpretation of the state constitution, the charter granting the railroad a tax exemption

> must be read as if it contained a proviso that the legislature might in the meantime alter, amend or repeal the act. Hence, as the legislature is left entirely free to act upon the subject, no subsequent legislation could possibly impair the obligation of the contract, if such exemption can be called a contract at all. If no statute *could* impair it, it goes without saying that none *did* impair it.

Id. at 74-75.

95. *See, e.g.*, Williams v. Baltimore, 289 U.S. 36, 44 (1933) (holding that though a railroad may hold a charter creating a contract with the state for a tax exemption, if such a contract is prohibited by state law the "contract will not give validity to what would otherwise be void"). The recognition that state constitutions may limit the ability of state legislatures to enter into contracts for tax exemptions is especially important because tax exemption contracts have been read narrowly by the Supreme Court. *See* United States Trust Co. of N.Y. v. New Jersey, 431 U.S. 1, 24 n.21 (1977) (noting that "tax exemption contracts generally have not received a sympathetic construction").

96. 80 U.S. (13 Wall.) 269 (1871).

97. *See id.* at 270.

the railroad's property from state taxation.[98] Despite this exemption, the General Assembly in 1869 placed a property tax on the franchises and rolling stock of all railroads.[99] In a lawsuit brought by the railroad, the North Carolina Supreme Court ruled that "[a] State cannot by contract or in any other mode surrender the power of taxation necessary for its existence."[100] The United States Supreme Court reversed, holding that the tax exemption provision was a term of the contract that the charter created between the state and the railroad, and that, accordingly, the tax exemption was protected from impairment by the Contracts Clause of the United States Constitution.[101]

Following the Supreme Court's decision that the General Assembly could not impair contracts for tax exemptions, the North Carolina Supreme Court expressed its frustration with this broad interpretation of the Contracts Clause. In *Worth v. Wilmington & Weldon Railroad*,[102] the North Carolina Supreme Court ruled that the State could not impose a tax on the gross receipts of a railroad because the railroad's 1852 charter exempted it from taxation.[103] The court noted that the facts of *Worth* were so similar to other United States Supreme Court cases establishing contracts for tax exemptions via legislative charters that the availability of a constitutional protection of such a contract was "no longer an open question for the court."[104] Importantly, however, the court expressed "regret . . . that the right of one general assembly to surrender a portion of the sovereign power to tax, so as to disable itself or its successor to resume it, has been recognized."[105] This sense of frustration with the Supreme Court's broad interpretation of the Contracts Clause and the resulting loss of state autonomy seems to have been the historical

98. *See* Raleigh & Gaston R.R. Co. v. Reid, 64 N.C. 155, 156 (1870), *rev'd*, 80 U.S. (13 Wall.) 269, 270 (1871). Despite the tax exemption provision in the railroad's 1852 charter, the North Carolina court upheld a property tax on the railroad based on the notion that the State could not contract away its taxation power and that contracts between individuals and the State must be construed in a meaning most favorable to the State. *See id.* at 158-59, 160.

99. *See id.* at 156. "Rolling stock" is comprised of all the locomotives and boxcars of a railroad. *See* WEBSTER'S NEW WORLD DICTIONARY 1164 (3d ed. 1988).

100. *Id.* at 160. The court concluded that the tax exemption provision was not an essential part of the contract created by the charter between the State and the railroad. *See id.* at 162-63. As a result, the State was not bound by that provision, thus making the newly enacted property tax valid. *See id.* at 163.

101. *See Raleigh & Gaston R.R.*, 80 U.S. (13 Wall.) at 270.

102. 89 N.C. 291 (1883).

103. *See id.* at 299-300.

104. *Id.* at 300.

105. *Id.* at 299-300.

driving force behind the adoption of North Carolina's constitutional amendment prohibiting the state from contracting away its power of taxation.[106]

Although the language of Article V, section 2(1) was first incorporated into the North Carolina Constitution in 1936,[107] the intent of the drafters is best evidenced by earlier attempts to amend the Constitution using similar language. The North Carolina General Assembly first sanctioned the language in question in 1913.[108] In that year, the General Assembly adopted a ban on the state contracting away its power of taxation, along with several other constitutional changes, as a proposed amendment to the North Carolina Constitution.[109] These amendments, however, were defeated by popular vote in the general election of 1914.[110] The deliberations of the commission that recommended these constitutional changes to the General Assembly shed some light on the intent behind the prohibition on contracting away the power of taxation.[111] An expert witness to the commission, in commenting on the language in question, stated that it "merely guards against the danger that the State Legislature may at some unguarded moment surrender to some interest its right of taxation and guarantee it perpetual exemption."[112] This statement, in combination with the earlier United States

106. *See* N.C. CONST. art. V, § 2(1) ("The power of taxation ... shall never be surrendered, suspended or contracted away."). *See generally* Sterk & Goldman, *supra* note 1, at 1319-20 (stating that once the Supreme Court defined the broad scope of the Contracts Clause, states moved to limit the effects of this interpretation by adopting constitutional provisions that prohibited legislatures from contracting away taxing power). Perceived abuses of tax exemptions in the nineteenth century were an additional factor leading to state constitutional restraints on legislatures' power to grant such exemptions. *See* Sterk & Goldman, *supra* note 1, at 1317.

107. *See* Act of April 29, 1935, ch. 248, § 1, 1935 N.C. Public Laws 270, 270. In 1936 the voters ratified an amendment to Article V, section 3 of the North Carolina Constitution that read:

> "Sec. 3. *State Taxation.* The power of taxation shall be exercised in a just and equitable manner, and shall never be surrendered, suspended or contracted away. Taxes on property shall be uniform as to each class of property taxed. Taxes shall be levied only for public purposes, and every act levying a tax shall state the object to which it is to be applied."

Id.; NORTH CAROLINA GOVERNMENT, 1585-1974: A NARRATIVE AND STATISTICAL HISTORY 920-21 (John L. Cheney, Jr., ed., 1975) (discussing 1935 Act's ratification by voters in 1936).

108. *See* Act of October 13, 1913, ch. 81, § 1, 1913 N.C. Public Laws [Ex. Sess.] 95, 97.

109. *See id.*

110. *See* NORTH CAROLINA GOVERNMENT, 1585-1974: A NARRATIVE AND STATISTICAL HISTORY, *supra* note 107, at 898.

111. *See* STATE OF N.C. COMM'N ON CONSTITUTIONAL AMENDMENTS, MINUTES OF THE COMMITTEE ON ARTICLE V, REVENUE AND TAXATION 33, S. 1884 (1913).

112. *Id.* (testimony of Dr. Adams of the University of Wisconsin).

Supreme Court rulings limiting the General Assembly's ability to repeal legislatively-created tax exemptions, suggests that North Carolina lawmakers intended to create a state constitutional provision that would prevent the federal courts from interpreting tax exemptions as creating contractual obligations.[113]

In other states with provisions similar to Article V, section 2(1), courts have pointed to legislative intent as a key factor in rejecting recent challenges to the repeal of tax exemptions on retirement benefits.[114] Much like North Carolina, these other states eliminated tax exemptions on the retirement benefits of state employees following the Supreme Court's decision in *Davis v. Michigan Department of Treasury*,[115] and subsequently faced lawsuits by retirees.[116] Yet in contrast to *Bailey*, other states with constitutional provisions similar to North Carolina's have uniformly interpreted those provisions as allowing the repeal of retirement benefit tax exemptions.[117]

In Georgia, state retirees lost their challenge to the repeal of a tax exemption on their retirement benefits because the Georgia Constitution provides that " '[t]he state may not suspend or irrevocably give, grant, limit or restrain the right of taxation' " and that laws to the contrary " 'are null and void.' "[118] The Georgia

113. *See* Sterk & Goldman, *supra* note 1, at 1319-20 (discussing states' efforts to prohibit legislatures from contracting away their taxing power after the Supreme Court's decision in *Raleigh & Gaston R.R.*); *see also* Gulf & Ship Island R.R. Co. v. Hewes, 183 U.S. 66, 71 (1901) (presuming that alleged legislative contracts are entered into in contemplation of the existing state constitution).

114. *See Bailey*, 348 N.C. at 148-50, 500 S.E.2d at 64-66. The state constitutional provisions that were interpreted differently contained very similar language to Article V, section 2(1). *See supra* note 6 (listing various state constitutional provisions).

115. 489 U.S. 803 (1989).

116. *See, e.g.*, Parrish v. Employees' Retirement Sys., 398 S.E.2d 353 (Ga. 1990); Sheehy v. Public Employees Retirement Div., 864 P.2d 762 (Mont. 1993); Hughes v. Oregon, 838 P.2d 1018 (Or. 1992).

117. *See Parrish*, 398 S.E.2d at 354; *Sheehy*, 864 P.2d at 770-71. In Oregon, a state without a constitutional limitation on the contracting away of the power of taxation, the state supreme court held in favor of retirees challenging the repeal of a tax exemption on their retirement benefits. *See Hughes*, 838 P.2d at 1038. The court held that the tax exemption constituted a contract between the state and its employees and that its subsequent repeal was an "impairment" of the contract therefore violating the Contracts Clause of the United States Constitution. *See id.* at 1038. Without a state constitutional provision preventing the state from contracting away its power of taxation, the State of Oregon was relegated to arguing that, through the nature of its sovereignty, it could not contract away its sovereign power of taxation. *See id.* at 1024. Not surprisingly, given the United States Supreme Court precedent on the subject, the Oregon Supreme Court summarily rejected this argument. *See id.* at 1025-26.

118. *Parrish*, 398 S.E.2d at 354 (quoting GA. CONST. art. VII, § 1(1)).

Supreme Court rejected arguments by the retirees that the tax exemption in question was not "irrevocable" because it ends when retirement payments to each employee cease.[119] Instead, the court concluded that enforcing the contract for a tax exemption would make the tax exemption "irrevocable" and thus, would violate the Georgia Constitution.[120]

The State of Montana faced a similar lawsuit following the *Davis* decision and the state legislature's subsequent repeal of a tax exemption on the retirement benefits of state employees. In *Sheehy v. Public Employees Retirement Division*,[121] the Montana Supreme Court concluded that the statute creating the tax exemption in question did not create a contractual right because the state constitution prohibited the state from surrendering or contracting away its power of taxation.[122] Because the state did not have the power to create a contract with state retirees ensuring them that their retirement benefits would never be taxed, the court concluded that the statute was simply a statement of policy regarding public employment.[123] The court held that, given the constitutional provision preventing the state from contracting away its power to tax, "the state cannot promise any group of taxpayers that it will never tax them."[124]

Other state courts, in cases which were not prompted by the *Davis* decision, have also interpreted similar state constitutional provisions as preventing their states from entering into contracts for permanent tax exemptions.[125] Following the legislative repeal of a tax exemption on state retirement benefits, the Supreme Judicial Court of Maine dismissed a lawsuit challenging this repeal, concluding that the original enactment of the tax exemption did not create a contractual obligation to state employees.[126] This interpretation of

119. *See id.* at 355.

120. *See id.* at 354-55.

121. 864 P.2d 762 (Mont. 1993).

122. *See id.* at 765-66; *see also* MONT. CONST. art. VIII, § 2 ("The power of taxation shall never be surrendered, suspended, or contracted away.").

123. *See Sheehy*, 864 P.2d at 765.

124. *Id.* at 766.

125. *See, e.g.*, Switzer v. City of Phoenix, 341 P.2d 427, 431 (Ariz. 1959) (holding that the state constitutional provision prohibiting the legislature from surrendering, suspending, or contracting away its taxation power left the legislature unencumbered in its ability to impose taxes); Blair v. State Tax Assessor, 485 A.2d 957, 960 (Me. 1984) (holding that because the state constitution forbids the legislature from suspending or surrendering the power of taxation, persons who receive state retirement allowances have no contractual entitlement to tax-exempt retirement benefits).

126. *See Blair*, 485 A.2d at 960.

the statute was based, in part, on the fact that the creation of such a contractual obligation would violate Article 9, section 9 of the Maine Constitution, which prohibits the state from surrendering its power of taxation.[127] Similarly, in interpreting a provision in the Arizona Constitution that is identical to the portion of Article V, section 2(1) at issue in *Bailey*, the Arizona Supreme Court concluded that the provision "was designed to leave legislators unencumbered in so far as their power to impose taxes."[128] Several other state courts have interpreted such constitutional limitations in a similar fashion.[129]

As evidenced by the foregoing cases, the North Carolina Supreme Court's interpretation of the constitutional prohibition on contracting away the power of taxation is a deviation from the interpretation adopted by other states. This distinction raises the question of whether the supreme court's constitutional interpretation in *Bailey* was consistent with the intent behind the adoption of Article V, section 2(1) of the North Carolina Constitution. An additional question also arises as to how this constitutional interpretation will affect North Carolina public policy in the future.

As a matter of fairness, the North Carolina Supreme Court's decision in *Bailey* is on target. As a matter of constitutional interpretation, however, the court's opinion is questionable at best. The court rejected the State's interpretation of Article V, section 2(1) for three major reasons.[130] First, the court sided with the plaintiffs as a matter of fairness.[131] Second, the court interpreted the various subsections of Article V, section 2 in a way that dramatically limits the scope of the prohibition on the state contracting away its power of

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127. *See id.* at 960. The court held that:

> Even if we were to find the exemption to be a contractual right of state employment, the legislative grant of such a right would violate the Maine Constitution, which states: "The Legislature shall never, in any manner, suspend or surrender the power of taxation." We cannot presume the legislature would intentionally enact a statute that would contract away the power to tax on a permanent basis.

Id. at 960 (citation omitted).

128. *Switzer*, 341 P.2d at 431.

129. *See, e.g.*, Atlantic Richfield Co. v. State, 705 P.2d 418, 438 (Alaska 1985), *appeal dismissed*, 474 U.S. 1043 (1986) (holding that a constitutional restriction on the state contracting away the power of taxation prevented the state, through oil and gas leases, from limiting its ability to tax oil); Reserve Mining Co. v. State, 310 N.W.2d 487, 494 (Minn. 1981) (ruling that a state statute did not create a permanent tax exemption because the state constitution, which forbids the surrender, suspension, or contracting away of tax power, does not allow the state to contract away the legislature's ability to tax).

130. *See Bailey*, 348 N.C. at 147-50, 500 S.E.2d at 64-66.

131. *See id.*

taxation.[132] Third, the court asserted that United States Supreme Court precedent supported its interpretation.[133]

The court began its analysis of Article V, section 2(1) by arguing that basic fairness would not allow the state to raise constitutional defenses to its contract with state employees.[134] In addition to citing the general rule that a party cannot accept benefits conferred under a statute and then question the constitutionality of that statute in order to avoid its burdens,[135] the court suggested that the state's proposed interpretation would allow it to issue tax-exempt bonds, collect millions of dollars from their purchase, and then retrospectively repeal investors' tax-free interest advantage.[136] After describing this scenario, the court concluded that "[t]he basis for prohibiting such action is fundamental fairness."[137]

Given this compelling argument, the court could have chosen to base its opinion solely on grounds of estoppel, thus reaching its desired result while avoiding its questionable constitutional interpretation of Article V, section 2(1).[138] Because the State used the tax exemption on retirement payments as an inducement to enter into and remain in state employment, the court could have simply estopped the State from raising a constitutional challenge to the creation of contractual rights stemming from this arrangement. Such a result would follow longstanding North Carolina precedent, such as *Convent of Sisters of St. Joseph v. City of Winston-Salem*,[139] in which the North Carolina Supreme Court estopped a plaintiff from challenging a city ordinance because he had previously accepted benefits under the ordinance he was contesting.[140] The *Sisters of St. Joseph* court stated that " 'one who voluntarily proceeds under a statute and claims benefits thereby conferred will not be heard to question its constitutionality in order to avoid its burdens.' "[141] The court in *Bailey*, however, did not recognize estoppel as a possibility

132. *See id.* at 148, 500 S.E.2d at 64.
133. *See id.* at 148-49, 500 S.E.2d at 64-65.
134. *See id.* at 147, 500 S.E.2d at 64.
135. *See id.*
136. *See id.* at 149, 500 S.E.2d at 65.
137. *Id.*
138. *See, e.g.*, Convent of Sisters of St. Joseph v. City of Winston-Salem, 243 N.C. 316, 325, 90 S.E.2d 879, 885 (1956) (holding that the Bishop of the Diocese of Raleigh had waived any right to contest the validity of a zoning ordinance by accepting the benefits of the provision).
139. 243 N.C. 316, 90 S.E.2d 879 (1956).
140. *See id.* at 325-26, 90 S.E.2d at 885-86.
141. *Id.* at 324, 90 S.E.2d at 885 (quoting 11 AM. JUR. *Constitutional Law* § 123 (1937)).

and instead continued its constitutional analysis.[142] The court's resulting interpretation of Article V, section 2(1) as allowing the state to contract for permanent tax exemptions, differs significantly from interpretations of similar constitutional provisions by other state courts.[143] The North Carolina court's unique constitutional analysis raises questions concerning the validity of the court's structural interpretation of Article V, section 2(1) and whether its interpretation was consistent with the provision's intended purpose.

In *Bailey*, the supreme court interpreted the structure of Article V, section 2 of the North Carolina Constitution in a fashion that significantly limits the scope of the prohibition on the state contracting away its power of taxation.[144] The court concluded that Article V, section 2(1) allows the State to enter into contracts for tax exemptions without contracting away the "power" of taxation as long as the contract is for a public purpose.[145] The court held that because certain subsections of Article V, section 2 allowed the state to grant tax exemptions,[146] the granting of a tax exemption was not equivalent to relinquishing the "power" of taxation.[147] If it were, the court reasoned, then the constitution would prohibit tax exemptions—a result incongruous with other express provisions of section 2.[148]

The problem with the court's analysis is that the State did not argue that Article V, section 2(1) prevented it from granting tax exemptions.[149] Rather, the State argued that the constitution prevented it from making contracts for *permanent* tax exemptions.[150] Under this interpretation of the constitutional provision in question, the original statute granting the tax exemption on retirement benefits was an expression of state policy rather than a contract for a permanent exemption.[151] This limitation on the state's ability to make

142. *See Bailey*, 348 N.C. at 147-50, 500 S.E.2d at 64-66.

143. *See id.*

144. *See id.* at 148, 500 S.E.2d at 64.

145. *See id.*

146. *See id.* The subsections relied upon by the court do not provide sweeping support for the court's contention that Article V envisions the state having broad authority to create permanent income tax exemptions. Article V, section 2(6) provides that "[t]he rate of tax on incomes shall not in any case exceed ten percent, and there shall be allowed personal exemptions and deductions so that only net incomes are taxed." N.C. CONST. art. V, § 2(6). Additionally, section 2(3) establishes that "[n]o taxing authority other than the General Assembly may grant [property tax] exemptions." N.C. CONST. art. V, § 2(3).

147. *See Bailey*, 348 N.C. at 148, 500 S.E.2d at 64.

148. *See id.*

149. *See* Defendant-Appellants' Brief at 45, *Bailey* (No. 53PA96).

150. *See id.*

151. *See, e.g.*, Sheehy v. Public Employees Retirement Div., 864 P.2d 762, 765 (Mont. 1993) (holding that because the state constitution prohibited the state from contracting

contracts for permanent tax exemptions is supported by decisions in all other states that have interpreted similar constitutional provisions.[152] Surprisingly, the North Carolina Supreme Court ignored this argument and ruled that Article V, section 2(1) did not prevent the state from entering into contracts for either permanent or non-permanent tax exemptions.[153]

In addition to relying on the constitutional provisions expressly permitting the state to grant tax exemptions, the supreme court's structural interpretation also depended on an overly broad reading of Article V, section 2(7), which allows the State to enter into contracts for public purposes.[154] Lost in the court's analysis is the fact that the statutes creating the retirement plans at issue in *Bailey* predate the adoption of Article V, section 2(7) in 1970.[155] In contrast, Article V, section 2(1)'s prohibition on the state contracting away its power of taxation was adopted as part of the state constitution prior to the legislative creation of the first retirement plan.[156] Thus, Article V, section 2(7) could not have given the state the authority to contract for permanent tax exemptions in this case because this constitutional subsection did not even exist at the time the General Assembly

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with state retirees for a permanent tax exemption, the statute creating the exemption was simply a statement of policy regarding public employment).

152. *See, e.g.*, Switzer v. City of Phoenix, 341 P.2d 427, 431 (Ariz. 1959) (holding that an Arizona Constitution provision prohibiting the legislature from surrendering, suspending, or contracting away its taxation power left the legislature unencumbered in its ability to impose taxes); Parrish v. Employees' Retirement Sys., 398 S.E.2d 353, 354 (Ga. 1990) (holding that the Georgia Constitution prevents the creation of "irrevocable" tax exemptions); Blair v. State Tax Assessor, 485 A.2d 957, 960 (Me. 1984) (ruling that the Maine Constitution prevents the legislature from granting state retirees permanent tax exemptions); *Sheehy*, 864 P.2d at 770-71 (ruling that the Montana Constitution barred the state from granting permanent tax exemptions on state employee retirement benefits).

153. *See Bailey*, 348 N.C. at 148, 500 S.E.2d at 64.

154. *See id.* Article V, section 2(7) provides that the "State ... may contract with ... any person ... for the accomplishment of public purposes only." N.C. CONST. art. V, § 2(7). The North Carolina Supreme Court has developed a two-prong test for determining if a particular government undertaking is for a "public purpose" as required by the state constitution. *See* Madison Cablevision v. City of Morganton, 325 N.C. 634, 646, 386 S.E.2d 200, 207 (1989). First, a municipal undertaking must involve a reasonable connection with the convenience and necessity of the particular municipality. *See id.* Second, the activity must benefit the public generally, as opposed to special interests or persons. *See id.* As a result of this loosely defined two-prong test, the "public purpose" provision of the North Carolina Constitution has been broadly construed. *See id.*

155. *See Bailey*, 348 N.C. at 136-38, 500 S.E.2d at 57-58. Most of the 13 different retirement plans in question in *Bailey* were created by the General Assembly before 1973. *See id.*

156. Article V, section 2(1) was adopted by the North Carolina legislature in 1935. *See* Act of April 29, 1935, ch. 248, § 1, 1935 N.C. Public Laws 270, 270.

originally granted the tax exemptions in question.[157] Additionally, the Local Government Finance Study Commission's report recommending the addition of Article V, section 2(7) suggests that the intent of the provision was limited to allowing local governments to make appropriations to private organizations and did not contemplate the creation of permanent tax exemption contracts.[158] Therefore, Article V, section 2(7) should not have been interpreted as the basis for creating a contractual obligation between the state and public employees.

The court in *Bailey* supported the questionable structure of its analysis with selective use of United States Supreme Court precedent.[159] Specifically, the North Carolina Supreme Court cites *United States Trust* to support the notion that a state may contract for a permanent tax exemption without undermining the state's sovereignty.[160] The court's contention is indisputable, given the Supreme Court's consistent rulings on this subject.[161] Unfortunately, however, the court's analysis of Supreme Court precedent is incomplete because it failed to analyze other Supreme Court cases that suggest that a state constitution may prevent a state from entering into a contract for a permanent tax exemption in the first place.[162] In fact, these Supreme Court rulings prompted North

157. *See* Act of April 4, 1939, ch. 390, § 2, 1939 N.C. Public Laws 837, 839 (creating the Local Governmental Employees' Retirement System).

158. *See* NORTH CAROLINA LOCAL GOV'T STUDY COMM'N, REPORT OF THE 1968 LOCAL GOVERNMENT STUDY 19 (1969). The Commission commented that the intent behind Article V, section 2(7) was to codify two previous North Carolina Supreme Court decisions holding "that local governments may make appropriations to private organizations for the accomplishment of public purposes so long as the object of expenditure is identified and so long as the local government retains ultimate control over the disposition of public funds," thereby removing "any reasonable doubt that government may cooperate with private enterprise in the accomplishment of public purposes." *Id.* at 19-20 (referring to the rule enumerated in *Dennis v. City of Raleigh*, 253 N.C. 400, 405, 116 S.E.2d 923, 927 (1960), and *Horner v. Chamber of Commerce*, 235 N.C. 77, 81-82, 68 S.E.2d 660, 663 (1952)).

159. *See id.* at 148-49, 500 S.E.2d at 64-65.

160. *See id.* (citing United States Trust Co. of N.Y. v. New Jersey, 431 U.S. 1, 23-25 (1977)).

161. *See, e.g., United States Trust*, 431 U.S. at 23-25 (holding that the Contract Clause prevents a state from impairing a legislatively created contract); State Bank of Ohio v. Knoop, 57 U.S. (16 How.) 369, 384 (1853) (ruling that a state legislature has the power to make a binding, constitutionally protected contract for a tax exemption); New Jersey v. Wilson, 11 U.S. (7 Cranch) 164, 166-67 (1812) (establishing the principle that the United States Constitution prevents states from impairing legislatively created contracts for permanent tax exemptions).

162. *See, e.g.*, Williams v. Baltimore, 289 U.S. 36, 44 (1933); Gulf and Ship Island R.R. Co. v. Hewes, 183 U.S. 66, 74-75 (1901); Home of the Friendless v. Rouse, 75 U.S. (8 Wall.) 430, 438 (1868).

Carolina to adopt Article V, section 2(1), in order to leave legislators unencumbered in their power to impose taxes.[163] If a state constitution prevents the creation of contracts for permanent tax exemptions, then the Supreme Court will construe an alleged contract in light of this state constitutional restriction and will characterize the legislative act in question as a statement of policy, rather than the creation of a contractual obligation.[164] The court's failure in *Bailey* to consider alternative Supreme Court precedent is important because Article V, section 2(1) was adopted as an amendment to the state constitution prior to the passage of legislation exempting the retirement benefits of state employees from taxation.[165] Therefore, a strong argument exists that if the North Carolina Constitution prohibits the state from contracting away its power of taxation, then the General Assembly is prevented from entering into a contract with state and local employees for a permanent tax exemption.[166] This unexamined United States Supreme Court precedent and the strong interpretive argument it creates undermines the logic of the *Bailey* decision.

In addition to the problems with the court's structural analysis and its selective reading of Supreme Court precedent, the court's interpretation is also inconsistent with the intent behind the adoption of Article V, section 2(1). The legislative and legal history surrounding the adoption of Article V, section 2(1) give both explicit and implicit support to the argument that the General Assembly intended the constitutional provision to prevent the creation of permanent tax exemptions, thus leaving lawmakers unencumbered in their ability to change tax policies.[167] Ironically, the court's analysis in *Bailey* reached the opposite interpretation and; in fact, completely failed to consider the intent of the General Assembly in adopting

163. *See supra* notes 107-13 and accompanying text (describing North Carolina lawmakers' intent in adopting Article V, section 2(1).

164. *See Hewes*, 183 U.S. at 74-75; *supra* notes 90-95 and accompanying text.

165. *See* Act of Apr. 29, 1935, ch. 248, § 1, 1935 N.C. Sess. Laws 270, 270 (proposing language later ratified in N.C. CONST. art. V, § 2(1)). The earliest tax exemption for any retirement system was contained in the initial legislation creating the Local Governmental Employees' Retirement System in 1939. *See* Act of Apr. 4, 1939, ch. 390, §§ 2, 11, 1939 N.C. Sess. Laws 837, 839, 856 (codified as amended at N.C. GEN. STAT. §§ 128-22, 128-31 (1999)).

166. *See, e.g.*, Sheehy v. Public Employees Retirement Div., 864 P.2d 762, 765 (Mont. 1993); *see also* Sterk & Goldman, *supra* note 1, at 1319-20 (arguing that state constitutional provisions, such as Article V, section 2(1), prevent successful Contracts Clause claims based on legislative grants creating permanent tax exemptions).

167. *See supra* notes 108-13 and accompanying text.

Article V, section 2(1).[168] This interpretation violates the court's own guidelines for constitutional construction,[169] which state that "the fundamental principle of constitutional construction is to give effect to the intent of the framers."[170] The court's failure to assess the General Assembly's intent also conflicts with the approach taken by other state courts that have relied significantly on the intent of the state legislature in interpreting similar constitutional provisions.[171]

Given the foregoing analysis, the *Bailey* decision's interpretation of Article V, section 2(1) is questionable at best.[172] But why did the court so clearly reject the constitutional interpretation adopted by other state courts and instead strain to create its own unique interpretation of the scope of Article V, section 2(1)? The answer may well lie in the court's overriding feeling that the state's repeal of the tax exemption on the retirement benefits of public employees was simply unfair.[173] This concern for fairness is evident not just in the

168. *See Bailey*, 348 N.C. at 147-50, 500 S.E.2d at 64-66.

169. *See* Sneed v. Greensboro City Bd. of Educ., 299 N.C. 609, 613, 264 S.E.2d 106, 110 (1980) (interpreting the scope of the North Carolina Constitution's guarantee that public school tuition will be free of charge); *In re* Martin, 295 N.C. 291, 299, 245 S.E.2d 766, 771 (1978) (interpreting the scope of the judiciary's constitutional powers); Perry v. Stancil, 237 N.C. 442, 444, 75 S.E.2d 512, 514 (1953) (interpreting the constitutional provision granting women the power to convey property).

170. *Perry*, 237 N.C. at 444, 75 S.E.2d at 513 (internal quotation marks and citation omitted). The court in *Perry* emphasized the importance of legislative intent in constitutional construction by stating that:

> Constitutional provisions should be construed in consonance with the objects and purposes in contemplation at the time of their adoption. To ascertain the intent of those by whom the language was used, we must consider the conditions as they then existed and the purpose sought to be accomplished. Inquiry should be directed to the old law, the mischief, and the remedy. The court should place itself as nearly as possible in the position of the men who framed the instrument.

Id.

171. *See, e.g.*, Switzer v. City of Phoenix, 341 P.2d 427, 430-31 (Ariz. 1959) (using the Minutes of the Arizona Constitutional Convention to support its interpretation of the legislature's intent in amending the state constitution); Parrish v. Employees' Retirement Sys., 398 S.E.2d 353, 356 (Ga. 1990) (relying on notes from the Georgia Constitutional Convention of 1877 to support its constitutional interpretation).

172. *See supra* notes 144-71 and accompanying text. The court's structural analysis of Article V, section 2 of the North Carolina Constitution is flawed. *See supra* notes 144-58 and accompanying text. Additionally, the court's reliance on selective Supreme Court precedent to support its interpretation is undermined by other precedent supporting an alternative interpretation of Article V, section 2(1). *See supra* notes 159-66 and accompanying text. Finally, the interpretation adopted by the court is not consistent with the intent behind the adoption of Article V, section 2(1), and violates the court's own established procedures regarding the interpretation of state constitutional provisions. *See supra* notes 167-71 and accompanying text.

173. *See Bailey*, 348 N.C. at 149, 500 S.E.2d at 65 (stating that "[t]he basis for prohibiting such action is fundamental fairness").

court's interpretation of Article V, section 2(1), but also by its statutory interpretation in the *Bailey* opinion regarding which retirees were entitled to tax refunds.[174]

The court in *Bailey* took a pro-taxpayer stance in ruling that the State was responsible for refunding money to all state and local retirees taxed unconstitutionally, not simply those who followed the state's statutory protest requirements.[175] This ruling was both surprising and controversial[176] because the court had rejected constitutional claims in two previous decisions on the ground that the plaintiffs failed to adhere strictly to the statutorily prescribed procedure for protesting taxes.[177] The court in *Bailey* explicitly rejected its sweeping statements in these earlier cases that prevented taxpayers from recovering refunds of unconstitutional taxes where they failed to follow the statutory protest requirements.[178]

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174. *See id.* at 163, 500 S.E.2d at 73 (noting that "fundamental fairness" seemed to dictate an easy answer to the statutory interpretation).

175. *See id.* at 163-67, 500 S.E.2d at 73-76. This was an important ruling because it significantly increased the number of retirees entitled to receive refunds and increased the financial burden on the state treasury. *See* Rawlins, *supra* note 14, at A13. Additionally, the court's pro-taxpayer interpretation of the statutory protest requirements in *Bailey* impacted another 1998 North Carolina Supreme Court case and resulted in the state owing hundreds of millions of dollars in additional refunds to state taxpayers who paid unconstitutional intangibles taxes. *See* Smith v. State, 349 N.C. 332, 342, 507 S.E.2d 28, 34 (1998) (Frye, J., concurring) (stating that the *Bailey* decision requires the state to refund all "taxes paid under the unconstitutional intangibles tax scheme, notwithstanding [taxpayers] failure to follow the protest requirements of N.C.G.S. § 105-267").

176. *See Bailey*, 348 N.C. at 168-69, 500 S.E.2d at 76-77 (Webb, J., concurring in part and dissenting in part) (noting that the court should not overturn contrary precedent and should instead follow the plain meaning of the statute by limiting refunds to those taxpayers paying under protest). The court's interpretation of the effect of section 105-267 of the North Carolina General Statutes on the state's obligation to refund unconstitutional taxes was the only portion of the *Bailey* decision to which members of the court dissented. *See id.* at 167, 500 S.E.2d at 76 (Frye, J., concurring in part, dissenting in part); *id.* at 168, 500 S.E.2d at 76 (Webb, J., concurring in part, dissenting in part).

177. *See generally* Swanson v. North Carolina, 335 N.C. 674, 683, 441 S.E.2d 537, 542 (1994) (preventing taxpayer plaintiffs from recovering tax refunds due to their failure to follow the protest requirements of N.C. GEN. STAT. § 105-267 (1997 & 1999 Supp.)); Bailey v. North Carolina ("Bailey I"), 330 N.C. 227, 235, 412 S.E.2d 295, 300 (1991) (holding that only those taxpayers that followed the statutory protest requirements were eligible to receive refunds of unconstitutional taxes).

178. *See Bailey*, 348 N.C. at 167, 500 S.E.2d at 76 (holding that the statutory protest requirements do not shield the State from making refunds to all taxpayers who were unconstitutionally taxed and stating, "[t]o the extent that our rulings in *Bailey I* and *Swanson* imply otherwise, they are hereby disavowed"). The court in *Bailey* held that the statutory protest requirements of section 105-267 of the North Carolina General Statutes were simply procedural and designed "to establish the parameters within which a contested tax case must arise, not to preclude recovery for those determined via the resulting case to have been unconstitutionally taxed." *Id.* at 165, 500 S.E.2d at 74.

The court confirmed that it based its new pro-taxpayer interpretation of the statute on what it perceived to be the fair result.[179] In beginning its statutory analysis, the court stated that "fundamental fairness would seem to dictate an easy answer" if it were not for the court's previous decisions forcing taxpayers to adhere strictly to the statutory protest requirements.[180] The court went on to rule that "[i]t would be unjust to limit recovery" to only those taxpayers who knew how to follow the formal protest requirements that are required in order to receive a refund.[181] Thus, the notion of "fundamental fairness" played a significant role in both the court's statutory and constitutional interpretations in *Bailey*.[182] This focus on fairness in the *Bailey* decision as a whole may help explain the rationale behind the court's unique, pro-taxpayer interpretation of Article V, section 2(1).[183]

Aside from the question of whether the court's interpretation of Article V, section 2(1) was correct, the key issue for the future is determining what effect this interpretation will have on North Carolina state and local tax policy. The court's interpretation allows both state and local officials to enter into contracts for permanent tax exemptions as long as they are for public purposes.[184] Consequently, this ruling could have an important impact on economic development policies, many of which rely on tax incentives to attract industry to the state or to a particular area. In 1996, the North Carolina Supreme Court ruled that direct incentive payments to private enterprises in order to encourage business expansion constituted a valid "public purpose" as required by the state constitution.[185] The court's decision as to what it considered a legitimate "public purpose" was extremely broad and included any activity designed to encourage job growth

179. *See id.* at 163, 166, 500 S.E.2d at 73, 75.

180. *Id.* at 163, 500 S.E.2d at 73.

181. *Id.* at 166, 500 S.E.2d at 75.

182. In its constitutional interpretation, the court stated that "[t]he basis for prohibiting [the state from using Article V, § 2(1) to escape liability] is fundamental fairness." *Id.* at 149, 500 S.E.2d at 65.

183. The court's interpretation of Article V, section 2(1) was unique considering the interpretations given to similar constitutional provisions by other state supreme courts. *See, e.g.*, Switzer v. City of Phoenix, 341 P.2d 427, 431 (Ariz. 1959); Parrish v. Employees' Retirement Sys., 398 S.E.2d 353, 354 (Ga. 1990); Blair v. State Tax Assessor, 485 A.2d 957, 960 (Me. 1984); Sheehy v. Public Employees Retirement Div., 864 P.2d 762, 770-71 (Mont. 1993).

184. *See Bailey*, 348 N.C. at 148, 500 S.E.2d at 64.

185. *See* Maready v. City of Winston-Salem, 342 N.C. 708, 723-24, 467 S.E.2d 615, 624-25 (1996).

and an expansion of the tax base.[186] Given this broad definition of a "public purpose," the *Bailey* decision places few, if any, limitations on when the state or local governments can contract with private businesses for permanent tax exemptions.[187]

The court's constitutional interpretation in *Bailey* will allow exactly the type of permanent tax breaks for private businesses that Article V, section 2(1) was designed to prevent. It was the granting of permanent tax exemptions to railroads in the nineteenth century that led to the widespread adoption of provisions such as Article V, section 2(1).[188] The General Assembly apparently intended for the constitutional prohibition on the state contracting away its power of taxation to prevent such permanent tax exemptions, thus leaving legislators unencumbered in their power to impose taxes.[189] The *Bailey* decision undermines this goal.

Following *Bailey*, public officials once again must exercise caution in passing legislation that grants tax exemptions to private entities. The court's conclusion that the legislation creating the state retirement system constituted a contract for a permanent tax exemption puts the burden on the government to prove that tax incentives for private companies are not permanent.[190] Thus, if public officials decide to grant non-permanent tax incentives to encourage economic development, the legislative or administrative action creating the tax exemption must clearly specify that it is for a limited duration or that it is merely a statement of current government policy that is subject to repeal.[191] Given the *Bailey* court's stance, failure to

186. *See Maready*, 342 N.C. at 741-42, 467 S.E.2d at 635-36 (Orr, J., dissenting) (stating that the court's interpretation of what constitutes a "public purpose" is so broad that it would allow a local government to provide golf club memberships to the executives of a company if such memberships would induce the executives to move their company and create new jobs in the community).

187. *See Bailey*, 348 N.C. at 148, 500 S.E.2d at 64 (holding that the state may contract for permanent tax exemptions if the contract is for a public purpose).

188. *See* Raleigh & Gaston R.R. Co. v. Reid, 80 U.S. 269, 270 (1872); *see also* Sterk & Goldman, *supra* note 1, at 1319-20 (describing states' attempts to limit their ability to grant permanent tax exemptions by adopting constitutional provisions that prohibit legislatures from contracting away their taxing power).

189. *See supra* notes 107-113 and accompanying text.

190. *See Bailey*, 348 N.C. at 147-50, 500 S.E.2d at 64-65.

191. The court's willingness to hold that the state legislation constituted a contract for a permanent tax exemption stands in contrast to other state courts that have been less sympathetic in construing tax exemption contracts. *See, e.g.*, United States Trust Co. of N.Y. v. New Jersey, 431 U.S. 1, 24 n.21 (1977) (observing that "tax exemption contracts generally have not received a sympathetic construction"); Sheehy v. Public Employees Retirement Div., 864 P.2d 762, 765 (Mont. 1993) (holding that legislation granting a tax exemption to the retirement benefits of state employees was simply a statement of

qualify such a tax exemption could result in the creation of a permanent tax break for the private company in question as well as a restriction on the government's future ability to revise its tax policy to account for changing economic conditions.

Though the *Bailey* decision may represent a triumph of fairness for state retirees, the court's emphasis on reaching a fair outcome resulted in the virtual elimination of the constitutional prohibition on the state contracting away its power of taxation.[192] As a result of the North Carolina Supreme Court's decision, the state constitution no longer protects taxpayers from imprudent government actions that create irrevocable, long-term tax breaks for private individuals.[193] Such an interpretation stands in stark contrast to the original intent behind the adoption of Article V, section 2(1).[194]

The court's overriding concern with reaching the "fair" result produced a convoluted constitutional interpretation. The court's structural analysis rejected the plain meaning of Article V, section 2(1) and instead relied on an inapposite subsection of Article V to limit the breadth of the constitutional prohibition in question.[195] Similarly, the court conveniently failed to undertake an analysis of the basic intent behind the adoption of the provision.[196] The *Bailey* decision also reflected a selective use of Supreme Court precedent.[197] Given these fundamental flaws in the court's constitutional analysis, it is not surprising that the court's resulting interpretation differed dramatically from all other state supreme court interpretations of similar provisions.

As a matter of fairness, the court was correct in preventing the state from reneging on its agreement to exempt state employee retirement benefits from state income taxation. The court, however, could have legitimately reached this "fair" result without undermining the intent of Article V, section 2(1).[198] Instead of creating a convoluted constitutional interpretation, the court could have simply ruled that the state was estopped from questioning the constitutionality of the statutory tax exemption since the state had

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government policy and not a contract for such an exemption).

192. *See* N.C. CONST. art. V, § 2(1) ("[t]he power of taxation ... shall never be surrendered, suspended or contracted away").

193. *See Bailey*, 348 N.C. at 148, 500 S.E.2d at 64.

194. *See supra* notes 96-113 and accompanying text.

195. *See supra* notes 144-58 and accompanying text.

196. *See supra* notes 167-71 and accompanying text.

197. *See supra* notes 159-66 and accompanying text.

198. *See* Convent of Sisters of St. Joseph v. City of Winston-Salem, 243 N.C. 316, 325, 90 S.E.2d 879, 885 (1956).

willingly accepted the benefits created by this statute for fifty years.[199] This common-sense alternative to the court's action could have eliminated the need for the court to adopt its questionable constitutional interpretation of Article V, section 2(1) and thus, would have prevented the potentially troublesome impact of this interpretation on North Carolina public policy.[200]

In its rush to help state retirees in *Bailey*, the North Carolina Supreme Court may have inadvertently cleared the way for the return of the tax policy problems that plagued the state in the nineteenth century.[201] Today, economic development tax breaks have expanded beyond granting tax exemptions to railroads and now include tax incentives for a wide array of private businesses.[202] Following *Bailey*, state and local governments may find themselves locked into agreements for perpetual tax exemptions that they never intended to make permanent.[203] Although many may have assumed that the North Carolina Constitution prevented the creation of such permanent tax breaks, the state supreme court's unique interpretation of Article V, section 2(1) opens the floodgates to such claims by private businesses.

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199. *See id.* at 324, 90 S.E.2d at 885 (holding that "one who voluntarily proceeds under a statute and claims benefits thereby conferred will not be heard to question its constitutionality in order to avoid its burdens").

200. Even if the court relied on estoppel principles to aid the plaintiff-retirees, businesses might try to invoke such principles to prevent local governments from repealing tax exemptions by arguing that the government benefits from tax exemptions by convincing businesses to relocate or expand. The use of estoppel, however, would give courts more leeway in refusing to protect such tax exemptions because, unlike a constitutional protection, the use of estoppel is a matter of equity and gives judges flexibility in its application.

201. *See supra* notes 96-106 and accompanying text.

202. In *Maready*, Forsyth County's local governments provided tax incentives to a wide variety of businesses, including: banks, a tobacco manufacturer, an air-conditioning distributor, and Wake Forest University. *See* Maready v. City of Winston-Salem, 342 N.C. 708, 736-37, 467 S.E.2d 615, 632-33 (1996) (Orr, J., dissenting) (listing the types of incentives provided to businesses).

203. *See supra* notes 184-91 and accompanying text.

The Whys of Lies and *Vaughan v. MetraHealth*: Can an Employer's Lie Be Used to Make an Inference of Discrimination?

Imagine that you are an African-American job applicant. You apply for a position for which you are qualified, but the employer does not hire you. Instead, it continues the search and hires a white applicant with similar qualifications. You suspect that the employer did not hire you because of racial prejudice. You file suit, and the employer answers your complaint by claiming that the real reason for its refusal to hire you was that you did not have an outgoing demeanor. During discovery, you find that your ratings by the interviewer for personality and demeanor were higher than those for the hired applicant; however, no other admissible evidence is discovered showing that the employer discriminated against you.[1] During depositions, the body language, intonations, and facial expressions of many of the employer's witnesses lead you to believe that they are lying and that racism played a part in their hiring decision. Should you lose your day in court when the defendant's proffered explanation is a lie?

Now, imagine that you are the employer in this hypothetical situation. You have been sued, and in defense, you offer a nondiscriminatory reason for the hiring decision that was given to you by your personnel manager. Later, you discover that the manager lied to you. You do not know the manager's real motivation for not hiring the plaintiff, but you know that his motivation was not discrimination because you know him well, and he has an excellent record and reputation for fair and impartial hiring practices. Should you be forced to defend a discrimination suit at considerable expense and risk to your reputation when the plaintiff has presented no additional evidence of discrimination?

Discrimination cases often present such questions, forcing courts to balance the rights of potentially aggrieved plaintiffs against the interests of potentially innocent employers. In striking this balance, the federal courts have historically looked to the congressional goals

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1. *Cf.* Foster v. Dalton, 71 F.3d 52, 56 (1st Cir. 1995) (addressing a case in which the employer justified its hiring decision by claiming that the selected candidate was better qualified, when he was not).

of Title VII of the Civil Rights Act of 1964 ("Title VII")[2] and the Age Discrimination in Employment Act of 1967 ("ADEA"),[3] both of which were designed to prevent and redress discriminatory employment practices.[4] Because Title VII claims often turn on issues of intent[5] and are therefore generally difficult to prove, the Supreme

2. Civil Rights Act of 1964, Pub. L. No. 88-352, §§ 701-16, 78 Stat. 241, 253-66 (1964) (codified as amended at 42 U.S.C. §§ 2000e to 2000e-17 (1994)). Title VII provides that it shall be unlawful for an employer "to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin." 42 U.S.C. § 2000e-2(a)(1) (1994).

3. Age Discrimination in Employment Act of 1967, Pub. L. No. 90-202, 81 Stat. 602, 602-08 (1967) (codified as amended at 29 U.S.C.A. §§ 621-634 (1996)). The ADEA provides that it shall be unlawful for an employer "to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's age." 29 U.S.C. § 623(a)(1) (1994).

4. *See, e.g.*, Griggs v. Duke Power, 401 U.S. 424, 430-31 (1971) (noting the preventative goal of Title VII); Williams v. Banning, 72 F.3d 552, 553 (7th Cir. 1995) (noting the compensatory aims of the 1991 amendments to Title VII); *see also* Migneault v. Peck, 158 F.3d 1131, 1138 (10th Cir. 1998) (noting preventative goal of ADEA), *petition for cert. filed*, 67 U.S.L.W. 3496 (U.S. Jan. 20, 1999) (No. 98-1178); Coger v. Board of Regents, 154 F.3d 296, 307 (6th Cir. 1998) (noting preventative and remedial goals of ADEA), *petition for cert. filed*, 67 U.S.L.W. 3364 (U.S. Nov. 16, 1998) (No. 98-821).

Title VII and the ADEA are treated as one for the purposes of this Note, which focuses on the plaintiff's burden to overcome summary judgment. The Fourth Circuit treats the issue identically under both statutes. *See* Gillins v. Berkeley Elec. Coop., 148 F.3d 413, 416 fn. (4th Cir. 1998) (noting that the same framework applies with equal force to Title VII and ADEA claims). Congress lifted much of the ADEA's language directly from Title VII, and all courts use Title VII in interpreting the ADEA. *See* Lorillard v. Pons, 434 U.S. 575, 584 (1978) ("[T]he prohibitions of the ADEA were derived *in haec verba* from Title VII."); *see also* Paquin v. Federal Nat'l Mortgage Ass'n, 119 F.3d 23, 26 (D.C. Cir. 1997) (applying the Title VII framework in the context of the ADEA).

This Note generally refers to Title VII, but indicates differences between Title VII and the ADEA where appropriate. The two statutes do differ in some areas. For example, Title VII contains an exemption for religious educational institutions, while the ADEA does not. *Compare* 42 U.S.C. § 2000e-2(e)(2) (allowing educational institutions to make employment decisions on the basis of religion if they are controlled by a particular religious group and are directed toward propagating that religion), *with* 29 U.S.C. § 623(f) (omitting the religious exception despite other language in the ADEA which is parallel to § 2000e-2(e)). *See generally* JOEL WILLIAM FRIEDMAN & GEORGE M. STRICKLER, JR., THE LAW OF EMPLOYMENT DISCRIMINATION 983-97, 1014 (4th ed. 1997) (comparing Title VII and the ADEA).

5. *See, e.g.*, United States Postal Serv. Bd. of Governors v. Aikens, 460 U.S. 711, 716 (1983) (noting that there will "seldom be 'eyewitness' testimony as to the employer's mental processes"); Hardin v. Pitney-Bowes, Inc., 451 U.S. 1008, 1008-09 (1981) (Rehnquist, J., dissenting from denial of certiorari) (stating in an ADEA case that the showing of discrimination turned on the defendant's intent and noting that issues of motive and intent are not appropriately resolved on summary judgment); Sheridan v. E.I. DuPont de Nemours & Co., 100 F.3d 1061, 1071 (3d Cir. 1996) (en banc) ("Cases charging discrimination are uniquely difficult to prove and often depend on circumstantial evidence."); *see also* Aka v. Washington Hosp. Ctr., 156 F.3d 1284, 1298-99 (D.C. Cir.

Court initially took an expansive view of the statute and fashioned holdings that were supportive of plaintiffs' claims.[6] Later cases, however, have reflected the concern that these supportive holdings should apply only when an employer has in fact discriminated, so that Title VII will not be transformed into a general wrongful discharge statute.[7]

Following the Supreme Court's early establishment of a special prima facie case[8] and a burden-shifting scheme[9] for Title VII, a split developed among the circuits concerning how much weight to give a showing that an employer has proffered an untrue explanation for a challenged employment action.[10] In 1993, the Supreme Court addressed this issue in *St. Mary's Honor Center v. Hicks*,[11] holding

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1998) (in banc) (noting in an employment discrimination case that the central issue for the jury was to determine the credibility of the plaintiff and defendant).

6. *See generally* McDonnell Douglas Corp. v. Green, 411 U.S. 792, 802-05 (1973) (establishing the elements of a prima facie case for Title VII). In order to show a prima facie case under Title VII, the plaintiff must show that she was in a protected class; that she applied for and was qualified for an open position or was discharged from an existing position for which she was qualified; that the employer rejected her for the position; and that the position remained open. *See id.* at 802; *see also* Fisher v. Vassar College, 114 F.3d 1332, 1335-37 (2d Cir. 1997) (in banc) (noting that the effect of the prima facie case is to allow the plaintiff to bring suit with only a minimal showing, thus requiring the employer to produce evidence to justify its employment decision upon a minimal showing by the plaintiff), *cert. denied*, 522 U.S. 1075 (1998), *reh'g denied*, 118 S. Ct. 1341 (1998). This prima facie showing generally is viewed as being generous to Title VII plaintiffs. *See Fisher*, 114 F.3d at 1335-37 (noting that this prima facie case is viewed as minimal and citing numerous opinions supporting this view).

7. *See* St. Mary's Honor Ctr. v. Hicks, 509 U.S. 502, 514-15 (1993) (stating that Title VII liability is only appropriate where a "factfinder determines, according to proper procedures, *that the employer has unlawfully discriminated*"); *cf.* Robert Brookins, Hicks, *Lies, and Ideology: The Wages of Sin Is Now Exculpation*, 28 CREIGHTON L. REV. 939, 942-44 (1995) (stating that *Hicks* was decided at least in part to further a policy agenda on the part of the Court to make it harder for plaintiffs to prove Title VII claims).

8. *See McDonnell Douglas*, 411 U.S. at 802-05; *Fisher*, 114 F.3d at 1335-37 (discussing the special prima facie case under Title VII). In the context of Title VII, the term "prima facie case" does not indicate how much evidence that the plaintiff must produce in order to prevail at trial. *See Fisher*, 114 F.3d at 1335-37. Instead, it is the minimal showing that a plaintiff must make to compel the defendant to articulate a legitimate, nondiscriminatory reason for the challenged employment action. *See id.*

9. *See* Texas Dep't of Community Affairs v. Burdine, 450 U.S. 248, 252-56 (1981). Under the *Burdine* framework, a plaintiff must set forth a prima facie case. The employer then has the burden of producing a legitimate, nondiscriminatory reason for the challenged employment action. If the employer carries this burden, the plaintiff then must prove discrimination by a preponderance of the evidence. *See id.*

10. *See* Kline v. Tennessee Valley Auth., 128 F.3d 337, 342-44 (6th Cir. 1997) (describing the development of the split among the circuit courts which led to *Hicks*), *reh'g en banc denied*, No. 94-6355, 1998 U.S. App. LEXIS 5559 (6th Cir. Feb. 11, 1998).

11. 509 U.S. 502 (1993). *Hicks* is discussed in detail, *infra* notes 97-106 and accompanying text.

that if an employer's proffered reason was found to be false, and thus a pretext,[12] a directed verdict in favor of the plaintiff would be allowed, but not compelled.[13] Rather than resolving the controversy, however, the Court's holding has sparked much debate among federal circuit courts.[14] In particular, *Hicks* has raised questions about what standard courts should apply when ruling on defendants' motions for summary judgment.[15] The circuits are divided over whether a plaintiff who has made out a prima facie case and offered evidence that the employer's proffered reason for the challenged employment action is false should be able to overcome summary judgment as a matter of law.[16] In an attempt to grapple with the meaning of *Hicks*, courts have adopted phrases to define their interpretations of the case. They categorize themselves and each other either as "pretext only" or as "pretext plus."[17]

In *Vaughan v. MetraHealth*,[18] the Fourth Circuit recently defined its position to be "pretext plus" and held that a plaintiff in a discrimination case must do more to avoid summary judgment than

12. Courts sometimes use the term "pretext" to mean that the reason given was not the true reason, and at other times to mean that the proffered reason was pretext for discrimination. *See* Aka v. Washington Hosp. Ctr., 156 F.3d 1284, 1288 n.3 (D.C. Cir. 1998) (in banc). This Note will use the word "pretext" to mean that the reason was not true, not as shorthand for "pretext for discrimination."

13. *See Hicks*, 509 U.S. at 511.

14. *See, e.g.*, Anderson v. Barter Healthcare Corp., 13 F.3d 1120, 1122-23 (7th Cir. 1994) (noting the disagreements among federal courts about the evidentiary burdens in Title VII claims). *See generally* Thomas Duley, Comment, *Summary Judgment and Title VII After* Hicks: *How Much Evidence Does It Take to Make an Inference?* 28 U.C. DAVIS L. REV. 261, 277-84 (1994) (detailing the confusion among courts in applying *Hicks* to the employee's burden of proof).

15. *See* Alison M. Donahue, Casebrief, *Employment Law—Ramifications of* St. Mary's Honor Center v. Hicks: *The Third Circuit's Revival of the "Pretext Only" Standard at Summary Judgment*, 41 VILL. L. REV. 1287, 1299 (1996) ("As a result of the conflicting interpretations of the meaning of *Hicks*, the circuit courts are split on the question of what evidence is sufficient to create a triable issue of pretext for discrimination at the summary judgment stage.").

16. *Compare, e.g.*, Kline v. Tennessee Valley Auth., 128 F.3d 337, 346-47 (6th Cir. 1997) (concluding that a plaintiff can prevail by raising a genuine dispute over the veracity of the employer's proffered reason for the challenged employment decision), *reh'g en banc denied*, No. 94-6355, 1998 U.S. App. LEXIS 5559 (6th Cir. Feb. 11, 1998), *and* Washington v. Garrett, 10 F.3d 1421, 1433 (9th Cir. 1993) (same), *with* Hidalgo v. Overseas Condado Ins. Agencies, Inc., 120 F.3d 328, 335-37 (1st Cir. 1997) (stating that a plaintiff's showing of pretext will not necessarily overcome an employer's motion for summary judgment).

17. *See Aka*, 156 F.3d at 1292 n.7 (rejecting the use of this terminology, but noting its use by other circuits); *see also infra* note 74 (discussing the circuits' use of "pretext only" generally to mean that only a showing of pretext and a prima facie case are required to withstand summary judgment, and "pretext plus" generally to mean that additional evidence of discrimination is also required).

18. 145 F.3d 197, 202 (4th Cir. 1998).

make out a prima facie case of discrimination and show that the employer has lied about the real reason for the challenged employment decision. Instead, under *Vaughan*, a plaintiff also must put forward enough admissible evidence of discrimination that a trier of fact could conclude by a preponderance of the evidence that the employer's true reason for discharging or failing to hire the plaintiff was discrimination.[19]

This Note examines the Fourth Circuit's decision in *Vaughan*, focusing on the standard of proof adopted in the decision and the way in which the court's use of the term "pretext plus" has influenced the understanding of *Hicks* in subsequent Fourth Circuit decisions. After reviewing the facts and holding of *Vaughan*,[20] the Note traces the evolution of the proof pattern required by courts under Title VII.[21] The Note then examines the Supreme Court's decision in *Hicks*[22] and the circuit courts' subsequent competing interpretations of that case.[23] Finally, the Note considers how *Vaughan's* adoption of the "pretext plus" label has affected the interpretation of *Hicks* and the disposition of motions for summary judgment in the Fourth Circuit and questions whether the standard is consistent with *Hicks* and the goals of Title VII.[24]

Janet Vaughan was an employee of Metropolitan Life Insurance ("MetLife") for nine years before the company formed a joint venture with Travelers Group, Inc., at which time she became an employee of MetraHealth, the new joint venture.[25] Pursuant to the formation of the joint venture, MetLife reorganized its structure and eliminated a number of positions, including several in the Richmond, Virginia, office where Vaughan worked.[26] After the reorganization, only one employee would manage provider relations in the Richmond office, a position for which there were two qualified candidates: Vaughan, who was fifty-seven years old, and Harriet Meetz, who was forty-five.[27]

Paul Cooper, a vice president of MetraHealth's District of Columbia hub, selected Meetz for the job and terminated Vaughan

19. *See id.*
20. *See infra* notes 25-71 and accompanying text.
21. *See infra* notes 72-96 and accompanying text.
22. *See infra* notes 97-106 and accompanying text.
23. *See infra* notes 107-53 and accompanying text.
24. *See infra* notes 154-218 and accompanying text.
25. *See Vaughan*, 145 F.3d at 199.
26. *See id.*
27. *See id.* at 199-200.

and six other Richmond employees.[28] Cooper appeared to have made his decision, at least in part, prior to meeting either candidate: He chose to interview Meetz in a leisurely three-hour meeting,[29] but interviewed Vaughan in the Richmond office for less than an hour on a day when he interviewed roughly fourteen other employees.[30] Cooper then went on to interview Meetz a second time without affording Vaughan the same opportunity.[31]

Following her termination, Vaughan sued MetraHealth, claiming that it had violated the ADEA.[32] MetraHealth responded by making a motion for summary judgment.[33] After reviewing Vaughan's evidence, the United States District Court for the Eastern District of Virginia found that she had made a prima facie case under the ADEA.[34] Citing the prima facie case requirements under Title VII,[35] the court found that Vaughan was in a protected class as a person over age forty, that she had been discharged, that she was qualified for the position from which she was discharged, and that she was replaced by another worker who was substantially younger.[36]

Under the proof framework for Title VII and ADEA claims, once an employee has made out a prima facie case, the employer then has the burden of production to articulate a " 'legitimate nondiscriminatory reason for the challenged employment decision.' "[37] MetraHealth's proffered reason, later challenged by

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28. *See id.*

29. *See id.*

30. *See id.* at 199.

31. *See* Vaughn v. Metropolitan Life Ins. Co., No. 3:96CV06, 1996 U.S. Dist. LEXIS 11077, at *4 (E.D. Va. July 11, 1996), *aff'd sub nom.* Vaughan v. MetraHealth, 145 F.3d at 199.

32. *See Vaughan*, 145 F.3d at 200. Vaughan also sued MetLife, but the district court dismissed the complaint against that company. *See id.*

33. *See Vaughn*, 1996 U.S. Dist. LEXIS 11077, at *9-10.

34. *See Vaughn*, 1996 U.S. Dist. LEXIS 11077, at *9-16.

35. *See id.* at *9-10 (citing O'Connor v. Consolidated Coin Caterers Corp., 517 U.S. 308, 310-13 (1996) (indicating that an ADEA claim may be sustained where the employee hired or retained is significantly younger than the employee discharged or rejected); McDonnell Douglas Corp. v. Green, 411 U.S. 792, 802-05 (1973) (discussing the method of proof applicable to Title VII claims); Herold v. Hajoca Corp., 864 F.2d 317, 319 (4th Cir. 1988) (stating the elements of the prima facie case of an ADEA claim)).

36. *See Vaughn*, 1996 U.S. Dist. LEXIS 11077, at *14-15.

37. *Id.* at *15-16 (quoting O'Connor v. Consolidated Coin Caterers Corp., 84 F.3d 718, 719 (4th Cir. 1996)). Curiously, the district court cited the downsizing that was taking place within MetraHealth as the legitimate reason for the employment decision, rather than the reason proffered by the company for terminating Vaughan in the course of its downsizing. *See id.* at *16. The court should have cited the employer's proffered reason for firing Vaughan in particular—the requirements of the downsizing manual. *See id.* at *17-18. The ADEA does not forbid firing in general, but rather firing because of age,

Vaughan as a pretext, was compliance with its downsizing policy as set forth in its downsizing manual.[38] The district court in *Vaughan* concluded that this reason satisfied MetraHealth's burden of production.[39]

Vaughan then had to prove discrimination by a preponderance of the evidence in order to win her case under the Title VII and ADEA framework.[40] In addition to the elements of her prima facie case,[41] Vaughan pointed to evidence that MetraHealth had conducted an "Adverse Impact Analysis" in connection with its downsizing plan indicating that it could acceptably terminate seven older workers from the pool of thirteen in the Richmond office.[42] Vaughan alleged that the impact analysis also showed that the company did in fact terminate seven workers from that office, six of whom were over forty years old.[43]

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subject to certain legitimate age related concerns. *See* Hazen Paper Co. v. Biggins, 507 U.S. 604, 610-11 (1993). Vaughan apparently did not allege that the decision to downsize was motivated by MetraHealth's desire to fire older employees, but rather that age played an inappropriate role in the company's selection of Meetz over her. *See Vaughn*, 1996 U.S. Dist. LEXIS 11077, at *17-19. Therefore, the court ought to have made reference to the decision to retain Meetz and fire Vaughan, not to the decision to eliminate a position.

When discussing whether Vaughan had produced evidence that the employer's reason was pretext, the district court focused on the employer's reason for firing Vaughan, not its decision to downsize. *See id.* The court of appeals also addressed the decision to eliminate Vaughan in particular and did not question the decision to downsize. *See Vaughan*, 145 F.3d at 200. Therefore, for the purposes of this Note and in accordance with the understanding of the court of appeals and the discussion of pretext by the district court, the "employer's articulated reason" will refer to MetraHealth's articulated reason for firing Vaughan, not its articulated reason for downsizing and eliminating a position.

38. *See Vaughan*, 145 F.3d at 200-01.

39. *See Vaughn*, 1996 U.S. Dist. LEXIS 11077, at *16.

40. *See id.* at *16-17. As the Fourth Circuit has stated in previous cases, a presumption of discrimination arises when a plaintiff has established a prima facie case under Title VII. *See O'Connor*, 84 F.3d at 719. If the employer then meets its burden of production, the presumption of discrimination " 'drops out of the picture' and the plaintiff bears the ultimate burden of proving both that the employer's asserted reason was pretextual and that the plaintiff's age was the true reason for the challenged employment decision." *Id.* (quoting St. Mary's Honor Ctr. v. Hicks, 509 U.S. 502, 510-11 (1993)) (citations omitted).

41. *See Vaughn*, 1996 U.S. Dist. LEXIS 11077, at *14-15 (stating that Vaughan had satisfied her burden of presenting a prima facie case because she had shown that she was in the protected age group, that she was qualified for the position, that she had been terminated, and that the company had filled the position with a substantially younger employee).

42. *See id.* at *25-26. The court did not clearly explain how the company defined "acceptable," but stated that the analysis was designed to reflect "whether potential reductions in certain groups of those persons [categorized by race, sex, and age] would create an 'adverse impact' on that group." *Id.* at *25.

43. *See id.* at *25.

Vaughan also pointed to irregularities in the selection process that could have indicated discrimination. For example, Cooper appeared to have made his decision before actually meeting the candidates,[44] suggesting that he based his decision on a discriminatory factor, such as age, rather than on any qualitative difference between the two candidates.[45] Cooper also filled out the corporate downsizing forms to evaluate the candidates without reviewing their personnel files and with " 'no first-hand knowledge of the past performance levels of either Harriet Meetz or [Janet Vaughan].' "[46] Although Vaughan was older, Cooper scored Meetz higher in the categories of "qualifications, specific experience, abilities and strengths."[47]

To show discrimination under the Title VII and ADEA framework, Vaughan was also required to prove that the employer's proffered reason for firing her was a pretext.[48] MetraHealth offered its "elaborate Downsizing Policy, which is memorialized in a 144-page Downsizing Manual" as a reason for terminating Vaughan.[49] In response, Vaughan introduced evidence indicating that Cooper had never seen the downsizing manual before his deposition.[50] The manual explicitly called for an objective evaluation and reliance on " 'facts v. opinions.' "[51] In contrast, Cooper asserted that " '[m]anagement is a highly subjective art' " and that he relied on his

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44. *See Vaughan*, 145 F.3d at 199-200; *supra* notes 29-31 (noting discrepancies in the number and length of interviews given to Vaughan and Meetz).

45. *See Vaughan*, 145 F.3d at 200-01.

46. *Id.* at 200 (apparently quoting from the record without citation).

47. *Id.* at 203. In fact, Vaughan had a total of nine years' experience with MetLife and MetraHealth; the court's opinion does not disclose Meetz's length of employment. *See id.* at 200-01 ("Cooper admitted ... that, when he terminated Vaughan, he was unaware of the extent of her experience with MetLife and did not know that she helped develop MetLife's Health Maintenance Organization ... network in Boston ...."), 203 (discussing Cooper's ranking of Meetz as superior in specific experience). Ordinarily, one might posit that an older worker would rate higher on experience than a younger worker. Thus, ranking a younger worker higher in the category of experience without inquiring into the work records of the two candidates seems curious and might suggest discrimination to a reasonable factfinder.

48. *See* Texas Dep't. of Community Affairs v. Burdine, 450 U.S. 248, 256 (1981) (stating that once a legitimate, nondiscriminatory reason has been offered by the employer, the plaintiff may go on to prove discrimination directly by persuading the court that discrimination was the real reason, or indirectly by showing that the reason offered by the employer is not worthy of belief); O'Connor v. Consolidated Coin Caterers Corp., 84 F.3d 718, 719 (4th Cir. 1996) (applying *Burdine*'s proof scheme to the ADEA).

49. *Vaughan*, 145 F.3d at 200. MetraHealth offered this explanation both in its answers to Vaughan's interrogatories and in its own motion for summary judgment. *See id.*

50. *See id.*

51. *Id.* (apparently quoting from the manual without citation).

subjective judgment in choosing Meetz over Vaughan.[52] Based on this information, the district court concluded, and the Fourth Circuit confirmed, that "the fact that MetraHealth often failed to follow its downsizing policy [was] 'considerable evidence' that this reason was pretext."[53]

Vaughan relied upon the Fourth Circuit's holding in *Herold v. Hajoca*[54] to argue that the evidence that she offered was sufficient to support her claim for discrimination.[55] In *Hajoca*, which was also an ADEA case, the plaintiff had avoided summary judgment by showing that the employer's proffered reason for firing him was false and that the employer had fired another older employee while retaining younger ones.[56] Vaughan interpreted *Hajoca* as holding that a triable issue of age discrimination exists whenever a plaintiff makes out the elements of a prima facie case and offers evidence that the employer's legitimate, nondiscriminatory reason is pretext, but the district court disagreed.[57] Instead, the court distinguished *Hajoca* because the plaintiff there had offered direct evidence of age discrimination in addition to the evidence introduced to show pretext.[58] In Vaughan's case, however, the district court found that the evidence from the Adverse Impact Analysis was insufficient to support her claim of bias against older workers.[59] Vaughan's counsel argued that the analysis

52. *Id.*

53. *Id.* at 201. The Fourth Circuit agreed that Vaughan had raised a genuine dispute over the credibility of the proffered justification. *See id.*

54. 864 F.2d 317 (4th Cir. 1988). In *Hajoca*, the plaintiff-appellee, Warren Herold, argued that the jury finding of discrimination should be upheld over the defendant-appellant's motions for summary judgment, directed verdict, and judgment non obstante verdicto because he had shown discrimination in part by showing that the employer had lied about the reason for his termination. *See id.* at 318-19. The employer offered several reasons for the termination: that the plaintiff's job was the easiest to eliminate; that policy would not allow the company to terminate a less senior employee in favor of Herold if the two were in different job categories; that Herold was less versatile in performing other jobs; and that Herold was not as good an employee as those retained. *See id.* at 320. Herold rebutted these reasons at trial. *See id.* In addition, he offered evidence that when making cutbacks, the employer had terminated an older truck driver while retaining two younger ones. *See id.* On appeal, the court held that the plaintiff had presented sufficient evidence from which a jury could find both that the reasons offered by the employer were pretext and that the real reason was age discrimination. *See id.* at 320-21.

55. *See* Vaughn v. Metropolitan Life Ins. Co., No. 3:96CV06, 1996 U.S. Dist. LEXIS 11077, at *20-21 (E.D.Va. July 11, 1996).

56. *See Hajoca*, 864 F.2d at 318-20.

57. *See Vaughn*, 1996 U.S. Dist. LEXIS 11077, at *21.

58. *See id.* at *21-22 (citing *Hajoca*, 864 F.2d at 320). The plaintiff in Hajoca showed that the employer had laid off an older truck driver while retaining two younger ones. *See Hajoca*, 864 F.2d at 320.

59. *See Vaughn*, 1996 U.S. Dist. LEXIS 11077, at *23-26.

showed that six out of the seven employees terminated in the Richmond office were over forty, but the court discounted this argument because Vaughan did not produce expert testimony or other evidence to support her counsel's interpretation of the analysis.[60] Although the court found considerable evidence that the reason proffered by MetraHealth was false, it granted MetraHealth's motion for summary judgment.[61] The court based its decision on its finding that Vaughan had failed to produce evidence from which a reasonable juror could conclude that age discrimination was, more likely than not, the reason for her termination.[62]

On appeal, Vaughan presented two questions to the Fourth Circuit. One question was whether the showing of pretext plus the prima facie case was sufficient as a matter of law to overcome the motion for summary judgment.[63] Second, Vaughan asked the court to review the case to determine whether *all* of the evidence presented—including not just the fact that the employer's proffered reason was false, but also the evidence regarding the candidates' respective qualifications, the job interview procedure, and the ages of the other employees who were terminated—would as a whole defeat summary judgment.[64]

On the first issue, Vaughan argued that a finding of pretext should forestall a defendant's motion for summary judgment.[65] The court rejected this argument, holding that "Vaughan must adduce some evidence that MetraHealth's proffered justification was not just

60. *See id.* The court subjected the evidence regarding the Adverse Impact Analysis to careful scrutiny because it viewed the report as statistical evidence and, therefore, inherently open to manipulation. *See id.* at *23-24 (citing EEOC v. Western Elec. Co., 713 F.2d 1011, 1018 (4th Cir. 1983) (discussing use of statistical evidence in employment discrimination cases); Rosado v. Virginia Commonwealth Univ., 927 F. Supp. 917, 935-36 (E.D. Va. 1996) (same)).

61. *See id.* at *17, *27.

62. *See id.* at *20, *27.

63. *See Vaughan*, 145 F.3d. at 201 (stating that Vaughan argued that she could overcome a motion for summary judgment merely upon showing pretext); *see also* Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247-48 (1986) (establishing the standard for summary judgment).

64. *See Vaughan*, 145 F.3d at 202-03 (reviewing the evidence that Vaughan had offered to see whether it was sufficient to overcome summary judgment); *see also* Bailey v. University of N.C., No. 98-1501, 1998 U.S. App. LEXIS 29941, at *3 (4th Cir. Nov. 23, 1998) (stating that a grant of summary judgment is reviewed de novo (citing Higgins v. E.I. DuPont de Nemours & Co., 863 F.2d 1162, 1167 (4th Cir. 1988))).

65. *See Vaughan*, 145 F.3d at 201 (" 'A plaintiff in an age discrimination case may defeat a summary judgment motion brought by the employer if the plaintiff produces evidence that the employer proffered a phony reason for firing the employee.' " (quoting Wohl v. Spectrum Mfg., Inc., 94 F.3d 353, 355 (7th Cir. 1996))).

a pretext, but a pretext *for age discrimination.*"[66] The court reasoned that "[t]his approach, dubbed 'pretext plus,' is a better approach than 'pretext only' "[67] because it is consistent with the statement of the Supreme Court in *Hicks* that " 'nothing in law would permit us to substitute for the required finding ... of discrimination, the much different (and much lesser) finding that the employer's explanation ... was not believable.' "[68] Accordingly, the court concluded that Vaughan had failed to carry her burden of proof to avoid summary judgment.[69]

The Fourth Circuit then turned to the second issue, examining Vaughan's evidence of discrimination de novo. The court concluded that Vaughan's evidence was insufficient to permit a trier of fact to find for the plaintiff.[70] Because the court found that Vaughan had failed to meet the required burden of proof, it upheld the district court's grant of summary judgment.[71]

By adopting the "pretext plus" analysis in *Vaughan*,[72] the Fourth Circuit not only elaborated on its interpretation of *Hicks*, but also announced its position on the growing controversy over terminology that has arisen in the wake of *Hicks*.[73] Circuits have adopted the phrases "pretext only" and "pretext plus" to describe their interpretations of *Hicks*, but often use the same labels to apply different meanings.[74] To understand the controversy and the

66. *Id.* at 204 (emphasis added).

67. *Id.* at 202.

68. *Id.* (quoting St. Mary's Honor Ctr. v. Hicks, 509 U.S. 502, 514-15 (1993)).

69. *See id.*; *see also* Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247-48 (1986) (establishing the standard for summary judgment).

70. *See Vaughan*, 145 F.3d at 202-04.

71. *See id.*

72. *Id.* at 202. The court did not repudiate its earlier holding in *Hajoca*, instead citing the case as good authority. *See id.* at 200 (citing *Hajoca* for the proposition that an ADEA plaintiff can prevail by showing that the defendant's proffered reason is pretext and that age discrimination was the more likely reason for the dismissal). However, the court did not use or refer to its holding in *Hajoca* in its analysis of what weight should be given to the finding of pretext. Instead, the court relied directly on *Hicks* and the interpretation of *Hicks* in earlier decisions by the Fourth Circuit and by other circuits. *See id.* at 201-03 (citing, e.g., *Hicks*, 509 U.S. at 515; Theard v. Glaxo, Inc., 47 F.3d 676, 680 (4th Cir. 1995); Woods v. Friction Materials, Inc., 30 F.3d 255, 260-61 n.3 (1st Cir. 1994) (interpreting *Hicks*).

73. *See, e.g*, Aka v. Washington Hosp. Ctr., 156 F.3d 1284, 1289-90 (D.C. Cir. 1998) (in banc) (noting the split in the circuits over the proper interpretation of *Hicks*).

74. *See Vaughan*, 145 F.3d at 201. The Fourth Circuit discussed the difference between "pretext only" and "pretext plus" by comparing *Wohl v. Spectrum Mfg., Inc.*, 94 F.3d 353, 355 (7th Cir. 1996) (adopting the "pretext only" approach), with *Woods v. Friction Materials, Inc.*, 30 F.3d 255, 260-61 n.3 (1st Cir. 1994) (adopting the "pretext plus" approach). *See Vaughan*, 145 F.3d at 201; *cf.* Kline v. Tennessee Valley Auth., 128 F.3d

significance of *Vaughan*, it is helpful to consider the role that pretext has played in court rulings creating the overall framework of proof required by Title VII and the ADEA.[75]

Title VII was adopted to prevent and rectify employment discrimination on the basis of race, religion, color, national origin, and sex.[76] Similarly, the ADEA was adopted to prevent and rectify discrimination on the basis of age.[77] In the landmark case *McDonnell*

337, 343-44 (6th Cir. 1997) (discussing the pre-*Hicks* interpretations of the appropriate weight given a showing that the employer's proffered reason was false in terms of "pretext plus" and "pretext only" and describing the *Hicks* approach as being the "permissive pretext" standard), *reh'g en banc denied*, No. 94-6355, 1998 U.S. App. LEXIS 5559 (6th Cir. Feb. 11, 1998).

This Note will avoid using the term "pretext plus" as it is applied by the Fourth Circuit in *Vaughan* to mean that a showing of pretext alone will never overcome a motion for summary judgment. *See Vaughan*, 145 F.3d at 202. Instead, this Note will describe such an interpretation as one "presuming insufficiency" because circuits using this approach presume that a showing of pretext, together with the bare elements of the prima facie case, will not be enough to overcome a defendant's motion for summary judgment. *See infra* notes 155-59 and accompanying text (contrasting *Vaughan*'s holding with the approaches taken by other circuit courts).

Some courts have rejected the terminology of "pretext plus" and "pretext only" in describing a fact-sensitive standard. *See, e.g.*, *Aka*, 156 F.3d at 1292 n.7. Courts have also used "pretext only" to refer to the fact-sensitive approach. *See id.* at 1312 (Silberman, J., dissenting) (stating that the majority's approach would devolve into "pretext only"). Still other courts have referred to this approach as "permissive pretext." *See Kline*, 128 F.3d at 343-46 (stating that *Hicks* had rejected both "pretext only" and "pretext plus" and had instead adopted a "permissive pretext" approach under which the evidence of pretext creates a permissible, but not mandatory, inference of discrimination). This Note will refer to the case-by-case, fact-specific interpretation as the "fact-sensitive standard," because it would permit, but not compel, a court to disallow a defendant's motion for summary judgment, depending on the facts of the case. *See infra* notes 126-53 and accompanying text (discussing the fact-sensitive approach and variations between courts that have adopted this analysis).

Other courts have used "pretext only" to refer to holdings that plaintiffs will overcome motions for summary judgment as a matter of law whenever they show pretext. *See, e.g.*, *Vaughan*, 145 F.3d at 201 (characterizing *Wohl*, 94 F.3d at 355, as "pretext only"). This Note will refer to such interpretations as "presumed sufficiency" because courts that use this approach presume that a showing that the employer's proffered explanation is false will be enough to overcome a motion for summary judgment. *See infra* notes 114-125 and accompanying text (discussing the presumed sufficiency approach in more detail).

75. *See infra* notes 76-153 and accompanying text.

76. *See* 42 U.S.C. §§ 2000e to 2000e-17 (1994); *see also* Taxman v. Board of Educ. of Piscataway, 91 F.3d 1547, 1557 (3d Cir. 1996) (in banc) (discussing the legislative history of Title VII).

77. *See* 29 U.S.C.A. §§ 621-634 (1996); *id.* § 621(b) (stating that the purpose of the chapter is "to promote employment of older persons based on their ability rather than age; to prohibit arbitrary age discrimination in employment; [and] to help employers and workers find ways of meeting problems arising from the impact of age on employment"); *see also* Lorillard v. Pons, 434 U.S. 575, 577 (1978) (stating that the ADEA "broadly prohibits arbitrary discrimination in the workplace based on age").

Douglas Corp. v. Green,[78] the Supreme Court set forth the elements of a prima facie case under Title VII.[79] The Court held that a plaintiff must show that she belongs to a protected class, that she applied and was qualified for a job opening, that she was rejected despite being qualified, and that after the rejection the position remained open to persons with the plaintiff's qualifications.[80] Once a prima facie case has been presented, a presumption of discrimination arises which supports judgment for the plaintiff if not rebutted.[81] The employer then has the burden to come forward with a legitimate reason for its action.[82] If the employer meets this burden, the employee must prove her case by a preponderance of the evidence.[83]

Following the decision in *McDonnell Douglas*, lower courts disagreed whether the employer's burden of showing a legitimate, nondiscriminatory reason for the challenged employment action was

78. 411 U.S. 792 (1973).

79. *See id.* at 802-05. In *McDonnell Douglas*, the plaintiff was a black employee who was laid off and then participated in demonstrations protesting perceived discrimination by the defendant employer. *See id.* at 794-95. The plaintiff then applied to the defendant for a position as a mechanic, for which he was qualified. *See id.* at 796. The employer refused to rehire him because of his involvement in the demonstrations. *See id.* The plaintiff filed suit alleging that the employer had violated Title VII through racial discrimination and retaliation for protected opposition to unlawful discrimination. *See id.* The Supreme Court held that the plaintiff had made out a prima facie case of discrimination and that the employer had articulated a legitimate reason for its decision. *See id.* at 802-05. The Court explained that the plaintiff could prove his case on remand by showing that the defendant's articulated reason was pretext—for example, by showing that whites who had participated in the demonstrations had been retained or rehired—as well as by other evidence of discrimination. *See id.* at 804-05. On retrial, the Court explained, the plaintiff must be given "a full and fair opportunity to demonstrate by competent evidence that the presumptively valid reasons for his rejection were in fact a coverup for a racially discriminatory decision." *Id.* at 805.

80. *See id.* at 802. This definition of "prima facie case" is unusual and has been described as " 'minimal,' 'de minimis' or 'not onerous.' " Fisher v. Vassar College, 114 F.3d 1332, 1340-41 n.7 (2d Cir. 1997) (in banc) (citing, e.g., Luciano v. Olsten Corp., 110 F.3d 210, 215 (2d Cir. 1997), *cert. denied*, 522 U.S. 1075 (1998), *reh'g denied*, 118 S. Ct. 1341 (1998); EEOC v. Avery Dennison Corp., 104 F.3d 858, 861 (6th Cir. 1997); Kehoe v. Anheuser-Busch Inc., 96 F.3d 1095, 1105 n.13 (8th Cir. 1996); Nichols v. Loral Vought Sys. Corp., 81 F.3d 38, 41 (5th Cir. 1996)), *cert. denied*, 522 U.S. 1075 (1998), *reh'g denied*, 118 S. Ct. 1341 (1998)).

81. *See McDonnell Douglas*, 411 U.S. at 802-03; *see also* St. Mary's Honor Ctr. v. Hicks, 509 U.S. 502, 510 n.3 (1993) (citing *McDonnell Douglas* for the proposition that the presumption arises once the plaintiff establishes the prima facie case by a preponderance of the evidence).

82. *See McDonnell Douglas*, 411 U.S. at 802.

83. *See id.* at 804-05. The ways that an employee may prove a case of unlawful discrimination are more fully articulated in *Texas Department of Community Affairs v. Burdine*, 450 U.S. 248, 256 (1981), and again in *Hicks*, 509 U.S. at 507-15. *See infra* notes 85-105 and accompanying text.

a burden of production or a burden of persuasion.[84] The Supreme Court settled this question in *Texas Department of Community Affairs v. Burdine*,[85] holding that the employer has the burden of production.[86] The Court stated that this holding was consistent with the understanding that the ultimate burden of persuading the trier of fact that discrimination occurred remains with the plaintiff at all times.[87] The Court explained that the employer would meet its burden if its "evidence raises a genuine issue of fact as to whether it discriminated against the plaintiff."[88] The employer could raise a genuine issue of fact, for example, by introducing admissible evidence of nondiscriminatory reasons for rejecting the plaintiff.[89]

The Court stated that the employer's burden of production serves to meet the plaintiff's prima facie case and to "frame the factual issue with sufficient clarity so that the plaintiff will have a full and fair opportunity to demonstrate pretext."[90] After the employer articulates a legitimate, nondiscriminatory reason for the employment decision, the employee must have the opportunity to show that the proffered reason was not the true reason.[91] At this stage, the

84. *Compare Burdine*, 608 F.2d 563, 568-69 (5th Cir. 1979) (holding that the employer has the burden of persuasion in order to withstand summary judgment for the plaintiff), *rev'd*, 450 U.S. at 252, *with* Lieberman v. Grant, 630 F.2d 60, 65 (2d Cir. 1980) (holding that the employer has only a burden of production).

85. 450 U.S. 248 (1981).

86. *See id.* at 254-55. Joyce Ann Burdine began working for the Texas Department of Community Affairs ("TDCA") in January 1972 and was promoted after six months. *See id.* at 250. Burdine's supervisor resigned a few months after her first promotion. Although Burdine applied for the job, it was not awarded to her and the position remained open for six months. *See id.* Pursuant to concerns about inefficiencies in the division in which Burdine worked, TDCA hired a male from another division into the vacant supervisory position. *See id.* at 250-51. The new supervisor fired Burdine and two other employees and retained another male. *See id.* at 251. Burdine was soon rehired into another TDCA division at a level equivalent to the supervisory position that she had been denied. *See id.* She sued, alleging that TDCA had discriminated based on gender in its promotion and firing decisions. *See id.* The district court concluded in a bench trial that Burdine had not been the victim of gender discrimination based on testimony by TDCA's executive director that "employment decisions ... were based on consultation among trusted advisers and a nondiscriminatory evaluation of the relative qualifications of the individuals involved." *Id.* The Fifth Circuit reversed in part after evaluating the proffered evidence based on its understanding that the employer has the burden of proving a legitimate, nondiscriminatory reason for the employment action by a preponderance of the evidence. *See Burdine*, 608 F.2d at 567. The circuit court held that TDCA had failed to rebut the presumption of discrimination regarding its decision to fire Burdine. *See Burdine*, 450 U.S. at 252.

87. *See Burdine*, 450 U.S. at 253.

88. *Id.* at 254-55.

89. *See id.*

90. *Id.* at 255-56.

91. *See id.* at 256.

plaintiff's burden "merges with the ultimate burden of persuading the court that she has been the victim of discrimination."[92] The plaintiff could meet this burden of persuasion either directly, by showing that discrimination was more likely than not the real motivation behind the employment decision, or indirectly, by showing that the employer's proffered explanation is not worthy of being believed.[93]

Lower courts initially interpreted *Burdine* as holding that a plaintiff's indirect showing of discrimination that discredits the employer's proffered explanation would sustain judgment for the plaintiff as a matter of law.[94] Gradually, however, a rift began to form between the circuits concerning what weight should be given to a plaintiff's showing that the employer's proffered reason was untrue and, therefore, a pretext.[95] While some courts held that a showing of pretext would suffice for a plaintiff to prevail, other circuits required plaintiffs to show both pretext and additional evidence of discrimination.[96] The Supreme Court addressed this evolving

92. *Id.*

93. *See id.*

94. *See* Brookins, *supra* note 7, at 946 (noting that for 20 years, nearly all federal circuits interpreted *McDonnell Douglas* and *Burdine* as permitting plaintiffs to demonstrate unlawful discrimination either directly or indirectly "by showing that the defendant's articulated reasons were not the true reasons for the negative employment decision").

95. *See* Kara R. Moheban, Comment, *Summary Judgment in Context of Title VII and ADEA Claims: A First Circuit Analysis*—Woodman v. Haemonetics Corp., *51 F.3d 1087 (1st Cir. 1995)*, 30 SUFFOLK U. L. REV. 927, 927, 929-30 (1997). Initially courts seemed to agree that the plaintiff could prevail upon a showing of pretext. *See* Brookins, *supra* note 7, at 946. Over time, however, a number of circuits began to require both a showing of pretext and "proof that a specific impermissible factor such as race influenced or actually triggered the adverse decision." Brookins, *supra* note 7, at 946 & nn.36-41 (comparing MacDissi v. Valmont Indus., Inc., 856 F.2d 1054, 1059 (8th Cir. 1988) (holding that when an employer gives an untrue reason for firing a plaintiff, the untruth could be taken as sufficient evidence to persuade the finder of fact that discrimination occurred), and Bishopp v. District of Columbia, 788 F.2d 781, 789 (D.C. Cir. 1986) (holding that the particular employer's reason was "unworthy of credence as a matter of law" and finding this unworthiness to be enough for the plaintiff to prevail), and Thornbrough v. Columbus & Greenville R.R. Co., 760 F.2d 633, 647 (5th Cir. 1985) (holding that a showing of pretext would suffice for a plaintiff to prevail), with Spencer v. General Elec. Co., 894 F.2d 651, 659 (4th Cir. 1990) (holding that a plaintiff must show evidence of discrimination and pretext), *overruled on other grounds*, Farrar v. Hobby, 506 U.S. 103 (1992), and Hawkins v. Ceco Corp., 883 F.2d 977, 981 n.3 (11th Cir. 1989) (noting that a bare showing of pretext would not support a holding for the plaintiff), and North v. Madison Area Ass'n for Retarded Citizens-Developmental Ctrs. Corp., 844 F.2d 401, 406 (7th Cir. 1988) (holding that even after a showing of pretext the plaintiff must show that discrimination was the "but for" cause of the employment action)).

96. *See* Maria Therese Mancini, Case Comment, *Employment Law: Proving Pretext May Be Insufficient in Title VII Cases*—St. Mary's Honor Center v. Hicks, *113 S. Ct. 2742 (1993)*, 28 SUFFOLK U. L. REV. 235, 238-39 (1994).

disagreement in *St. Mary's Honor Center v. Hicks*,[97] holding that when the factfinder does not believe the reasons put forward by the defendant, his disbelief may support a finding of intentional discrimination when coupled with the evidence put forward in the prima facie case.[98] Accordingly, the Court concluded, "rejection of the defendant's proffered reasons will *permit* the trier of fact to infer the ultimate fact of intentional discrimination."[99] However, the Court held that a rule which would *compel* judgment for the plaintiff upon a finding of pretext would contradict "our repeated admonition that the Title VII plaintiff at all times bears the 'ultimate burden of persuasion.' "[100] Thus, the Court found that *Burdine*'s language regarding indirect proof of discrimination should not be interpreted to compel a judgment as a matter of law in favor of the plaintiff upon a showing of pretext, but rather that it should be interpreted to permit a judgment as a matter of law upon a showing of pretext as part of the showing of discrimination.[101]

In dissent, Justice Souter took a different view of the importance of a showing of pretext, concluding that *Burdine* would compel a finding for the plaintiff.[102] His dissent also cast doubt on the meaning

97. 509 U.S. 502 (1993). Melvin Hicks sued the State of Missouri after being fired from his job as a correctional officer at a halfway house. *See id.* at 505. Although Hicks had a satisfactory work record and had been promoted to shift commander, a new supervisor targeted him with increasingly severe criticisms and disciplinary actions, culminating in Hicks's termination after a heated exchange of words between the two. *See id.* The Department of Corrections justified the discharge based on the severity and number of rules violations. *See id.* at 507-08. The district court concluded that these explanations were false because it found that other shift commanders were not disciplined under similar circumstances and that the final verbal confrontation was deliberately provoked as an excuse to fire Hicks. *See id.* Nevertheless, the district court directed a verdict in favor of the employer, finding that Hicks had failed to carry his burden of showing that race was the motivating factor behind his termination. *See id.* at 508. The Eighth Circuit Court of Appeals reversed that decision, reasoning that a defendant whose articulated reason for its employment action had proved false was in the same position as a defendant who had not articulated a legitimate, nondiscriminatory reason. *See id.* at 508-09. Therefore, the appellate court concluded, a directed verdict for the plaintiff was appropriate. *See id.* The Supreme Court reversed and remanded the case for further proceedings. *See id.* at 525.

98. *See id.* at 511.

99. *Id.*

100. *Id.* at 511 (citing United States Postal Serv. Bd. of Governors v. Aikens, 460 U.S. 711, 716 (1983)).

101. *See Hicks*, 509 U.S. at 517-18 ("[P]roving the employer's reason false becomes part of (and often considerably assists) the greater enterprise of proving that the real reason was intentional discrimination.").

102. *See id.* at 531 (Souter, J., dissenting) ("[T]he plaintiff can meet his burden of persuasion in either of two ways: 'either directly by persuading the court that a discriminatory reason more likely motivated the employer or indirectly by showing that

of the Court's holding. Specifically, Justice Souter suggested that the holding would support an interpretation that all plaintiffs would need to show more than a prima facie case.[103] Furthermore, he worried that the Court's opinion could support a "more extreme conclusion, that proof of falsity of the employer's articulated reasons will not even be sufficient to sustain judgment for the plaintiff."[104] The dissent referred to this heightened standard of proof as a " 'pretext-plus' " approach that would "turn *Burdine* on its head, and ... result in summary judgment for the employer in many cases."[105] Other commentators have made similar criticisms of *Hicks*, arguing that the decision undermined Title VII and retaliated against Congress for passing amendments in 1991 to strengthen Title VII.[106]

Rather than resolving the lower courts' confusion concerning the proper weight of a showing of pretext, *Hicks* has been cited liberally by some circuit courts as affirming their previous, differing interpretations.[107] Meanwhile, other circuits have changed their

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the employer's proffered explanation is unworthy of credence.' " (quoting Texas Dep't of Community Affairs v. Burdine, 450 U.S. 248, 256 (1981))). Justices White, Blackmun and Stevens joined in the dissent. *See id.* at 525 (Souter, J., dissenting).

103. *See id.* at 535 (Souter, J., dissenting).

104. *Id.* (Souter, J., dissenting).

105. *Id.* (Souter, J., dissenting) (citations omitted). In fact, because Congress has left *Burdine* intact while undermining several intervening Supreme Court decisions, the holding in *Burdine* now should have more weight as precedent. *See* Faragher v. City of Boca Raton, 118 S. Ct. 2275, 2291 n.4 (1998) (indicating that where the Supreme Court has interpreted Title VII and Congress has subsequently enacted legislation that leaves the decision intact, the decision takes on added weight); Burlington Indus., Inc. v. Ellerth, 118 S. Ct. 2257, 2270 (1998) (same); *see also* Brookins, *supra* note 7, at 942 (discussing the effect of the Civil Rights Act of 1991 upon Supreme Court decisions handed down in the late 1980s); Janice R. Franke, *Retroactivity of the Civil Rights Act of 1991*, 31 AM. BUS. L.J. 483, 500 (1993) (same).

106. *See* Brookins, *supra* note 7, at 943. Professor Brookins concludes:

> In effect, the Court is selecting evidentiary rules that once were swords for victims of discrimination, melting those rules, and reforging them into shields for employers. Still, these important interpretive conflicts are mere skirmishes in a war to determine the kismet of this nation's antidiscrimination policy; the ferocity of this policy-related war will be positively related to the political and ideological gap between Congress and the Court. Today, that "gap" is an ideological chasm. Ironically, the Civil Rights Act of 1991 ... has substantially upped the ante, thereby causing the Court to increase the number, intensity, and blatancy of its attacks in an effort to protect employers' interests.... The ink had hardly dried on the Civil Rights Act of 1991 before the Court had launched another attack, through *Hicks*....

Id.; *see also* Kristen T. Saam, Note, *Rewarding Employers' Lies: Making Intentional Discrimination Under Title VII Harder to Prove*, 44 DEPAUL L. REV. 673, 702-14 (1995) (criticizing *Hicks*).

107. *Compare, e.g.*, *Vaughan*, 145 F.3d at 202 (explicitly adopting a "pretext plus" approach based on its interpretation of *Hicks*), *and* Spencer v. General Elec. Co., 894 F.2d

interpretation of the weight accorded to a showing of pretext from "pretext plus" to "pretext only" and vice versa.[108] These shifts are complicated further by the circuits' inconsistent interpretations of the terms "pretext,"[109] "pretext plus," and "pretext only,"[110] echoing the disagreement in *Hicks* between the majority and dissent on the proper interpretation of *Burdine*.[111] The result is that the circuit courts are now spread out along a continuum from an approach of presumed sufficiency, represented by the Seventh Circuit's analysis in *Wohl v. Spectrum Manufacturing*,[112] to an approach of presumed insufficiency, represented by *Vaughan*.[113]

In *Wohl*, the Seventh Circuit read *Hicks* as holding that a plaintiff can defeat a motion for summary judgment by raising a genuine issue of fact as to the veracity of an employer's proffered reason for the challenged employment decision.[114] The court

651, 659 (4th Cir. 1990) (implicitly adopting a "pretext plus" approach before *Hicks* by requiring the plaintiff to show both evidence that the employer's reason was false and that discrimination was the true reason), *overruled on other grounds*, Farrar v. Hobby, 506 U.S. 103 (1992), *with* Sheridan v. E.I. Dupont de Nemours & Co., 100 F.3d 1061, 1066-67 (3d Cir. 1996) (en banc) (following "pretext only" standard after *Hicks*), *and* Duffy v. Wheeling Pittsburgh Steel Corp., 738 F.2d 1393, 1396 (3d Cir. 1984) (adopting "pretext only" standard before *Hicks*).

108. *Compare, e.g.*, Ryther v. Kare 11, 108 F.3d 832, 837 (8th Cir. 1997) (stating that a showing of pretext may be used as evidence for discrimination, but emphasizing that "evidence of pretext will not by itself be enough to make a submissible case."), *cert. denied*, 521 U.S. 1119 (1997), *and* MacDissi v. Valmont Indus., Inc., 856 F.2d 1054, 1059 (8th Cir. 1988) (holding that when an employer gives an untrue reason for firing a plaintiff, the untruth could be taken as evidence of discrimination), *with* Anderson v. Baxter Healthcare Corp., 13 F.3d 1120, 1123-24 (7th Cir. 1994) (citing *Hicks* for the proposition that a plaintiff can overcome a motion for summary judgment upon a showing of pretext), *and* North v. Madison Area Ass'n for Retarded Citizens-Developmental Ctrs. Corp., 844 F.2d 401, 406 (7th Cir. 1988) (holding that even after a showing of pretext the plaintiff must show that discrimination was the "but for" cause of the employment action).

109. *See, e.g.*, Aka v. Washington Hosp. Ctr., 156 F.3d 1284, 1288 n.3 (D.C. Cir. 1998) (in banc) ("The term 'pretext' can be slippery; sometimes it means that an employer's explanation is incorrect, and sometimes it means both that the explanation is incorrect *and* that the employer's real reason was discriminatory.").

110. *See, e.g., id.* at 1290 n.5 (interpreting the court's decision as being in line with the fact-sensitive position articulated by the Second Circuit in *Fisher v. Vassar College*, 114 F.3d 1332, 1335-38 (2d Cir. 1997) (in banc), *cert. denied*, 522 U.S. 1075 (1998), *reh'g denied*, 118 S. Ct. 1341 (1998)); *cf. id.* at 1307-10 (Silberman, J., dissenting) (criticizing the majority for adopting what he believed would evolve into a "pretext only" approach); *see also supra* note 74 (discussing the circuit courts' use of "pretext plus" and "pretext only" to mean different things).

111. *See* St. Mary's Honor Ctr. v. Hicks, 509 U.S. 502, 511, 517 (1993); *cf. id.* at 536 (Souter, J., dissenting) (criticizing the majority's interpretation of *Burdine* as requiring proof of discrimination beyond proof of pretext).

112. 94 F.3d 353 (7th Cir. 1996).

113. 145 F.3d at 202.

114. 94 F.3d at 355.

reasoned that if a finding of pretext would allow a judgment for the plaintiff, then the possibility of such a finding should be enough for the plaintiff to proceed to trial.[115]

Martin Wohl had worked as Controller of Spectrum Manufacturing, Inc. ("Spectrum") for four years when, at the age of fifty-four, he was fired and replaced by a worker who was twenty years younger.[116] To counter Wohl's claim under the ADEA, Spectrum presented evidence that Wohl had failed to get along with his supervisor and had failed to generate accurate accounting reports.[117] The district court granted Spectrum's motion for summary judgment because it found that Wohl had failed to raise a genuine issue of material fact as to the veracity of the proffered reasons.[118]

The Seventh Circuit Court of Appeals reversed because it concluded that Wohl had offered evidence that, when viewed in the light most favorable to the plaintiff, showed that he had resolved previous difficulties with his supervisor and that the accounting report problems were not Wohl's fault.[119] Based solely on Wohl's prima facie case and rebuttal of the defendant's legitimate, nondiscriminatory reasons, the Seventh Circuit held that summary judgment was inappropriate.[120] The court stated that a plaintiff in an age-discrimination case may defeat a motion for summary judgment simply by showing that the defendant has produced a "phony" reason for firing the employee.[121] Reasoning that a factfinder could infer discrimination from a finding of pretext, the court ruled that summary judgment was inappropriate and remanded the case.[122]

The *Wohl* analysis has been described as "pretext only"[123] because it presumes that the elements of the prima facie case,

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115. *See id.*

116. *See id.*

117. *See id.* at 354-55.

118. *See id.* at 354.

119. *See id.* at 356-57. Specifically, Wohl introduced evidence that the irregularities in his accounting reports were due to his supervisor's unorthodox billing practices and that he had called management's attention to the problem. *See id.*

120. *See id.* at 358-59.

121. *See id.* at 355 (citing St. Mary's Honor Ctr. v. Hicks, 509 U.S. 502, 511 (1993)).

122. *See id.* at 358-59. Specifically, the court in *Wohl* regarded evidence that the employer's proffered reason for firing Wohl was false as evidence that the reason was a pretext for discrimination. *See id.* at 358 ("Wohl points to a number of additional factors that support his claim that Spectrum's proffered reasons were a pretext *for age discrimination.*" (emphasis added)). According to the *Wohl* analysis, courts can draw an inference of discrimination from a showing of pretext when considering a motion for summary judgment. *See id.*

123. *See Vaughan*, 145 F.3d at 201.

together with an inference of discrimination drawn from a showing of pretext, would be enough for a finder of fact to decide the case in the plaintiff's favor.[124] As a result, courts following this analysis consider summary judgment inappropriate when a plaintiff has made out a prima facie case and has brought forward evidence that the employer's proffered legitimate, nondiscriminatory reason is false.[125]

The presumed sufficiency approach of the court in *Wohl* differs from the fact-sensitive approach applied by the Circuit Court of Appeals for the District of Columbia in *Aka v. Washington Hospital Center*.[126] In *Aka*, the court discussed the meaning of *Hicks* at some length, concluding that all evidence must be considered in context to determine whether to grant summary judgment when the plaintiff has only produced evidence to support his prima facie case and to attack the employer's proffered explanation.[127] The court found that under the *Hicks* standard, "a plaintiff's discrediting of an employer's stated reason for its employment decision is entitled to considerable weight."[128] Although the court explicitly left open the possibility that a defendant could obtain summary judgment even when the plaintiff offers evidence of pretext,[129] it rejected "any reading of *Hicks* under which employment discrimination plaintiffs would be routinely required to submit evidence over and above rebutting the employer's stated explanation in order to avoid summary judgment."[130] The *Aka* court refused to characterize its approach in terms of "pretext plus"

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124. *See Wohl*, 94 F.3d at 355.

125. Other courts have come to a similar conclusion in applying the rule of *Hicks* at the summary judgment stage. *See* Kline v. Tennessee Valley Auth., 128 F.3d 337, 343-47 (6th Cir. 1997), *reh'g en banc denied*, No. 94-6355, 1998 U.S. App. LEXIS 5559 (6th Cir. Feb. 11, 1998); Sheridan v. E.I. DuPont de Nemours & Co., 100 F.3d 1061, 1066-72 (3d Cir. 1996) (en banc); Randle v. City of Aurora, 69 F.3d 441, 451 (10th Cir. 1995); Anderson v. Baxter Healthcare Corp., 13 F.3d 1120, 1123-24 (7th Cir. 1994); Washington v. Garrett, 10 F.3d 1421, 1433 (9th Cir. 1993).

126. 156 F.3d 1284 (D.C. Cir. 1998) (in banc). Etim U. Aka sued his employer after his applications for job transfers were rejected repeatedly. *See id.* at 1286-87. Aka, who was 56, was unable to perform the duties of his original job after undergoing heart bypass surgery. *See id.* Although the plaintiff also filed a claim under the Americans with Disabilities Act, this Note will not discuss that claim.

The district court granted summary judgment in favor of the defendants, but a divided panel of the D.C. Circuit partially vacated that decision. *See id.* at 1288. The circuit court granted rehearing in banc and again vacated the summary judgment. *See id.*

127. *See id.* at 1289-91.

128. *Id.* at 1290.

129. *See id.* at 1291 ("If a plaintiff shoots himself in the foot, surely there is no point in sending the case to the jury." (citing Rothmeier v. Investment Advisers, Inc., 85 F.3d 1328, 1337-38 (8th Cir. 1996))).

130. *Id.* at 1290.

or "pretext only,"[131] but the dissent criticized the majority's holding as "ineluctably devolv(ing) into the 'pretext only' approach."[132]

The *Aka* approach, which allows a showing of pretext to defeat a motion for summary judgment when the facts showing pretext also do not contradict an inference of discrimination, is "fact-sensitive."[133] The fact-sensitive approach might allow some cases to go to trial when the employer has proffered a false reason for the employment decision, but when the true reason was not discrimination.[134] The defendant would not lose automatically because the proffered reason was false, however, because at trial the plaintiff would still be required to persuade the finder of fact that discrimination had occurred.[135] Thus, a fact-sensitive approach allows an employer to avoid liability for discrimination when a factfinder determines that neither discrimination nor the employer's articulated reason was the true reason for the challenged employment action.[136]

The First Circuit's opinion in *Foster v. Dalton*[137] demonstrates how the fact-sensitive approach can work in an employer's favor. The defendant-employer in the case claimed that it preferred the chosen job candidate to the plaintiff because the selected candidate was more qualified.[138] At trial, however, evidence showed that the plaintiff was better qualified and that the defendant purposely had modified the job description so that the chosen candidate could qualify at all.[139] While the offered reason was false, the trial court found that the actual reason was not discrimination, but rather was favoritism for the

131. *See id.* at 1292 n.7. The court stated that it refused to use the "pretext-plus" term because:

> [The wording] obscures the distinction between (1) requiring that plaintiffs both discredit the employer's explanation *and* show discrimination, and (2) presumptively requiring that plaintiffs provide more than discrediting evidence alone in order to show discrimination.... [W]e ... adopt the first of these two approaches, but reject the second.

Id.

132. *Id.* at 1312 (Silberman, J., dissenting).

133. *See id.* at 1291-93 (describing when the court would or would not allow a showing of pretext to overcome a motion for summary judgment); *supra* note 74 and accompanying text (defining the fact-sensitive approach).

134. *See, e.g.*, Foster v. Dalton, 71 F.3d 52, 54-55 (1st Cir. 1995) (involving a case where the defendant prevailed at trial despite having offered a false reason for the challenged employment option).

135. *See id.*

136. *See id.*

137. 71 F.3d 52 (1st Cir. 1995).

138. *See id.* at 56.

139. *See id.* at 54-55.

supervisor's "fishing buddy."[140] Based on these facts, the court found for the defendant.[141]

The First Circuit affirmed the district court's holding.[142] The court held that factfinders could find against a Title VII plaintiff when the employer's proffered reason was false but when a legitimate, nondiscriminatory reason had been shown.[143] In *Dalton*, the trial judge weighed the evidence and determined that cronyism was the real reason for the employment decision.[144] Thus, the procedural posture of *Dalton* was similar to that in *Hicks* because the plaintiff-appellant already had received a full opportunity to show discrimination at trial.[145] The *Dalton* court illustrated the functional outcome of *Hicks*[146] by allowing the plaintiff an opportunity to prove his case while still permitting the finder of fact to find for the defendant based on the facts of the case.[147]

Following the First Circuit's lead, the Second Circuit in *Fisher v. Vassar College*[148] also adhered to a fact-sensitive approach.[149] The

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140. *See id.*
141. *See id.*
142. *See id.*
143. *See id.* at 56-58.
144. *See id.*
145. *See* 509 U.S. 502, 505 (1993).
146. *See id.* at 511 (stating that a showing of pretext would permit, but not compel, a finder of fact to find discrimination).
147. This assumes that cronyism is a legitimate, nondiscriminatory reason for hiring one candidate over another. In *Dalton*, the court rejected the plaintiff's argument that cronyism is itself a form of discrimination and suggested that an attack on cronyism would be better suited to a disparate impact claim. 71 F.3d at 57 (indicating that a policy of nepotism can be evidence of discrimination in employment (citing EEOC v. Steamship Clerks Union, Local 1066, 48 F.3d 594, 606 (1st Cir. 1995))).
148. 114 F.3d 1332 (2d Cir. 1997) (in banc), *cert. denied*, 522 U.S. 1075 (1998), *reh'g denied*, 118 S. Ct. 1341 (1998). In *Fisher*, the court was called upon to decide whether appellate review for clear error was appropriate in a Title VII case in which the trier of fact found liability supported by a prima facie case and a sustainable showing of pretext. *See id.* at 1333. The court, in a limited in banc review, held that a review for clear error is appropriate and is not barred by the showing of pretext. *See id.* at 1347. The court came to this holding based on its understanding of *Hicks* as holding that evidence of pretext does not give enhanced weight to the evidentiary value of a showing of pretext. *See id.* at 1334-38 (citing *Hicks*, 509 U.S. at 507, 510-11). While *Fisher*, like *Aka v. Washington Hospital Center*, 156 F.3d 1284 (D.C. Cir. 1998) (in banc), adopted a fact-sensitive approach, the approach of the Second Circuit in *Fisher* is distinguishable from the fact-sensitive approach of the D.C. Circuit in *Aka*. Both circuits would allow a plaintiff to overcome a motion for summary judgment by presenting a prima facie case and showing pretext. However, the tone of the *Aka* opinion suggests that the D.C. Circuit would allow the plaintiff to do so whenever he has shown pretext, absent some evidence that pretext was covering something other than discrimination, while the Second Circuit's language suggests that it would not allow the inference drawn from the showing of pretext to defeat a motion for summary judgment unless the other evidence in the prima facie case creates a

court explained that there are many reasons why an employer might hide the true reason for an employment decision, only one of which is discrimination.[150] Although the court acknowledged that a showing by the plaintiff that the employer's proffered reason is false can be powerful evidence of discrimination,[151] "the power of that fact as support for a finding of discrimination is not, and should not be, a rule of law but a function of logic."[152] The court explained that the weight of the inference to be drawn from a showing of pretext would be proportional to the other evidence offered by the plaintiff.[153]

The Fourth Circuit's decision in *Vaughan v. MetraHealth* adds to this series of conflicting interpretations.[154] *Vaughan* has the advantage of being definite in its interpretation of *Hicks* in that the Fourth Circuit clearly stated that, in order to survive a motion for summary judgment, a plaintiff would have to show not only pretext,

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substantial suggestion of discrimination. In *Fisher*, the Second Circuit held:

> Accordingly, a Title VII plaintiff may prevail only if an employer's proffered reasons are shown to be a pretext *for discrimination*, either because the pretext finding itself points to discrimination or because other evidence in the record points in that direction—or both. And the Supreme Court tells us that "a reason cannot be proved to be a 'pretext *for discrimination*' unless it is shown both that the reason was false, *and* that discrimination was the real reason." We have recognized again and again that a plaintiff does not necessarily satisfy the ultimate burden of showing intentional discrimination by showing pretext alone. A finding of pretext may advance a plaintiff's case, but a plaintiff cannot prevail without establishing intentional discrimination by a preponderance of the evidence.

114 F.3d at 1339 (quoting *Hicks*, 509 U.S. at 515) (citation omitted). In contrast, the D.C. Circuit in *Aka* held:

> Although we find that rebuttal evidence alone will not always suffice to permit an inference, we do not endorse a reading of *Hicks* under which employment discrimination plaintiffs are presumptively required to submit evidence of discrimination over and above such a rebuttal in order to avoid summary judgment. . . .[W]e read *Hicks* (and other relevant case law) to mean that such a showing does have considerable evidentiary significance.

156 F.3d at 1292. *Compare also Fisher*, 114 F.3d at 1345-47 (explaining that there is no "fixed or special" value given to false statements in discrimination cases), *with Aka*, 156 F.3d at 1293 (stating that according to evidentiary principles "a lie is evidence of conscious guilt"), *and id.* at 1291 (referring to the "often great" evidentiary weight given to the plaintiffs showing that the defendant's proffered explanation is false).

149. *See Fisher*, 114 F.3d at 1346-47.

150. *See id.* at 1346.

151. *See id.* at 1345.

152. *Id.*

153. *See id.* at 1346-47 ("Generally speaking, the stronger the evidence that illegal discrimination is present, the greater the likelihood that discrimination is what the employer's false statement seeks to conceal. And, conversely, the weaker the evidence of discrimination, the less reason there is to believe the employer's false statement concealed discrimination. . . .").

154. *See Vaughan*, 145 F.3d at 204.

but also additional evidence to support the conclusion that the pretext was a cover for discrimination.[155] This approach is provides a more rigorous standard for plaintiffs than the presumed sufficiency approach taken by the Seventh Circuit in *Wohl*,[156] or even the fact-sensitive analysis applied by the D.C. and Second Circuits.[157] Yet while the standard articulated in *Vaughan* is clear, it is open to criticism because it expands the Supreme Court's reasoning in *Hicks* in the context of summary judgment, and thus follows the interpretation suggested by Justice Souter's dissent rather than the majority opinion.[158] In addition, by adopting the terminology "pretext plus," the *Vaughan* court sent a signal that has been interpreted by lower courts to mean that the Fourth Circuit has substantially raised the bar that plaintiffs must pass to overcome a motion for summary judgment.[159]

The Fourth Circuit reached this result despite clear language in *Hicks* stating that a factfinder may infer intentional discrimination based solely on disbelief of the employer's proffered reasons and the elements of the prima facie case.[160] In her appeal, Vaughan used this

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155. *See id.*

156. *See id.* (rejecting the "pretext only" approach); *supra* notes 114-25 and accompanying text discussing *Wohl*).

157. *Compare Vaughan*, 145 F.3d at 202 (stating that the prima facie case combined with a showing of pretext will not, without more, be sufficient to overcome a motion for summary judgment), *with Aka*, 156 F.3d 1284, 1292 (D.C. Cir. 1998) (in banc) (affording a finding of pretext considerable evidentiary weight), *and Fisher*, 114 F.3d at 1338 (holding that the sufficiency of the finding of pretext to support a finding of discrimination depends on the circumstances of the case).

158. *See* St. Mary's Honor Ctr. v. Hicks, 509 U.S. 502, 535 (1993) (Souter, J., dissenting) ("But other language in the Court's opinion supports a more extreme conclusion, that proof of falsity of the employer's articulated reasons will not even be sufficient to sustain judgment for the plaintiff."); *cf. Vaughan*, 145 F.3d at 202 n.2 (following the interpretation of the dissent and citing *Hicks*, 509 U.S. at 535-36 (Souter, J., dissenting)).

159. *See, e.g.*, Venable v. Apfel, 19 F. Supp. 2d 455, 461-65 (M.D.N.C. 1998) (citing *Vaughan* and granting summary judgment to the employer); *see also* Love v. J.C. Penney Co., No. 4:97CV00549, 1998 U.S. Dist. LEXIS 17300, at *36 (M.D.N.C. Aug. 27, 1998) (granting summary judgment to the employer in an ADEA claim); *infra* notes 211-12 (discussing subsequent decisions by the Fourth Circuit and by federal district courts within the circuit).

160. *See Vaughan*, 145 F.3d at 201. The Fourth Circuit quoted the following passage:

> "The factfinder's disbelief of the reasons put forward by the defendant (particularly if disbelief is accompanied by a suspicion of mendacity) may, together with the elements of the primary facie case, suffice to show intentional discrimination. Thus, rejection of the defendant's proffered reasons will *permit* the trier of fact to infer the ultimate fact of intentional discrimination, and the Court of Appeals was correct when it noted upon such rejection, '[n]o additional proof of discrimination is *required*.' "

Vaughan, 145 F.3d at 201 (quoting *Hicks*, 509 U.S. at 511 (quoting Hicks v. St. Mary's

language to argue that plaintiffs are protected from summary judgment once they have made out a prima facie case and have shown pretext, but the Fourth Circuit rejected this interpretation.[161] Instead, the court focused on the Supreme Court's holding based on the facts of *Hicks* that the plaintiff in that case was not entitled to a directed verdict.[162] The *Vaughan* court concluded that "[i]n so holding the Court emphasized that the final stage of the ... proof scheme requires the plaintiff to prove that the employer's proffered justification is 'a pretext *for discrimination.*' "[163]

This interpretation of *Hicks* is the interpretation feared by Justice Souter in his dissent, rather than the interpretation adopted by the Court itself.[164] The holding in *Hicks*, as understood by the Supreme Court majority, was that judges could properly infer discrimination from a showing of pretext, but that the plaintiff would not be entitled to prevail unless that inference was actually made by the finder of fact.[165] The court in *Vaughan* concluded that *Hicks* "teaches that to survive a motion for summary judgment under the *McDonnell Douglas* paradigm, the plaintiff *must* do more than merely raise a jury question about the veracity of the employer's proffered justification."[166] *Hicks*, however, never required the plaintiff to show more than the prima facie case and pretext to prevail. Rather, *Hicks* stands for the proposition that the plaintiff would not prevail in every

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Honor Ctr., 970 F.2d 487, 493 (8th Cir. 1992) (alteration in original))).

161. *See id.* (distinguishing the Fourth Circuit's analysis from what it referred to as the " 'pretext only' analytical model" in *Wohl v. Spectrum Manufacturing, Inc.*, 94 F.3d 353, 355 (7th Cir. 1996), which stated that "[a] plaintiff in an age discrimination case may defeat a summary judgment motion brought by the employer if the plaintiff produces evidence that the employer proffered a phony reason for firing the employee.").

162. *See id.* at 201-02.

163. *Id.* at 201 (quoting *Hicks*, 509 U.S. at 515).

164. The Court stated that a finding of pretext coupled with the prima facie case could be enough for a fact finder to infer discrimination. *See Hicks*, 509 U.S. at 511. The Court resolved the apparent conflict between this statement and its statement that the plaintiff must show "both that the reason was false and that discrimination was the real reason" by explaining that "[e]ven though ... rejection of the defendant's proffered reason is enough at law to *sustain* a finding of discrimination, *there must be a finding of discrimination.*" *Id.* at 511 n.4. In his dissent, however, Justice Souter criticized the Court's holding as being susceptible to the interpretation later adopted by the Fourth Circuit in *Vaughan*. *See id.* at 535-36 (Souter, J., dissenting). In fact, the Fourth Circuit in *Vaughan* cited Justice Souter's dissent in supporting its interpretation of *Hicks*. *See Vaughan*, 145 F.3d at 202 n.2 (citing *Hicks*, 509 U.S. at 535-36 (Souter, J., dissenting)). Generally, if there is a conflict between the majority's understanding of its own holding and the dissent's understanding of the majority, the majority's understanding should prevail. *See* J. MYRON JACOBSTEIN & ROY M. MERSKY, FUNDAMENTALS OF LEGAL RESEARCH 26 (5th ed. 1990).

165. *Hicks*, 509 U.S. at 511-12.

166. *Vaughan*, 145 F.3d at 202 (emphasis added).

case as a matter of law upon such a showing.[167]

The holding in *Vaughan* illustrates the difficulty of applying *Hicks*, which focused on the trial court's refusal to grant a directed verdict,[168] to a motion for summary judgment. This difficulty is especially troublesome because many Title VII cases are resolved at the summary judgment phase.[169] Although the standard for a motion for a directed verdict is the same as the standard for a motion for summary judgment,[170] the effect on the parties is markedly different. A motion for summary judgment may deny a plaintiff her day in court, whereas a motion for a directed verdict comes only at the close of the evidence.[171] Moreover, summary judgment is particularly inappropriate for resolving cases involving certain issues, such as motive, which require the fact finder to evaluate the credibility of the parties.[172] Thus, because motive generally is a central issue in Title

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167. *See Hicks*, 509 U.S. at 511; *cf.* Brookins, *supra* note 7, at 964-65 (noting that the "pretext-plus" passages of *Hicks*, read in conjunction with the "permissive" passages allowing a verdict for the plaintiff on a showing of a prima facie case and pretext, place *Hicks* in the middle ground of the continuum of circuits ranging from strict "pretext plus" to strict "pretext only").

168. *See Hicks*, 509 U.S. at 507-08.

169. *See* Visser v. Packer Eng'g Assocs., 924 F.2d 655, 661 (7th Cir. 1991) (Flaum, J., dissenting) ("[E]mployers and their counsel may well conclude that ... cases are won or lost on summary judgment ...."); *see also* Catherine J. Lanctot, *The Defendant Lies and the Plaintiff Loses: The Fallacy of the 'Pretext Plus' Rule in Employment Discrimination Cases*, 43 HASTINGS L.J. 57, 67-68 n.38 (1991) (noting that motions for summary judgment have become the primary battleground for employers in their attempts to avoid employment discrimination trials).

170. *Compare* FED. R. CIV. P. 50(a)(1) (stating that judgment as a matter of law is appropriate when "during a trial by jury a party has been fully heard on an issue and there is no legally sufficient evidentiary basis for a reasonable jury to find for that party"), *with* FED. R. CIV. P. 56(c) (stating that a grant of summary judgment is appropriate when the evidence, taken together, shows "that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law").

171. *See* Linda S. Mullenix, *Summary Judgment: Taming the Beast of Burdens*, 10 AM. J. TRIAL ADVOC. 433, 467-68 (1987).

172. *See* Hardin v. Pitney-Bowes, Inc., 451 U.S. 1008, 1008-10 (1981) (Rehnquist, J., dissenting from denial of certiorari). *Hardin* was a case brought under the ADEA. *See id.* (Rehnquist, J., dissenting from denial of certiorari). Justice Rehnquist dissented from denial of certiorari because he concluded that summary judgment was inappropriate where issues of motive and intent were integral to the case. He contended:

> It has long been established that it is inappropriate to resolve issues of credibility, motive, and intent on motions for summary judgment. It is equally clear that where such issues are presented, the submission of affidavits or depositions is insufficient to support a motion for summary judgment.... [T]his Court has recently questioned the propriety of deciding defamation cases on summary judgment where the defendant's state of mind is called into question under the "actual malice" standard....
>
> This case illustrates the frequency with which courts misapprehend the rule against summary judgment....

VII lawsuits,[173] it is particularly damaging to resolve these cases at the summary judgment phase.[174] The dissent in *Hicks* feared that the Court's holding would lead to just such a damaging result.[175]

The majority's holding in *Hicks*, however, strongly supports an argument against routine disposition of Title VII cases on summary judgment when the plaintiff has shown that the employer's offered explanation is pretext.[176] *Hicks* allows an inference of discrimination to be made from a showing of pretext.[177] In ruling on a motion for summary judgment, all justifiable inferences must be drawn in favor of the non-moving party.[178] Therefore, in deciding a motion for summary judgment, an inference of discrimination may be drawn from a showing of pretext.[179] This conclusion is supported by language in *Hicks* stating that upon the employer's production of a nondiscriminatory reason for the challenged action, the plaintiff should have a " 'full and fair opportunity' " to prove his case.[180] The Court's emphasis on the importance of the ability of the Title VII plaintiff to have this " 'full and fair opportunity' " makes it particularly important that when summary judgment is urged against

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> Summary judgment simply may not be granted when such matters as the defendant's motive and intent are questioned. . . .
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> Just as summary judgment is inappropriate in qualified-immunity cases and in defamation cases, it is inappropriate here.

Id. (Rehnquist, J., dissenting from denial of certiorari) (citations omitted).

173. *See, e.g.*, United States Postal Serv. Bd. of Governors v. Aikens, 460 U.S. 711, 716 (1983) (noting that there will "seldom be 'eyewitness' testimony as to the employer's mental processes"); Sheridan v. E.I. DuPont de Nemours & Co., 100 F.3d 1061, 1071 (3d Cir. 1996) (en banc) ("Cases charging discrimination are uniquely difficult to prove and often depend on circumstantial evidence."); *see also* Aka v. Washington Hosp. Ctr., 156 F.3d 1284, 1298-99 (D.C. Cir. 1998) (in banc) (noting in an employment discrimination case that the central issue for the jury was to determine the credibility of the plaintiff and defendant).

174. *See Hardin*, 451 U.S. at 1008-10. (Rehnquist, J., dissenting from denial of certiorari).

175. *See* St. Mary's Honor Ctr. v. Hicks, 509 U.S. 502, 535 (1993) (Souter, J., dissenting).

176. *See id.* at 522-24 (explaining that the employer's proffered explanation will be assessed by the factfinder and rebutted at trial, contemplating that the plaintiff will have passed the summary judgment phase).

177. *See id.* at 511.

178. *See* Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 255 (1986).

179. *See, e.g.*, Sheridan v. E.I. Dupont de Nemours & Co., 100 F.3d 1061, 1070-72 (3d Cir. 1996) (en banc) (drawing such an inference in the context of a motion for judgment non obstante verdicto); Wohl v. Spectrum Mfg., Inc., 94 F.3d 353, 358-59 (7th Cir. 1996) (drawing such an inference in the context of summary judgment); Randle v. City of Aurora, 69 F.3d 441, 451 (10th Cir. 1995) (same); Washington v. Garrett, 10 F.3d 1421, 1434 (9th Cir. 1993) (same).

180. *See Hicks*, 509 U.S. at 507-08 (quoting Texas Dep't of Community Affairs v. Burdine, 450 U.S. 248, 256 (1981)).

a plaintiff, courts should draw all inferences in favor of that plaintiff as the non-moving party.[181] Because the trial court in *Vaughan* did not draw an inference of discrimination from the showing of pretext,[182] the court denied Vaughan a " 'full and fair opportunity' " to have her claim assessed by a trier of fact who would have weighed the credibility and motives of the witnesses.[183]

Even if the Fourth Circuit had not followed this logic and allowed plaintiffs to defeat motions for summary judgment automatically upon a showing of pretext, Vaughan would almost certainly have received a day in court under the more conservative fact-sensitive standard.[184] In *Vaughan*, the plaintiff had brought

181. *See id.*; *see also Liberty Lobby, Inc.*, 477 U.S. at 255 (stating that "the evidence of the non-movant is to be believed, and all justifiable inferences are to be drawn in his favor").

182. *Vaughan*, 145 F. 3d at 202-04.

183. There is a legitimate question regarding whether a plaintiff who has merely raised an issue of pretext by disputing the veracity of the employer's proffered reason would be entitled to an inference of pretext and then an inference of discrimination from the inference of pretext. However, this question should be answered in view of the clear standard of *Liberty Lobby, Inc.*, 477 U.S. at 257, which stated that the non-moving party must "present evidence from which a jury might return a verdict in his favor." *Id.* Where a Title VII plaintiff has presented evidence of pretext—not merely allegations—and confronts a motion for summary judgment, the court ought properly to take the evidence presented by the plaintiff as true and draw the inference of discrimination in favor of the plaintiff from the evidence showing pretext. *See id.* at 252-55. The exception is when the evidence showing pretext shows some other, nondiscriminatory reasons for the action, thereby defeating the inference of discrimination. *See* Aka v. Washington Hosp. Ctr., 156 F.3d 1284, 1291 (D.C. Cir. 1998) (in banc) (stating that the inference of discrimination should not be made either where there is only weak evidence of pretext and abundant evidence that no discrimination occurred or where the evidence of pretext itself disproves the notion of discrimination, such as when the plaintiff "shoots himself in the foot"). This analysis is supported by common sense; when asked why an employer would lie when faced with a charge of discrimination, unless the evidence of pretext points away from discrimination, a reasonable trier of fact could infer that the answer would be that the employer lied to hide discrimination. *See, e.g.*, *Sheridan*, 100 F.3d at 1066-72 (adopting the view that a plaintiff may always withstand summary judgment by demonstrating a genuine issue regarding the veracity of the employer's proffered reason); *see also Aka*, 156 F.3d at 1292 (giving such evidence considerable weight, absent some reason to conclude that the evidence of pretext does not point to discrimination); *cf.* Foster v. Dalton, 71 F.3d 52, 56 (1st Cir. 1995) (in which the defendant proffered a false reason for the employment decision, but a legitimate reason was unearthed at trial). *But cf.* Fisher v. Vassar College, 114 F.3d 1332, 1346-47 (2d Cir. 1997) (in banc) (affording the showing of pretext varying weight, depending on the weight of other evidence), *cert. denied*, 522 U.S. 1075 (1998), *reh'g denied*, 118 S. Ct. 1341 (1998).

184. *Cf. Aka*, 156 F.3d at 1293 ("If the jury can infer that the employer's explanation is not only a mistaken one in terms of the facts, but a lie, that should provide even stronger evidence of discrimination.... The jury can conclude that an employer who fabricates a false explanation has something to hide; that 'something' may well be discriminatory intent."); *Fisher*, 114 F.3d at 1338 ("To the extent that an actor in defendant's position is unlikely to have proffered a false explanation except to conceal a discriminatory motive,

forward evidence of pretext that suggested the employer had actively concealed its true reasons for terminating her.[185] The Fourth Circuit noted that the plaintiff had provided considerable evidence that the employer's proffered reason was false and that the employer, despite this showing, did not present evidence of any other reason.[186] Thus, *Vaughan* is a case in which the disbelief in the employer's proffered reason should be coupled with a suspicion of deliberate deception, making the inference of discrimination from the showing of pretext particularly strong.[187]

Vaughan is also distinguishable from the fact-sensitive precedents in which a clear, nondiscriminatory reason for the challenged decision emerged during discovery.[188] In *Vaughan*, no finding was made regarding the real reason for the employment action.[189] MetraHealth offered its downsizing manual as the reason for Vaughan's termination, while Cooper offered the "subjective art of management," and the court of appeals suggested that Meetz's HMO experience and her clinical training as a dentist justified her selection over Vaughan.[190] Any of these reasons would be a legitimate, nondiscriminatory reason if it was found to be true, but the conflict between the defendant's own witnesses suggested that a credibility determination was needed, a process which ordinarily is

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then the false explanation will be powerful evidence of discrimination").

185. *See Vaughan* 145 F.3d at 201. In fact, the evidence offered by the employer itself conflicted with the justification to which it clung. Cooper, the decision-maker, stated that he had never seen the manual prior to his deposition, yet even in light of this undisputed testimony, MetraHealth continued to insist that the guidelines in the manual were the reason for the selection of Meetz over Vaughan. *See id.* at 200. If a legitimate, nondiscriminatory reason for MetraHealth's decision existed, one wonders why MetraHealth never chose to discover and advance that reason for consideration.

186. *See id.* at 201 ("While MetraHealth continues to insist that it has substantially complied with the Downsizing Manual, we agree with the district court that Vaughan has raised a genuine dispute over the credibility of the employer's proffered justification.").

187. *Cf.* St. Mary's Honor Ctr. v. Hicks, 509 U.S. 502, 511 (1993) (stating that where the showing that the employer's proffered explanation was false was coupled with a suspicion of mendacity that a verdict for the plaintiff would be appropriate).

188. *Cf.* Chaffin v. Carter, No. 98-30155, 1999 WL 414269, at *3-4 (5th Cir. June 22, 1999) (upholding summary judgment for the employer in a Family Medical Leave Act case in which the employer proffered a clear reason for firing the plaintiff after she refused to justify drinking at a bar while taking an extended paid leave from work, and the employee did not offer sufficient proof of pretext); Hall v. Giant Food, Inc., 175 F.3d 1074, 1080 (D.C. Cir. 1999) (holding under the ADEA that the employee had failed to show pretext and that the employer had provided a legitimate reason for firing the plaintiff, specifically a failure to follow company procedures); *Dalton*, 71 F.3d at 56 (holding for the defendant in a case in which the employer proffered a false reason for its employment decision, but a legitimate reason—cronyism—was unearthed at trial).

189. *See Vaughan*, 145 F.3d at 202-03.

190. *See id.* at 200-03.

left to the trier of fact.[191] If the defendant's proffered explanations were false, but the evidence showed a legitimate reason that a trier of fact could find to be the true reason, then summary judgment might be appropriate.[192] However, because *Vaughan* was a case in which the employer's proffered explanation seemed false, and no clear, true explanation for the employment decision was presented, summary judgment was not warranted.

Vaughan is also distinguishable from the fact-sensitive precedents because no clear explanation emerged to show why the employer lied about its decision. In *Dalton*, for example, the real reason arguably was not revealed at the outset because the supervisor did not want his employer to know that he had tweaked the hiring process in favor of a fishing buddy.[193] In *Vaughan*, however, no such motive appeared for hiding the true reason for the firing.[194] Thus, *Vaughan* is a case where a fact-sensitive approach, such as that used by the D.C. Circuit in *Aka*,[195] would draw a weighty inference of discrimination because no other reason for the pretext was clearly established.[196]

In addition to being inconsistent with the way that other circuit courts have analyzed *Hicks*, *Vaughan* is also problematic because it

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191. *See, e.g.*, Combs v. Plantation Planters, 106 F.3d 1519, 1531-32 (11th Cir. 1997) (citing Walker v. NationsBank of Florida, 53 F.3d 1548, 1563 (11th Cir. 1995) (Johnson, J., concurring specially)), *cert. denied*, 522 U.S. 1045 (1998).

192. Mixed motive cases are an exception. They occur when a plaintiff proves discrimination by a preponderance of the evidence, but the defendant proves other, legitimate reasons for the challenged action. *See* Price Waterhouse v. Hopkins, 490 U.S. 228, 244-47 (1989). At that point, the employer may attempt to prove by a preponderance of the evidence that the same decision would have been made, absent discrimination. *See id.* In such cases, summary judgment against the plaintiff would be inappropriate. *See id.* at 270-72 (O'Connor, J., concurring in judgment) (explaining the fact pattern giving rise to a mixed-motive case); Sam's Club v. NLRB, 160 F.3d 191, 200-01 & n.11 (4th Cir. 1998) (explaining the Fourth Circuit's understanding of *Price Waterhouse*). However, this standard for mixed-motive cases may not apply to the ADEA. *See* FRIEDMAN & STRICKLER, *supra* note 4, at 984. Moreover, under the Fourth Circuit's interpretation of a mixed-motive case, Vaughan's situation would not qualify because she did not have direct evidence of discrimination and because the employer did not admit that discrimination played a role in its employment decision. *Cf. Vaughan*, 145 F.3d at 200-01 (discussing Vaughan's circumstantial evidence and the employer's repeated denial of discrimination).

193. *See Dalton*, 71 F.3d at 54-55.

194. For example, in *Vaughan* the court selected certain points from Cooper's testimony to posit a legitimate reason for the selection of Meetz over Vaughan based on experience and background. *See Vaughan*, 145 F.3d at 203. The court's analysis begs the question as to why the employer did not proffer these reasons if they were true.

195. 156 F.3d 1284, 1292-93 (D.C. Cir. 1998).

196. *See id.* at 1291 (stating that no inference would be drawn when the plaintiff's own evidence of pretext points away from discrimination, thereby acknowledging an exception to the D.C. Circuit's general proposition that evidence of pretext would be significant).

sets a tougher standard at summary judgment than a plaintiff would have to face at trial. Assume that the case had gone to trial and that Vaughan had moved for a judgment as a matter of law at the close of the evidence.[197] If the trial judge determined that MetraHealth's proffered reason was unbelievable, that there was a suspicion of mendacity because the reason was obviously inconsistent with other evidence offered by the employer's own witnesses,[198] and that the plaintiff had presented a prima facie case,[199] the trial judge would, under *Hicks*, be able to grant judgment as a matter of law to Vaughan even if she had not introduced affirmative evidence of discrimination.[200] Alternatively, the trial judge could deny judgment as a matter of law to the defendant and send the case to the jury.[201] Given that judgment as a matter of law is permissible under *Hicks* at the close of evidence, the holding that the same evidence would not be sufficient to withstand a summary judgement motion by the defendant seems at odds both with *Hicks* and with the ordinary standard for summary judgment.[202]

The analysis used by the Fourth Circuit in *Vaughan* also seems inconsistent with the analysis that the court used in *Hajoca* in reviewing denial of a motion for a judgment non obstante verdicto,[203] which involves a standard of review similar to the one used on summary judgments.[204] In *Hajoca*, the court analyzed the evidence in

197. *See* FED. R. CIV. P. 50(a).

198. *See Vaughan*, 143 F.3d at 200-01.

199. *See* McDonnell Douglas Corp. v. Green, 411 U.S. 792, 802 (1973).

200. *See* St. Mary's Honor Ctr. v. Hicks, 509 U.S. 502, 511 (1993). *But see* Brookins, *supra* note 7, at 952-53 (stating that under *Hicks*, a trial court may not direct a verdict against an employer unless " '(1) any rational person would . . . find the existence of facts constituting a prima facie case, and (2) the defendant has failed to meet its burden of production—i.e. has failed to introduce evidence which, *taken as true*, would *permit* the conclusion that there was a nondiscriminatory reason.' " (quoting *Hicks*, 509 U.S. at 509)). In *Hicks*, the Court indicated that a directed verdict was compelled by the finding of a prima facie case if the employer failed to articulate a legitimate, nondiscriminatory reason for the challenged action; however, the Court did not say that this situation was the only one in which a directed verdict would be permitted. *Compare Hicks*, 509 U.S. at 509 (noting that a case need only go to the factfinder if any rational person would find the existence of a prima facie case and the employer has failed to produce a legitimate, nondiscriminatory reason for its actions), *with Hicks*, 509 U.S. at 511 (noting that disbelief of the defendant's reason will permit the factfinder to find discrimination).

201. *See* FED. R. CIV. P. 50(a).

202. *See Hicks*, 509 U.S. at 511; Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 254-55 (1986).

203. 864 F.2d 317, 319 (4th Cir. 1988).

204. *See id.* (stating that an appellate court should apply the same standard in reviewing a directed verdict or a judgment non obstante verdicto as was used by the trial court, namely, "whether, viewing the evidence in the light most favorable to the non-

the aggregate and upheld the verdict for the plaintiff.[205] In *Vaughan*, however, the Fourth Circuit never brought the evidence together in its de novo review.[206] Instead, the court first determined that the finding of pretext by itself would not overcome the motion for summary judgment.[207] The court then determined that the evidence of discrimination was not, *by itself*, enough to overcome a motion for summary judgment.[208] The court neglected to analyze whether the inference of discrimination drawn from the fact that the employer lied, together with the inference of discrimination drawn from the evidence regarding the candidates' qualifications, the interview procedure, and the termination of other older employees, was enough to overcome a motion for summary judgment. However, it may be significant to note that *Vaughan* specifically did not overturn *Hajoca*.[209] Thus, it is possible to read *Vaughan* as holding only that a plaintiff must show something more than the prima facie case plus pretext to overcome summary judgment, rather than creating a new requirement that the evidence offered apart from proof of pretext must be enough by itself to overcome a motion for summary judgment.[210]

Vaughan establishes that, in the Fourth Circuit, *Hicks* will be applied to require both a showing of pretext and evidence of discrimination for a plaintiff to overcome summary judgment. This requirement already has led the Fourth Circuit to cite to *Vaughan* to affirm eight out of eight cases involving a district court's grant of summary judgment to an employer under Title VII or the ADEA.[211]

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moving party and giving him the benefit of all reasonable inferences, there is sufficient evidence to support a jury verdict in his favor"); *see also Liberty Lobby, Inc.*, 477 U.S. at 254-55 (setting forth a similar standard for a motion for summary judgment).

205. *See Hajoca*, 864 F.2d at 319-21.

206. *See Vaughan*, 145 F.3d at 202-04; *cf. Hajoca*, 864 F.2d at 319-20 (considering all the evidence presented in aggregate).

207. *See Vaughan*, 145 F.3d at 201-02.

208. *See id.* at 202-04.

209. *See Vaughan*, 145 F.3d at 200 (citing *Hajoca* with apparent approval); *supra* note 72 (discussing *Vaughan*'s treatment of *Hajoca*).

210. *Cf. Vaughan*, 145 F.3d at 200 (citing *Hajoca* with apparent approval); *cf. also* Fultz v. Mullican Lumber & Mfg. Co., No. Civ. A. 97-0295-B, 1999 WL 252659, at *2-4 (W.D. Va. Feb. 12, 1999) (mem.) (citing *Vaughan* and stating that "a *strong* prima facie case of age discrimination coupled with evidence of pretext may allow a finding of age discrimination, without requiring additional evidence as to the 'plus' prong" (emphasis added)).

211. Search of WESTLAW, keycite feature (July 25, 1999) (searching all citations to "Vaughan v. MetraHealth, 145 F.3d 197"); *see also* Mason v. Baltimore Gas & Elec. Co., No. 98-1834, 1999 WL 436736, at *4, *10 (4th Cir. June 29, 1999) (per curiam) (unpublished disposition) (citing *Vaughan* and affirming summary judgment for the employer); Brunson v. Andrews Office & Supply Equip. Co., Inc., No. 98-2379, 1999 WL

Similarly, the district courts in the Fourth Circuit have cited *Vaughan* liberally to support rejections of plaintiff's claims.[212] A standard that sets the bar to the courtroom so high that plaintiffs routinely are denied their day in court, particularly when they may have meritorious claims, does not serve the purpose of Title VII to prevent discrimination in employment.[213] Indeed, the standard adopted in *Vaughan* is practically an invitation to deception: Absent a "smoking gun," the employer will win as long as it lies and sticks to that lie.[214]

Congress passed Title VII to end discrimination in the workplace, and all interpretations under Title VII should be performed with this goal in mind.[215] While the decision in *Vaughan* may prevent meritless claims from going to trial, it also may bar legitimate claims that would depend on the trial process to show motive and intent.[216] An alternative reading of the rule in *Vaughan* is possible, however. Read in light of *Hajoca*, the holding in *Vaughan* that the plaintiff must show more than a prima facie case and pretext

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371598, at *1 (4th Cir. June 8, 1999) (per curiam) (unpublished disposition) (same); Larebo v. Clemson Univ., No. 98-2234, 1999 WL 152863, at *4-5 (4th Cir. Mar. 22, 1999) (per curiam) (unpublished disposition) (same); Bailey v. University of N.C., No. 98-1501, 1998 WL 808220, at *2 (4th Cir. Nov. 23, 1998) (per curiam) (unpublished disposition) (same); Presley v. Bellsouth Telecomms., Inc., No. 98-1016, 1998 WL 610873, at *3-4 (4th Cir. Sept. 3, 1998) (per curiam) (unpublished disposition) (same); Tinsley v. First Union Nat'l Bank, 155 F.3d 435, 444-45 (4th Cir. 1998) (same); Thomas v. Randolph Hills Nursing Ctr., No. 97-2642, 1998 WL 454088, at *2 (4th Cir. July 28, 1998) (per curiam) (unpublished disposition) (same); Gillins v. Berkeley Elec. Coop., Inc., 148 F.3d 413, 416-17 (4th Cir. 1998) (same). *But cf.* Dockins v. Benchmark Communications, 1999 WL 292103, at *5 (4th Cir. Mar. 29, 1999) (upholding summary judgment for the employer without citing *Vaughan*); *id.* at *5-6 (King, J., dissenting) (citing *Vaughan* to dispute the majority's decision).

212. *See, e.g.*, Venable v. Apfel, 19 F. Supp. 2d 455, 461-65 (M.D.N.C. 1998) (citing *Vaughan* and granting summary judgment to the employer); *see also* Love v. J.C. Penney Co., No. 4:97CV00549, 1998 U.S. Dist. LEXIS 17300, at *36 (M.D.N.C. Aug. 27, 1998) (granting summary judgment to the employer in an ADEA claim).

213. *See* Taxman v. Board of Educ. of Piscataway, 91 F.3d 1547, 1557 (3d Cir. 1996) (in banc) (discussing the legislative history of Title VII).

214. *Cf.* Brookins, *supra* note 7, *passim* (criticizing *Hicks* as being susceptible to a "pretext plus" interpretation and thus rewarding an employer for lying).

215. *See Taxman*, 91 F.3d at 1557; *see also* Harris v. Forklift Sys., 510 U.S. 17, 21 (1993) (" 'The phrase "terms, conditions, or privileges of employment" evinces a congressional intent "to strike at the entire spectrum of disparate treatment of men and women" in employment . . . .' " (quoting Meritor Savings Bank, F.S.B. v. Vinson, 477 U.S. 57, 64 (1986) (quoting Los Angeles Dep't of Water & Power v. Manhart, 435 U.S. 702, 702 n.12 (1978)))).

216. *See* Hardin v. Pitney-Bowes, Inc., 451 U.S. 1008, 1008-10 (1981) (Rehnquist, J., dissenting from denial of certiorari) (stating in an ADEA case that the showing of discrimination turned on the defendant's intent and noting that issues of motive and intent are not appropriately resolved on summary judgment); *cf.* Brookins, *supra* note 7, at 953-57 (criticizing *Hicks* as adopting anti-plaintiff evidentiary standards).

to overcome summary judgment could still allow courts to include the inference of discrimination from the showing of pretext along with other evidence of discrimination, and thus would permit a more fact-sensitive approach to summary judgment motions. In turn, courts would gain more flexibility to allow potentially meritorious claims to go forward.[217] Ultimately, the Supreme Court or Congress should address the growing debate among the circuits so that courts can apply a uniform standard of proof for overcoming summary judgment under Title VII and the ADEA.[218]

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217. *Compare Hajoca*, 864 F.3d at 319-21 (including the evidence offered to show pretext in the pool of evidence showing discrimination), *with Vaughan*, 145 F.3d at 201-02 (stating that a plaintiff may survive a motion for summary judgment if she has produced some evidence on which a jury could base a finding of discrimination). *See generally* Moheban, *supra* note 95, at 955-58 (praising the First Circuit's flexible interpretation of *Hicks* as allowing motions for summary judgment by defendant's to be upheld or denied on a showing of a prima facie case and pretext).

218. *Cf.* Brookins, *supra* note 7, at 994-95 (stating that the decision in *Hicks* was an intentional attack on Title VII and that Congress should come forth with evidentiary and procedural rules under Title VII).

O'Brien v. O'Brien: The Changing Nature of Property Under the Equitable Distribution Laws in North Carolina

When a husband and wife seek a divorce, the trial court is faced with the daunting task of equitably distributing the couple's marital property between the two.[1] Equitable distribution of marital property does not necessarily require an equal division.[2] Rather, it requires a fair division that allows for the return of each spouse's investment in property acquired by the marital estate.[3] Consequently, equitable division of marital property furthers the state's policy of treating marriage as a partnership.[4] It also ensures that each spouse's contributions made prior to or during the marriage are returned to that spouse at the end of the marriage.[5]

In 1981, the North Carolina legislature adopted the Equitable Distribution Act (the "Act") to facilitate the division of property upon divorce.[6] Before a trial court divides a couple's property, the Act requires the court to classify each item as "marital" or "separate" property.[7] The court is allowed to divide marital property equitably

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1. *See* N.C. GEN. STAT. § 50-20(a) (1995 & 1998 Supp.) ("[T]he court shall determine what is marital property and shall provide for an equitable distribution of the marital property....").

2. *See* Sally Burnett Sharp, *The Partnership Ideal: The Development of Equitable Distribution in North Carolina*, 65 N.C. L. REV. 195, 244 (1987). Amendments to the Equitable Distribution Act, however, have created a statutory presumption that equitable means equal. *See id.* Thus, the trial court must divide the property equally unless one of the parties can establish that an unequal distribution is equitable. *See* White v. White, 312 N.C. 770, 776, 324 S.E.2d 829, 832-35 (1985). The trial court must make detailed findings of fact to support an unequal property distribution. *See* § 50-20(j).

3. *See generally* Suzanne Reynolds, *Increases in Separate Property and the Evolving Marital Partnership*, 24 WAKE FOREST L. REV. 239, 249-58 (1989) (tracing the concept of returning each spouse's investment back to Spanish civil law and concluding that the modern common law's treatment of marriage as a partnership is based on this concept).

4. *See* Hinton v. Hinton, 70 N.C. App. 665, 668-69, 321 S.E.2d 161, 163 (1984); White v. White, 64 N.C. App. 432, 432-33, 308 S.E.2d 68, 69 (1983), *modified and aff'd*, 312 N.C. 770, 324 S.E.2d 829 (1985); Sharp, *supra* note 2, at 198.

5. *See* Reynolds, *supra* note 3, at 249; Sharp, *supra* note 2, at 198; Lawrence W. Waggoner, *Marital Property Rights in Transition*, 59 MO. L. REV. 21, 43 (1994).

6. *See* Act of July 3, 1981, ch. 815, 1981 N.C. Sess. Laws 1184 (codified as amended at N.C. GEN. STAT. §§ 50-20, 50-21 (1995 & 1998 Supp.)).

7. *See* N.C. GEN. STAT. § 50-20(a) (requiring courts to classify property by allowing courts to only distribute marital property). Marital property is defined by the statute as all property acquired during marriage and before separation "except property determined to be separate property." § 50-20(b). Marital property is thought of as property that goes into the "marital pot." *See* Harriet N. Cohen & Patricia Hennessey, *Valuation of Property in Marital Dissolutions*, 23 FAM. L.Q. 339, 342 (1989); Sally Burnett Sharp, *Step By Step:*

between the divorcing couple, while separate property goes to the spouse that owns it.[8] One question that has consistently plagued the courts is how to classify increases in the value of separate property that occur during the marriage.[9]

In North Carolina, equitable distribution has undergone a series of changes since the adoption of the Act.[10] The statute was amended most recently in October 1997 to create a third category of property—"divisible property."[11] No cases interpreting the 1997 amendments have reached the North Carolina Court of Appeals.[12] In *O'Brien v. O'Brien*,[13] however, the appellate court recently decided issues under the earlier version of the equitable distribution statute that also will affect the interpretation of the newest amendments.[14] In *O'Brien*, the court of appeals examined the classification and distribution of the appreciation in an investment account where the account was

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The Development of the Distributive Consequences of Divorce, 76 N.C. L. REV. 2017, 2120 (1998). Only the property in this "marital pot" is subject to division and distribution between the parties. *See* § 50-20(a). Because it distinguishes between marital and separate property, North Carolina is considered a dual-property state. *See* Reynolds, *supra* note 3, at 245. Some states, on the other hand, divide all property owned by both spouses or either spouse at divorce. *See id.* The newest amendments to North Carolina's Equitable Distribution Act have created a third category—"divisible property." *See* N.C. GEN. STAT. § 50-20(b)(4) (1998 Supp.). Now, trial courts must determine whether property is marital, separate or divisible. *See infra* notes 98-103 and accompanying text (discussing divisible property in more detail).

8. *See* N.C. GEN. STAT. § 50-20(a)-(b) (1995 & 1998 Supp.). For further discussion of separate property, see *infra* notes 55-66.

9. *See* Reynolds, *supra* note 3, at 245; *infra* notes 63-97 (discussing post-separation appreciation).

10. *See generally* Sharp, *supra* note 2, at 198 (surveying changes in case law and legislative changes to the equitable distribution statute).

11. *See* Act of July 7, 1997, chs. 212, 302, 1997 N.C. Sess. Laws 406, 712 (codified as amended at N.C. GEN. STAT. §§ 50-20, 50-21 (Supp. 1998)) (amending the Equitable Distribution Act to allow for distribution of divisible property and retirement benefits); Kelly Falls Miller, *Family Law*, 20 CAMPBELL L. REV. 459, 461 (1998) (discussing divisible property and what is included within the statutory definition); Sharp, *supra*, note 7, at 2119 (defining divisible property as marital and separate property that increases or decreases in value between the date of separation and the date of distribution); *see also infra* notes 98-103 and accompanying text (discussing divisible property).

12. The amount of time it takes to get to the appellate courts has, as of yet, precluded appellate interpretation of the 1997 amendments. None of the property divisions that has reached the appellate courts to date has been decided after October 1997, when the amendments took effect. *See* § 50-20; *see also* Sharp, *supra* note 7, at 2107 (discussing the slow pace of the appellate process as the reason for the lack of interpretation of the amendments).

13. 131 N.C. App. 411, 508 S.E.2d 300 (1998), *disc. rev. denied*, 350 N.C. 98 (1999).

14. The amendments only applied to equitable distribution proceedings filed on or after October 1, 1997. *See* Act of July 7, 1997, ch. 302, § 3, 1997 N.C. Sess. Laws 712, 717. *O'Brien* was not decided pursuant to the 1997 amendments because the property distribution took place in May 1997. *See id.* at 414, 508 S.E.2d at 304.

separate property.[15] The court held that the appreciation was also separate property and, therefore, was not subject to equitable distribution despite active management of the account by both spouses during the marriage.[16]

This Note discusses the facts of *O'Brien*, its history in the trial court, and the appeals court's disposition of the case.[17] The Note then reviews the evolution of the distinction between "passive" and "active" increases in the value of property under North Carolina law and the effect that distinction has on the distribution of property.[18] Next, the Note discusses *O'Brien*'s impact on the classification and valuation of separate property.[19] Finally, the Note examines the holding's potential effects on future equitable distribution issues regarding investment accounts in the context of separate property, which was at issue in *O'Brien*, and in the context of divisible property, the new classification of property created by the 1997 amendments.[20]

Richard and Mabel O'Brien were married for more than twenty years.[21] After the couple had been married for approximately ten years, Mrs. O'Brien received a large inheritance from her father, which she placed in an investment account titled in both her husband's name and her own.[22] When it was opened, the account contained $168,000.[23] The O'Briens deposited $4500 of marital funds and withdrew $38,658 from the account for marital purposes over the course of the next few years.[24] At one point, a drop in the stock market reduced the account's value by approximately $20,000.[25] By the time of the divorce, however, the investment account had increased in value by $44,000 over the original balance due to market

15. *See id.* at 420, 508 S.E.2d at 306.
16. *See id.* at 421, 508 S.E.2d at 307.
17. *See infra* notes 21-43 and accompanying text.
18. *See infra* notes 44-103 and accompanying text.
19. *See infra* notes 104-45 and accompanying text.
20. *See infra* notes 145-56 and accompanying text.
21. *See O'Brien*, 131 N.C. App. at 414, 508 S.E.2d at 303.
22. *See id.* Following an investment broker's suggestion, Mrs. O'Brien listed the account as a joint account with right of survivorship. *See id.* In North Carolina, the titling of an account as joint property is irrelevant to its categorization upon dissolution of the marriage. *See* N.C. GEN. STAT. § 50-20(b)(2) (1995 & 1998 Supp.). Rather, any inheritance or gift received by either spouse is treated as separate property pursuant to the statutory definition of separate property. *See id.* ("[P]roperty ... shall remain separate property regardless of whether the title is in the name of the husband or wife or both ....").
23. *See O'Brien*, 131 N.C. App. at 414, 508 S.E.2d at 303.
24. *See id.*
25. *See id.* at 415, 508 S.E.2d at 303. At this time, the account was worth approximately $119,000. *See id.*

gains, dividends, and share reinvestment.[26]

When the O'Briens filed for divorce, Mr. O'Brien argued that the appreciation in the account was marital property because it was the result of investment decisions that the couple made together during the marriage. As a result, he asked the court to classify both the account and the appreciation as marital property subject to division and distribution under the Equitable Distribution Act.[27] The trial court, however, classified the entire investment account as the separate property of Mrs. O'Brien.[28] The court found that only $4550 of the investment account came from marital funds, and that those funds were consumed when the couple made their first withdrawal from the account.[29] Therefore, no marital funds remained in the account at the time of separation.[30]

Addressing the appreciation claim, the court ruled that the appreciation's classification as marital or separate property depended on whether the increase in value was the result of active efforts during

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26. *See id.* at 415, 508 S.E.2d at 304. The account value also increased because of gifts from Mrs. O'Brien's aunt, Mabel Dozier Stone. *See id.* at 415, 508 S.E.2d at 303-04. During the course of two years, Ms. Stone attempted to take advantage of the gift tax exemption, that allows people to give up to $10,000 annually to each relative tax-free. *See* 26 U.S.C.A. § 2001 (1998 Supp.); *O'Brien*, 113 N.C. App. at 415, 508 S.E.2d at 304. Consequently, Ms. Stone gave Mr. and Mrs. O'Brien $10,000 each two years in a row, but sent a note to Mr. O'Brien with each gift indicating that the money actually was intended for his wife. *See O'Brien*, 131 N.C. App. at 422, 508 S.E.2d at 308. Approximately $25,000 of this gift money was deposited in the investment account, and $10,000 was spent on the purchase of a car for Mrs. O'Brien. *See id.* Based on the intent of the donor, the court characterized the $20,000 in gifts from Ms. Stone to Mr. O'Brien as gifts to Mrs. O'Brien and, therefore, as part of Mrs. O'Brien's separate property. *See O'Brien*, 131 N.C. App. at 423, 508 S.E.2d at 308; *see also* N.C. GEN. STAT. § 50-20(b)(2) (including gifts received by either spouse during marriage within the definition of separate property).

27. *See O'Brien*, 131 N.C. App. at 419-420, 508 S.E.2d at 306-07.

28. *See id.* at 421, 423, 508 S.E.2d at 306, 307. The title to the investment account was irrelevant to the categorization of the property because property remains separate "regardless of whether the title is in the name of the husband or wife or both." N.C. GEN. STAT. § 50-20(b)(2) (1995 & 1998 Supp.).

29. *See O'Brien*, 131 N.C. App. at 419, 508 S.E.2d at 306. The court used $4550 because this figure was the amount of marital funds deposited into the account over the course of three years. *See id.* at 414, 508 S.E.2d at 303. During that same period, the couple withdrew $38,658. *See id.* The court stated that these withdrawals were for marital purposes. *See id.* The court of appeals has previously held that separate property retains its separate character in a bank account if the account level never drops below the amount of separate property invested in the account. *See* Brown v. Brown, 72 N.C. App. 332, 334, 324 S.E.2d 287, 288 (1985). In addition to arguing about the $4550, Mr. O'Brien argued that the amount given to him by his wife's aunt should have been treated as a deposit of his separate property into the account, but the trial court treated that money as a deposit of Mrs. O'Brien's separate property, pursuant to Ms. Stone's intent. *See O'Brien*, 131 N.C. App. at 423, 508 S.E.2d at 308.

30. *See O'Brien*, 131 N.C. App. at 419, 508 S.E.2d at 304.

the marriage or passive appreciation.[31] Active appreciation occurs when marital efforts or funds are expended to increase the value of an asset.[32] Such appreciation is considered marital property by the North Carolina courts and, therefore, can be divided and distributed.[33] Passive appreciation typically refers to growth that results from events outside the control of either spouse, such as inflation or interest, and is classified as separate property not subject to division and distribution.[34] The *O'Brien* trial court found that the increase had been passive despite Mr. O'Brien's meeting with an investment broker and selecting investments based on the broker's advice.[35] Therefore, the court ruled that the account was not subject to distribution between the parties.[36] Based on the trial court's findings, Mrs. O'Brien was entitled to the entire investment account, including its accumulated appreciation.[37]

Mr. O'Brien appealed the trial court's findings regarding the separate nature of the investment account itself, as well as its appreciation.[38] The court of appeals upheld the findings on both issues.[39] The appellate decision regarding the passive appreciation of the account is the first in North Carolina to discuss the passive/active distinction with respect to the appreciation of stocks, securities, mutual funds, or investment accounts.[40]

In addressing the passive/active issue, the court of appeals developed a multi-factored test to evaluate whether a spouse's involvement with investments is substantial enough to classify appreciation in the investment as active and, therefore, marital

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31. *See id.* at 420, 508 S.E.2d at 307.

32. *See id.* at 420, 508 S.E.2d at 306.

33. *See id.*

34. *See id.*

35. *See id.* at 421, 508 S.E.2d at 307.

36. *See id.*; *see also* Wade v. Wade, 72 N.C. App. 372, 379-81, 325 S.E.2d 260, 268-69 (1985) (discussing the differences between passive and active appreciation for the purposes of property distribution); *infra* notes 44-103 and accompanying text (discussing the development of the definitions of passive and active appreciation).

37. *See O'Brien*, 131 N.C. App. at 421, 508 S.E.2d at 307.

38. *See id.* at 416, 508 S.E.2d at 304.

39. *See id.* at 421, 423, 508 S.E.2d at 306, 307. The standard of review for findings regarding property distribution is abuse of discretion. *See id.* at 416, 508 S.E.2d at 304; *see also* Beightol v. Beightol, 90 N.C. App. 58, 60, 367 S.E.2d 347, 348 (1988) ("The distribution of marital property is vested in the discretion of the trial courts and the exercise of that discretion will not be upset absent clear abuse."). The court of appeals noted in *O'Brien* that this standard required it to uphold the trial court's findings unless they were "unsupported by any competent evidence." *O'Brien*, 131 N.C. App. at 416-17, 508 S.E.2d at 304 (citing *Beightol*, 90 N.C. App. at 60, 367 S.E.2d at 348).

40. *See O'Brien*, 131 N.C. App. at 420, 508 S.E.2d at 307.

property subject to equitable distribution.[41] The court held that trial judges should consider the relevant facts and circumstances of the particular case, such as

> (1) the nature of the investment; (2) the extent to which the investment decisions are made only by the party or parties, made by the party or parties in consultation with their investment broker, or solely made by the investment broker; (3) the frequency of contact between the investment broker and the parties; (4) whether the parties routinely made investment decisions in accordance with the recommendation of the investment broker, and the frequency with which the spouses made investment decisions contrary to the advice of the investment broker; (5) whether the spouses conducted their own research and regularly monitored the investments in their accounts, or whether they primarily relied on information supplied by the investment broker; and (6) whether the decisions or other activities, if any, made solely by the parties directly contributed to the increased value of the investment account.[42]

In *O'Brien*, the court held that the husband's meetings with the investment broker, along with his selecting from investment alternatives based on the broker's advice, did not constitute substantial activity sufficient to establish active appreciation.[43]

The distinction between passive and active appreciation at issue in *O'Brien* is important in two areas of equitable distribution law in North Carolina. The first, illustrated by the *O'Brien* case itself, is in determining whether the appreciation of separate assets that occurs during the course of a marriage is marital or separate property. The second is in the disposing of appreciation of marital assets that accrues after a divorcing couple separates, but before the couple's property is divided by the courts.

Property distribution in North Carolina requires three steps. The court must (1) classify what part of the property is marital and what part is separate, (2) calculate the net value of the marital property,

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41. *See* N.C. GEN. STAT. § 50-20(a) (1995 & 1998 Supp.); *O'Brien*, 131 N.C. App. at 421, 508 S.E.2d at 307.

42. *O'Brien*, 131 N.C. App. at 421, 508 S.E.2d at 307.

43. *Id.* Because establishing the appreciation as active converts it from separate property into marital property, the appreciation would be part of the "marital pot" subject to equitable division if the court had held that the appreciation was active. *See* § 50-20(a). Conversely, the court's holding that it was passive appreciation rendered the property separate and, therefore, outside the scope of property division. *See id.*; *O'Brien*, 131 N.C. App. at 421, 508 S.E.2d at 307.

and (3) distribute the marital property equitably based on a number of factors.[44] Classification, the first step of property distribution, was the central issue in *O'Brien*.[45] To determine what is marital property and what is separate property, North Carolina courts first consider the definition of those terms in the Equitable Distribution Act.[46] The Act defines marital property as property that was acquired by one or both spouses during the course of the marriage before separation and that is still owned by the spouses at the time the court distributes the marital assets.[47] The statute establishes a presumption that "all property acquired after the date of marriage and before the date of separation is marital property except property which is separate property .... This presumption may be rebutted by the greater weight of the evidence."[48]

The court of appeals has developed a scheme of dual burdens of proof to classify property as either marital or separate under the statute.[49] According to this scheme, the party seeking to classify an

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44. *See O'Brien*, 131 N.C. App. at 417, 508 S.E.2d at 304-05 (citing *Beightol*, 90 N.C. App. at 63, 367 S.E.2d at 350); Smith v. Smith, 111 N.C. App. 460, 470, 433 S.E.2d 196, 202 (1993), *rev'd on other grounds*, 336 N.C. 575, 444 S.E.2d 420 (1994); McIver v. McIver, 92 N.C. App. 116, 124, 374 S.E.2d 144, 149 (1988); Seifert v. Seifert, 82 N.C. App. 329, 334, 346 S.E.2d 504, 506 (1986), *aff'd and remanded*, 319 N.C. 367, 354 S.E.2d 506 (1987); Cable v. Cable, 76 N.C. App. 134, 137, 331 S.E.2d 765, 767 (1985).

Under the statute, equitable factors considered by the courts include the duration of the marriage, the age and health of both parties, the expectation of pension or retirement rights that are not marital property, direct or indirect contributions made by one spouse to the education or career of the other, and tax consequences to both parties. *See* § 50-20(c)(1)-(12).

45. *See O'Brien*, 131 N.C. App. at 417, 508 S.E.2d at 305.

46. *See id.*; *see also Cable*, 76 N.C. App. at 137, 331 S.E.2d at 767 ("Classification must be according to the statutory definitions of separate property and marital property.").

47. *See* § 50-20(b)(1).

48. *Id.* Nine states have created a statutory presumption that property that is acquired during the marriage by either spouse is marital property. *See* LAWRENCE J. GOLDEN, EQUITABLE DISTRIBUTION OF PROPERTY § 5.03, at 94-95 & n.10 (1983) (listing Colorado, Delaware, Illinois, Kentucky, Maine, Minnesota, Missouri, Pennsylvania, and Virginia). In 1985, the North Carolina Court of Appeals decided two cases that adopted this presumption. *See* McLeod v. McLeod, 74 N.C. App. 144, 157, 327 S.E.2d 910, 918 (1985) (speaking of the presumption of marital property as a "judicial gloss" on the language of the statute); Loeb v. Loeb, 72 N.C. App. 205, 209, 324 S.E.2d 33, 38 (1985) ("Guided by the legislative intent, we hold that the language of the Act ... creates a presumption that all property acquired by the parties during the course of the marriage is 'marital property.' " (citations omitted)). To the extent that these cases purported to create a presumption of marital property, they were overruled by the North Carolina Supreme Court in 1986. *See* Johnson v. Johnson, 317 N.C. 437, 454 n.4, 346 S.E.2d 430, 440 n.4 (1986).

49. *See* Atkins v. Atkins, 102 N.C. App. 199, 207, 401 S.E.2d 784, 788 (1991). In *Atkins*, the husband's mother gave the husband and wife a tract of land titled in both their names as tenants by the entirety. *See id.* at 202, 401 S.E.2d at 786. The husband argued

asset as marital property must demonstrate that the property meets the requirements as defined in the Equitable Distribution Act.[50] Then, the burden shifts to the party seeking to classify the property as separate[51] to show by a preponderance of the evidence that the property meets the definition of separate property found in the Act.[52] If both parties meet their burdens of proof, the statutory scheme requires the court to classify the property as separate.[53]

The categorization of marital property, then, by definition, depends on the definition of separate property.[54] Separate property is defined as "all real and personal property acquired by a spouse before marriage or acquired by a spouse by bequest, devise, descent, or gift during the course of the marriage."[55] When separate property is sold or otherwise exchanged, the statute states that the new assets remain separate property regardless of whether the title is in the name of the husband, wife, or both, "unless a contrary intention is expressly stated in the conveyance."[56] The statute also classifies "[t]he increase in value of separate property and the income derived from separate property . . . [as] separate property."[57]

As originally applied by the courts, the statute created a broad definition of separate property[58] that threatened to defeat the purposes of the Equitable Distribution Act—to treat marriage as a partnership and repay each spouse's contributions to the marital estate.[59] The North Carolina Court of Appeals began to rein in the

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that the tract of land was separate property because he received it from his mother in exchange for separate property. *See id.* at 206, 401 S.E.2d at 787. The court of appeals held that the wife met her burden of proving the marital nature of the property, and that the husband failed to meet his burden of proof that the property was separate. *See id.* at 207, 401 S.E.2d at 788. Thus, the trial court appropriately characterized the property as marital. *See id.* The court of appeals concluded that the party seeking to classify property as marital or separate must prove the nature of the property by the preponderance of the evidence. *See id.*

50. *See id.* For a list of the requirements, see *supra* text accompanying note 47.

51. *See Atkins*, 102 N.C. App. at 206, 401 S.E.2d at 787-88.

52. *See id.* Separate property is defined as property acquired by one spouse before marriage or by bequest, gift, devise or dissent during marriage. *See* N.C. GEN. STAT. § 50-20(b)(2) (1995 & 1998 Supp.); *infra* text accompanying notes 55-57.

53. *See Atkins*, 102 N.C. App. at 206, 401 S.E.2d at 788.

54. For further discussion of how this statutory definition of marital property creates contradictory conclusions when compared with the statutory definition of separate property, see Farleigh Hailes Earhart, Note, McLean v. McLean: *North Carolina Adopts the Gift Presumption in Equitable Distribution*, 68 N.C. L. REV. 1269, 1270 (1990).

55. § 50-20(b)(2).

56. *Id.*

57. *Id.*

58. *See* Sharp, *supra* note 2, at 222.

59. *See* Hinton v. Hinton, 70 N.C. App. 665, 668-69, 321 S.E.2d 161, 163 (1984); White

expanding scope of separate property in *Wade v. Wade*.[60] In *Wade*, the husband purchased a tract of land prior to marriage and titled it solely in his name. During the marriage, he constructed a house on the land, using some of his own funds and some of his wife's funds.[61] Upon divorce, he argued that the house and the land were his separate property because the land was acquired before marriage and the house constituted merely an increase in the value of the property.[62] The court of appeals held that the statutory definition of separate property, which classifies increases in value of separate property as separate,[63] was referring only to passive increases.[64] The court explained that passive increases result from forces such as inflation, rather than contributions, monetary or otherwise, by one or both spouses.[65] Passive appreciation remains separate property, but active contribution to separate property is considered marital property and, therefore, is subject to equitable distribution.[66]

Since *Wade*, the North Carolina courts have refined the distinction between passive and active appreciation to determine when increases in value can be treated as marital property. In *Lawing v. Lawing*,[67] for example, the court of appeals elaborated on its definition of passive appreciation. The Lawings had been married

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v. White, 64 N.C. App. 432, 432-33, 308 S.E.2d 68, 69 (1983), *modified and aff'd*, 312 N.C. 770, 324 S.E.2d 829 (1985); Sharp, *supra* note 2, at 198; Sally Burnett Sharp, *Equitable Distribution of Property in North Carolina: A Preliminary Analysis*, 61 N.C. L. REV. 247, 260-61 (1983); *see also infra* notes 136-45 and accompanying text (explaining how an expanded definition of separate property defeats the goals of the Act).

60. 72 N.C. App. 372, 325 S.E.2d 260 (1985).

61. *See id.* at 377, 325 S.E.2d at 267.

62. *See id.* at 378-79, 325 S.E.2d at 267. The Act defines increases in the value of separate property as separate property. *See* N.C. GEN. STAT. § 50-20(b)(2) (1995 & 1998 Supp.); *see also supra* note 57 and accompanying text (discussing this provision).

63. *See* § 50-20(b)(2).

64. *See Wade*, 72 N.C. App. at 380, 325 S.E.2d at 268.

65. *See id.* at 379, 325 S.E.2d at 268. The court explained its creation of a distinction between passive and active appreciation by detailing the unfair results that had been occurring based on a literal reading of the statute. *See id.* For example, if a husband entered into marriage owning his own business, it would be considered his separate property. Even if the wife helped him run the business for twenty years of marriage, upon divorce, a literal reading of the statute required that the entire appreciation of the business would go to the husband. *See, e.g.*, Leatherman v. Leatherman, 297 N.C. 618, 619-22, 256 S.E.2d 793, 794-96 (1979). The *Wade* court noted that this result is inequitable, and stated that the Act should be construed broadly as a remedial provision, in that it was "enacted to ensure a fairer distribution of marital assets than under the common law rules." *Wade*, 72 N.C. App. at 379, 325 S.E.2d at 267-68. In essence, the court of appeals rewrote the statute because the legislature originally wrote it in a way that produced unfair results.

66. *See* § 50-20(a).

67. 81 N.C. App. 159, 344 S.E.2d 100 (1986).

for more than forty years when they sought a divorce.[68] Both the husband and wife disputed the trial court's classification of various family businesses. In particular, the wife argued that the appreciation in shares of a closely held family business that the husband had inherited from his father should have been classified as marital property.[69] The court of appeals noted that "increases in value remained separate property only to the extent that the increases were passive, as opposed to active appreciation resulting from the contributions of the parties during the marriage."[70] The parties agreed that the wife was very active in the management and operation of the business during the marriage.[71] The court of appeals, however, held that the appreciation in the shares resulted in part from the active efforts of a third party who managed the corporation.[72] Based on this management, the court rejected the wife's argument that the entire appreciation was marital property, stating that it saw no distinction between " 'passive' increases in separate property (interest, inflation) and 'active' increases brought about by the labor of third parties for whom neither spouse has responsibility."[73] Thus, the court held that the portion of the increase in value that was attributable to the marital efforts of either spouse should be classified as marital property, but the portion attributable to the efforts of a third party would be classified as passive and, therefore, separate property.[74]

In determining whether appreciation is active, courts focus on whether marital funds or marital efforts have been invested in the separate property to generate the increase in value.[75] The court of appeals articulated the amount of effort necessary to establish active appreciation in *Beightol v. Beightol*.[76] The husband in *Beightol*

68. *See id.* at 161, 344 S.E.2d at 103.

69. *See id.* at 176, 344 S.E.2d at 110. The inheritance itself was separate property regardless of when it was received under the statutory definition of separate property. *See* § 50-20(b)(2).

70. *Lawing*, 81 N.C. App. at 174, 344 S.E.2d at 111 (citing McLeod v. McLeod, 74 N.C. App. 144, 327 S.E.2d 910 (1985); Phillips v. Phillips, 73 N.C. App. 68, 326 S.E.2d 57 (1985)).

71. *See id.* at 176, 344 S.E.2d at 112.

72. *See id.* at 175, 344 S.E.2d at 111.

73. *Id.*

74. *See id.* at 176, 344 S.E.2d at 112. By characterizing the increase in value as passive, the court of appeals necessarily categorized it as the separate property of the husband. It is unclear why the husband was any more entitled than the marital estate to the appreciation attributable to a third party.

75. *See* GOLDEN, *supra* note 48, § 5.39, at 159 (Brett R. Turner, ed., Supp. 1993).

76. 90 N.C. App. 58, 61-62, 367 S.E.2d 347, 349 (1988).

asserted that rental income earned during marriage from his separately owned condominium property was passive appreciation in value and should be treated as separate property.[77] The wife argued that the property's increased value was the result of active appreciation because both personal efforts *and* marital funds were expended in maintaining it.[78] Her personal efforts included making mortgage payments, communicating with the property manager, and cleaning and decorating the condominium.[79] The husband conceded these actions but argued that they fell within the wife's spousal duty of support[80] and, therefore, were de minimis contributions.[81] The court of appeals disagreed, holding that the property's increased value was active appreciation due to the wife's efforts and the expenditure of marital funds for mortgage payments.[82] It dismissed the husband's characterization of the wife's marital efforts, explaining that "no rule of law . . . even intimates that a non-titled spouse should be penalized and not allowed a return on his or her investment because the efforts expended were characteristic of those which a caring and loving spouse would have performed in any event."[83]

Courts have often struggled with changes in property value that occur after separation but before property distribution.[84] In 1988, the court of appeals held in *Truesdale v. Truesdale*[85] that post-separation appreciation is not marital property—and therefore not subject to equitable distribution—because it does not occur while the marriage is still intact.[86] Instead, the spouse who is awarded the underlying

77. *Id.* at 59-60, 367 S.E.2d at 348-49.

78. *See id.* at 60, 367 S.E.2d at 349.

79. *See id.*

80. The duty of support refers to the personal obligation of each spouse to support the other. *See, e.g.*, Kuder v. Schroeder, 110 N.C. App. 355, 357, 430 S.E.2d 271, 273 (1993) (noting that the duty of support arises from the marital relationship).

81. *See Beightol*, 90 N.C. App. at 60, 367 S.E.2d at 349.

82. *See id.* at 62, 367 S.E.2d at 349-50.

83. *Id.* at 60-61, 367 S.E.2d at 349.

84. North Carolina courts have traditionally evaluated marital property for the purposes of equitable distribution based on the date of separation. *See* N.C. GEN. STAT. § 50-20(a), (b)(1) (1995 & 1998 Supp.) (stating that the court only has the power to divide marital property, and defining marital property as property acquired before the date of separation). However, the value of the property may change significantly between that date and the date the division takes place, since the most common form of divorce can be obtained only if the parties separate for at least one year. *See* N.C. GEN. STAT. § 50-6 (1995). The legislature created "divisible" property to address this problem. *See* N.C. GEN. STAT. § 50-20(b)(4)(a)-(d) (1998 Supp.); *see also infra* notes 98-103 (discussing divisible property). The new category allows courts to divide some property acquired after separation, but before distribution. *See* § 50-20(b)(4)(a)-(d).

85. 89 N.C. App. 445, 446, 366 S.E.2d 512, 514 (1988).

86. *See id.* at 448, 336 S.E.2d at 514; *see also* N.C. GEN. STAT. § 50-20(b)(1)-(2)

asset receives the full amount of appreciation.[87] However, the court held that trial judges should take into account the causes and effects of post-separation appreciation along with the other factors identified by the Act in devising the most equitable distribution of the marital assets.[88] In other words, while post-separation appreciation is not included in the marital pot, courts can adjust the way they divide marital property based on the fact that one spouse will receive the benefit of the post-separation appreciation.[89]

In 1994, the North Carolina Supreme Court handed down a ruling in *Smith v. Smith*[90] suggesting that post-separation appreciation may also be a positive factor in equitable distribution where a spouse has worked actively to achieve the growth. Toward this end, the court held that trial courts are required to make findings of fact concerning whether post-separation appreciation is active or passive to help weigh the appreciation against other equitable distribution factors.[91] The court held that findings of fact are required—even though post-separation increases cannot be distributed as marital property—because the trial court must take the parties' post-separation activities into account in distributing the marital property.[92] This additional fact-finding is helpful because if the court

(1995 & 1998 Supp.) (defining marital and separate property); Sharp, *supra* note 2, at 204 (discussing difficulties of defining marital and separate property at the date of separation, rather than the date of distribution).

87. *See* § 50-20(a), (b)(2).

88. *See Truesdale*, 89 N.C. App. at 448-49, 366 S.E.2d at 514-15. In *Truesdale*, the issue was the appreciation of the parties' marital home after their separation. *See id.* at 446, 366 S.E.2d at 514.

89. The effect of this holding can be illustrated with a hypothetical couple who have a marital home worth $100,000 and a business in one spouse's name, which is operating at a loss at the time of separation, but is worth $500,000 on the date that equitable distribution takes place. *Cf. Nye v. Nye*, 100 N.C. App. 326, 327, 396 S.E.2d 91, 92 (1990) (involving the equitable distribution of a couple's assets where the defendant's business had no net value at the date of separation, but was worth $568,547.35 at distribution). If the court treats the increase in business value as part of the marital pot, it will divide the $600,000 in total assets between the husband and wife. However, if the increase in value is not included within the marital pot and instead is treated merely as a distributional factor, the owner of the business will get the full $500,000 increase, and the court will only have the authority to divide the value of the $100,000 home. Even if the court determines that the most equitable distribution is to give the bulk of the marital estate to the spouse that does not own the business, that spouse will receive far less than if the business was included in the marital pot. *See* Chandler v. Chandler, 108 N.C. App. 66, 68, 422 S.E.2d 587, 589 (1992); GOLDEN, *supra* note 48, § 5.02, at 93.

90. 336 N.C. 575, 444 S.E.2d 420 (1994).

91. *See id.* at 580, 444 S.E.2d at 423.

92. *See id.*; *see also* § 50-20(c)(11a) (stipulating that when developing an equitable distribution plan, courts should consider, among other factors, each party's efforts to expand, preserve, or waste the marital assets); Mishler v. Mishler, 90 N.C. App. 72, 77-78,

is to determine which distributional factors to consult upon division of the property, it must have a record of whether the post-separation increases in value were the result of a spouse's efforts.[93] If a spouse is actively responsible for the post-separation appreciation of an asset, presumably those actions would benefit the spouse as a consideration in the equitable distribution of the marital property. Although the appreciation for which the spouse may have been responsible is not divided as marital property, that spouse may receive a larger portion of the marital estate to compensate him for his efforts.

By holding as it did, the North Carolina Supreme Court vacated the majority of the court of appeals decision and implicitly adopted the reasoning of Judge Greene, who had concurred in part and dissented in part on the court of appeals.[94] In his opinion, Judge Greene equated the definition of active appreciation of pre-separation appreciation with the definition of active appreciation of post-separation appreciation.[95] He first stated that evidence of the "acts" of either spouse is important in two separate and distinct distributional factors.[96] He then noted, "[a]ny resulting increase (or decrease) in the value of marital property is 'active' in nature, *as that term has been used in the context of separate property occurring during the marriage.*"[97] His analysis equated the definitions in this one sentence, as if it was obvious that the definitions would be the same in the two different contexts.

The entire case law on post-separation appreciation, however, has been thrown into question by the passage of the 1997 amendments to the Equitable Distribution Act. The amendments created a new category of property—"divisible property"—to resolve the problems raised in *Truesdale* and later cases about property

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367 S.E.2d 385, 388 (1998) (remanding case for the trial court to consider whether the post-separation appreciation was active or passive).

93. *See Smith*, 336 N.C. at 580, 444 S.E.2d at 423. If the increase was "passive"—that is, if it resulted from forces other than a spouse's efforts—the court must consider the distributional factors under section 50-20(c). As one commentator has explained, "A court cannot determine which distributional factor is applicable if it does not first distinguish between post-separation increases in value due to a spouse's efforts (active appreciation) and the increases due to other causes (passive appreciation)." K. Edward Greene, *Active/Passive Appreciation, Post-Separation Activity and Income*, EQUITABLE DISTRIBUTION (Wake Forest University Continuing Legal Education, Winston-Salem, N.C.), Feb., 1994, at 227.

94. *See Smith*, 336 N.C. at 580, 444 S.E.2d at 423.

95. *See Smith*, 111 N.C. App. 460, 518-19, 433 S.E.2d 196, 230-31 (1993) (Greene, J., concurring in part and dissenting in part).

96. *See id.* at 518, 433 S.E.2d at 231.

97. *Id.* (emphasis added).

gained after the date of separation.[98] Under the amended Act, divisible property is subject to division and distribution by the courts even though it is not technically marital property. The amendments recognize four categories of divisible property: (1) appreciation and diminution in value of marital property not attributable to post-separation activities of a spouse; (2) property or property rights such as commissions or contract rights acquired as a result of efforts of either spouse during the marriage and before separation; (3) passive income from marital property such as dividends or interest; and (4) increases in marital debt, interest on the debt, and financing charges.[99]

In dividing property after the effective date of the 1997 amendments, the court will divide appreciation that qualifies as divisible property, rather than treating such appreciation merely as a distributional factor.[100] At least one commentator has noted that the new classification rescues a significant amount of property acquired after separation but before distribution from the "black hole" of North Carolina's equitable distribution case law.[101] Many people abused the pre-1997 law, the commentator notes, by structuring payments to occur after separation, thereby shielding assets from a spouse.[102] The divisible property amendments ensure that judges in equitable distribution proceedings can distribute passive appreciation that accrued during the period of separation.[103]

In light of the history of equitable distribution law in North Carolina, *O'Brien v. O'Brien* is important for two reasons: First, it is the first North Carolina case to apply the passive/active analysis to investment accounts. Second, it has implications for passive/active analysis under the 1997 amendments. The multi-factor test adopted and applied in *O'Brien* appears to modify the nature of the marital contribution previously required by North Carolina courts to constitute active appreciation.[104] This modification expands the

98. *See* Act of July 7, 1997, ch. 302, N.C. Sess. Laws 712 (codified as amended at N.C. GEN. STAT. §§ 50-20, 50-21 (Supp. 1998)); *see also* Sharp, *supra* note 7, at 2111 (concluding that the new category of divisible property ameliorates some of the problems associated with property valuation at the date of separation).

99. *See* § 50-20(b)(4)(a)-(d).

100. *See generally* Sharp, *supra* note 7, at 2111-16 (discussing divisible property and its effect on distribution of appreciation).

101. *See id.* at 2115.

102. *See id.* at 2113. Professor Sharp concludes that the "analytically challenged" results of North Carolina courts have exacerbated problems with the date of separation rule. *See id.* at 2112-16.

103. *See id.* at 2111-16 (discussing the effect of the divisible property amendments on the discretion of judges).

104. *See infra* notes 107-35 and accompanying text.

definition of passive appreciation under the North Carolina statutory scheme, with important implications for both pre-separation appreciation[105] and post-separation appreciation.[106]

As noted previously, North Carolina courts have traditionally looked to two items—the use of marital funds and the use of marital efforts—to determine whether appreciation in a separately owned asset is marital property.[107] State case law has presumed that appreciation in separate property is active and, therefore, marital unless it resulted from factors such as inflation or government action, which are completely outside the control of either spouse.[108] In *O'Brien*, however, the court suggests through its development and application of the multi-factored test that certain marital efforts may no longer suffice to establish active appreciation.[109] The case also suggests that the expenditure of marital funds, such as the $4550 deposit in the O'Briens' account, will not establish active appreciation of an investment account.[110] As a result, *O'Brien* alters the nature of the marital contribution required to establish active appreciation.

In developing the multi-factored test, the *O'Brien* court acknowledged that the question of investment account appreciation was new to North Carolina and looked to other jurisdictions for guidance.[111] The court focused on a Missouri case dealing with the

105. *See infra* notes 136-45 and accompanying text.

106. *See infra* notes 146-56 and accompanying text.

107. *See, e.g.*, Ciobanu v. Ciobanu, 104 N.C. App. 461, 465, 409 S.E.2d 749, 751 (1991) (stating that the marital estate is entitled to the share of appreciation acquired through "financial, managerial, and other contributions" of the marital estate); *supra* notes 75-83.

108. *See* Smith v. Smith, 111 N.C. App. 460, 474, 433 S.E.2d 196, 204 (1993), *rev'd on other grounds*, 336 N.C. 575, 444 S.E.2d 420 (1994); Lawing v. Lawing, 81 N.C. App. 159, 175, 344 S.E.2d 100, 111 (1986); McCleod v. McCleod, 74 N.C. App 144, 148, 327 S.E.2d 910, 913 (1985). The party seeking to have the property classified as passive bears the burden of proof by the preponderance of the evidence. *See O'Brien*, 131 N.C. App. at 418, 508 S.E.2d at 306.

Some states have distinguished between different types of marital efforts in determining what suffices to establish marital property. *See, e.g., In re Herr*, 705 S.W.2d 619, 623 (Mo. Ct. App. 1992) (listing cases from multiple states holding that homemaker services are not considered a marital contribution to appreciation of property).

109. *See supra* text accompanying note 42 for the *O'Brien* test.

110. *See infra* notes 132-35 and accompanying text (noting the *O'Brien* court's failure to discuss the expenditure of marital funds in the context of investment accounts).

111. *See O'Brien*, 131 N.C. App. at 420-21, 508 S.E.2d at 306-07. The court did not make clear why the established precedent regarding the active/passive distinction with respect to close corporations was not suited for application in the context of investment accounts. It also did not make clear why its analysis of the law of other jurisdictions was limited to Missouri case law, when it stated that it was looking to other jurisdictions for guidance. *See id.*

appreciation of an investment account.[112] In *Hoffman v. Hoffman*, the Missouri Court of Appeals defined the scope of marital efforts much more narrowly than North Carolina courts had defined such efforts in their earlier cases regarding family-owned businesses.[113] It held that the wife's personal services and efforts as a homemaker were not "sufficiently extensive to warrant additional compensation by sharing in her husband's separate property."[114] Missouri reiterated this analysis in 1992 when it distinguished the wife's contributions from other types of marital efforts by holding that the wife's actions were merely ordinary and "usual spousal duties," which did not amount to marital efforts.[115]

North Carolina explicitly rejected this distinction between spousal duties and other types of marital efforts in *Beightol v. Beightol*.[116] Yet the *O'Brien* court embraced Missouri's definition of marital efforts, stating that Missouri's approach is consistent with the public policy embodied in the North Carolina Equitable Distribution Act, even though Missouri's definition of marital efforts is inconsistent with the definition used in North Carolina.[117]

The multi-factored test in *O'Brien* indicates that, with respect to investment accounts, appreciation likely will remain separate property.[118] Whether this test applies outside the context of investment accounts is unclear.[119] If so, the *O'Brien* test modifies the

112. *See id.*

113. 676 S.W.2d 817, 826 (Mo. 1984) (en banc) (holding that the wife's contributions as homemaker, travelling companion, and entertainer did not constitute marital efforts).

114. *Id.*

115. *In re Herr*, 705 S.W.2d 619, 623 (Mo. Ct. App. 1992).

116. 90 N.C. App. 58, 60-61, 367 S.E.2d 347, 349 (1988) ("[N]o rule of law ... even intimates that a non-titled spouse should ... not [be] allowed a return on his or her investment because the efforts expended were characteristic of those which a caring and loving spouse would perform in any event."). For a discussion of *Beightol* and spousal duties, see *supra* notes 75-83 and accompanying text.

117. *See O'Brien*, 131 N.C. App at 421, 508 S.E.2d at 307.

118. Because investment activity carries a presumption of being outside the control of either spouse, the same rule may apply to retirement benefit increases, life insurance increases, or any other "natural increases" in the value of separate investment property. *See* Mary Moers Wenig, *Increase in Value of Separate Property During Marriage: Examination and Proposals*, 23 FAM. L.Q. 301, 330, 336 (1989); *see also infra* notes 136-45 and accompanying text (discussing how the multi-factored test restricts the scope of active appreciation).

119. *See* Wenig, *supra* note 118, at 330. Professor Wenig argues that the rationale courts give for refusing to grant marital status to appreciation of investments is that such appreciation is attributable solely to time, rather than to the industrious labor of either spouse. *See id.* If this is the rationale for not classifying investment appreciation as marital property, she argues that other types of appreciation are subject to the same labeling as separate property, such as the "natural increase" in the value of a family home

law North Carolina courts use to examine marital efforts and the appreciation of separate property.[120] With respect to family-owned businesses, the state's courts have never held that the marital effort had to reach a threshold level of activity or go beyond "mere" spousal duties.[121] Yet, based on *O'Brien*, courts now may require more than the performance of spousal duties to establish marital efforts for the purpose of labeling appreciation as active. Such a requirement would call *Beightol* into doubt.[122]

Many state courts distinguish between different types of assets when evaluating the question of active appreciation.[123] At least one commentator has noted that investment accounts, by their nature, are more susceptible to market forces that are outside the control of either spouse.[124] For instance, where one or both spouses make physical improvements to their marital home by expending personal effort, courts can easily identify the effort behind the improvements and the increased value in the marital home. In the context of an investment account, however, courts cannot easily identify such personal, physical effort. One commentator has noted that if this fact is a relevant distinction between investment accounts and other types of assets, then courts should be able to distinguish that portion of the increase in value to the marital home that results from market forces and treat it in the same manner as investment accounts.[125] Courts rarely, however, engage in this type of analysis; when they do, it results in a confusing doctrinal analysis.[126] This commentator believes that there is not a logical reason for the distinction between assets and that courts should treat all types of assets consistently within the active/passive appreciation analysis.[127]

Even if *O'Brien* applies only to investment accounts, it

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or increases in the value of retirement plans. *See id.* at 336.

120. See *supra* notes 75-83 and accompanying text for a discussion of what previously has constituted sufficient marital efforts under North Carolina law.

121. *See Beightol*, 90 N.C. App. at 61, 367 S.E.2d at 349.

122. *See supra* notes 75-83 and accompanying text (discussing *Beightol*).

123. *See* Wenig, *supra* note 118, at 322-30 (discussing the different types of assets as "prototypes" and describing the different rules applicable to each).

124. *See id.* at 326; *see also* Reynolds, *supra* note 3, at 249-52 (explaining that the distinction between "natural cause" appreciation and appreciation resulting from marital contributions was derived from Spanish civil law principles).

125. *See* Wenig, *supra* note 118, at 326-28 (discussing different methods of apportionment depending on the different asset to be divided, and stating that apportionment of "natural" increases does not take place when dividing value of the home, although a court could determine the portion attributable to "natural" causes).

126. *See id.* at 322-23, 327-28.

127. *See id.* at 327, 330-31 (stating that the inconsistencies only lead to one conclusion: "[T]he courts do not know what they are doing.").

establishes a more restrictive definition of marital efforts than *Beightol* did in the family-business context. The multi-factored test in *O'Brien* focuses on, among other considerations, the frequency of contact between one or both spouses and a broker, whether the spouse(s) made independent investment decisions without any help or advice from the broker, and whether those completely independent decisions were a direct contribution to the increase in value of the investment account.[128] The level of activity required by this test disregards decision-making by one or both spouse(s) as a sufficient marital effort in itself.[129] Prior cases held that anything within the control of either spouse constituted appropriate marital effort sufficient to classify the increase in value as marital.[130] For example, in a case involving a family-owned business, the court held that decision-making by one spouse was sufficient to establish active appreciation.[131] *O'Brien* modifies the presumption of active appreciation and raises the threshold of what qualifies as sufficient marital effort to establish active appreciation, at least with respect to investment accounts.

O'Brien also calls into question North Carolina courts' traditional approach to expenditures of marital funds that generate appreciation of separate property.[132] As discussed above, the courts have categorized appreciation of separate property as a marital asset where the appreciation is the result of marital efforts or the expenditure of marital funds.[133] The *O'Brien* court noted that $4550 of marital funds was deposited in the investment account in its discussion of other classification issues,[134] yet did not examine the expenditure of marital funds as an action that could have led to the increase in the value of the investment account. In the court's opinion, the expenditure of marital funds did not even warrant

128. *See O'Brien*, 131 N.C. App. at 421, 508 S.E.2d at 307.

129. *See* Reynolds, *supra* note 3, at 287-88.

130. *See* Lawing v. Lawing, 81 N.C. App. 159, 175, 344 S.E.2d 100, 111 (1986) (holding that appreciation resulting from a third party's actions rather than factors within control of the spouses was passive); McLeod v. McLeod, 74 N.C. App. 144, 148, 327 S.E.2d 910, 913, (1985) (holding that the existence of a decision that was within the control of a spouse was sufficient to classify resulting appreciation as active).

131. *See McLeod*, 74 N.C. App. at 151, 327 S.E.2d at 915 (holding that a decision to redeem shares established active appreciation).

132. *O'Brien*, 131 N.C. App. at 419, 508 S.E.2d at 306; *see also* Greene, *supra* note 93, at 220 (explaining that North Carolina considers the expenditure of either marital funds or marital efforts upon separate property to be a marital contribution).

133. *See O'Brien*, 131 N.C. App. at 420, 508 S.E.2d at 306; *supra* notes 75-83, 107 and accompanying text.

134. *See O'Brien*, 131 N.C. App. at 419, 508 S.E.2d at 306.

discussion in the context of the investment account's appreciation. At least one commentator has noted that courts are more willing to treat a portion of an investment account as marital property if the expenditure of marital funds went into the initial purchase of the account.[135] *O'Brien*'s lack of discussion about the marital expenditures, together with the adoption of the more limited definition of marital efforts, leaves open the question of what exactly it will take for a court to characterize increases in investment accounts as marital property.

The second issue raised by *O'Brien* is whether the court's application of the passive/active distinction broadens the scope of separate property in North Carolina. Under the *O'Brien* analysis, more property will be classified as separate because parties will be unable to meet the new, higher standards required to establish a marital contribution. By exempting more property from division and distribution, the *O'Brien* court frustrates the Equitable Distribution Act's goal to treat marriage as a partnership.[136]

One commentator has observed that the Uniform Partnership Act ("UPA"), which governs business partnerships, can provide useful principles for equitable distribution.[137] When a partnership dissolves, the UPA reimburses the contribution of each partner's separate property at its original value.[138] All profits are then divided equally.[139] Included within the definition of profits is any increase in value of the separate property, be it passive or active.[140] Thus, *all* increases in value are divided among the partners, regardless of whose efforts accounted for the appreciation.[141] Application of the UPA approach to marriage assumes that the partners contributed equally to the separate property, and that all increases in value should

135. *See* Reynolds, *supra* note 3, at 290. In *O'Brien*, the initial account was opened with separate property, specifically money from Mrs. O'Brien's inheritance. *See O'Brien*, 131 N.C. App. at 414, 508 S.E.2d at 302; *supra* note 22 and accompanying text.

136. *Cf.* Reynolds, *supra* note 3, at 293-94 (explaining that requirements that the effort be a direct cause of the appreciation undercut the notion of marriage as a partnership); Sharp, *supra* note 2, at 198-201 (discussing the policy of the Equitable Distribution Act to treat marriage as a partnership).

137. *See* Wenig, *supra* note 118, at 332-33.

138. UNIF. PARTNERSHIP ACT § 18(a) (1914); *see also* Wenig, *supra* note 118, at 332 (discussing the reimbursement rule and the Uniform Partnership Act).

139. *See* UNIF. PARTNERSHIP ACT § 18(a); Wenig, *supra* note 118, at 332-33 (calling for the reimbursement of separate contributions by spouses at their original value based on the UPA).

140. *See* Wenig, *supra* note 118, at 333.

141. *See id.*

be divided equally according to those equal contributions.[142] Likewise, if marriage is considered a partnership in which each spouse is assumed to be contributing equally, each spouse should be allowed to share equally in any property value increases which occur during the marriage.[143] Consequently, upon divorce, only the original value of the separate property should be reimbursed to the spouse who brought the separate property into the marital estate.

This partnership approach is markedly different from the one taken in *O'Brien*, in which the court attempted to distinguish active appreciation from passive appreciation by examining the nature of the contributions of each spouse.[144] Only if one spouse was industrious or put a great deal of effort into the appreciation of the separate property will the appreciation be deemed marital property. The *O'Brien* approach assumes *unequal* contributions of the spouses and, therefore, is inconsistent with the partnership approach to marriage.[145]

The third issue raised by *O'Brien* is the implications of the court's holding regarding the amount of marital efforts necessary to establish active appreciation for the disposition of "divisible property" under the 1997 amendments to the Equitable Distribution Act.[146] In particular, *O'Brien* may play a role in two categories of divisible property: increases in the value of marital property that are "not attributable to post-separation activities of a spouse"[147] and passive income from marital property, such as dividends and interest.[148] Because the first category of divisible property depends on appreciation *not* attributable to the activities of a spouse, it seems to require appreciation based on events outside of either party's control. Likewise, the definition of what is passive income may refer to events outside of either party's control. Thus, the interpretation of the divisible property amendment may require courts to use the distinction between active and passive appreciation that was previously established in *Smith*.[149] Accordingly, although the

142. *See id.*

143. *See id. But see* Reynolds, *supra* note 3, at 251-52 (arguing that the modern concept of marital partnership derives from the Spanish civil law's concept of marital partnership, which embraces a more individualistic approach to the efforts of each spouse).

144. *See O'Brien*, 131 N.C. App. at 420-21, 508 S.E.2d at 306-07.

145. *See* Wenig, *supra* note 118, at 333.

146. *See* N.C. GEN. STAT. § 50-20(b)(4) (Supp. 1998).

147. *Id.* § 50-20(b)(4)(a).

148. *Id.* § 50-20(b)(4)(c).

149. *See* Smith v. Smith, 111 N.C. App. 460, 518, 433 S.E.2d 196, 231 (1993) (Greene, J.,

passive/active distinction traditionally has applied only to increases in the value of *separate property*, the 1997 amendments' creation of divisible property means that the passive/active distinction may apply with respect to increases in the value of all *marital property* which occur after separation and before distribution.

In *Smith*, Judge Greene's opinion on the court of appeals suggested that the analysis of whether appreciation is active or passive is the same, regardless of whether the court is examining appreciation before or after separation.[150] If a court finds a marital contribution resulted in active appreciation to separate property before separation, it will classify the appreciation as marital and divide it equitably. Within the context of post-separation appreciation, however, a finding of sufficient post-separation activities has the opposite effect. In cases where courts find that appreciation has occurred because of the active efforts of a spouse after separation, that appreciation would no longer meet the definition of divisible property.[151] Since the increase in value occurred after separation and is not divisible property as defined by the statute, it is not subject to distribution. Whether this increase in value is to be treated as the separate property of the spouse responsible for the post-separation activity, or as an "other factor" to be weighed under *Truesdale* is not clear.[152] At least one commentator has noted this gap in the statute and the potential problems it may pose.[153]

The *O'Brien* decision, by raising the level of activity required for a finding of active appreciation, makes it more difficult for courts to take post-separation increases in the value of property out of the marital pot. Because of the difficulty in meeting the requirements of the multi-factored test, rather than the more lenient rule that activities outside the control of either spouse constitute passive appreciation, spouses will have more trouble proving that post-

concurring in part and dissenting in part), *rev'd in part*, 336 N.C. 575, 444 S.E.2d 420 (1994). Judge Greene's position was adopted by the North Carolina Supreme Court with its reversal of this portion of the court of appeals' holding. *See Smith*, 336 N.C. 575, 444 S.E.2d 420; *supra* notes 94-97 and accompanying text (discussing the court's implicit adoption of Judge Greene's opinion).

150. *See Smith*, 111 N.C. App. at 518, 433 S.E.2d at 231 (Greene, J., concurring in part and dissenting in part).

151. *See* § 50-20(b)(4)(a)-(d).

152. Truesdale v. Truesdale, 89 N.C. App. 445, 450, 366 S.E.2d 512, 516 (1988).

153. *See* Sharp, *supra* note 7, at 2144 n.501 ("The statute also excludes from divisible property increases or decreases in value of marital or divisible property that are the result of the activities of either spouse after separation. This provision in the new amendments is especially likely to cause difficulties for practitioners and the courts." (citations omitted)).

separation appreciation was due to active efforts and, therefore, does not qualify as divisible property subject to equitable distribution. In this context, then, *O'Brien* is consistent with the purpose of the Act and the 1997 amendments—to treat more property as subject to division. Because the date between separation and distribution is at least one year in every case of property distribution in North Carolina,[154] *O'Brien* may recapture a good deal of property that could have fallen into the cracks of the equitable distribution statute. If the property had not met the definition of divisible property, it may have been subject to treatment as an equitable factor under the *Truesdale* rule, which is often unpredictable and inequitable.[155] By treating more property as subject to division, *O'Brien* furthers the goals of treating marriage as a partnership and returning to each spouse their individual contributions to the marriage. It also promotes certainty and fairness.

One remaining question the North Carolina courts must resolve is whether the *O'Brien* test applies only to investment activities while leaving intact prior precedent analyzing active vs. passive appreciation of family-owned businesses. *O'Brien* signals that North Carolina courts may have begun to distinguish among types of assets within the active/passive analysis, although it did not provide sufficient explanation for this change. It is unclear why the court needed to develop a test for determining whether appreciation of an investment account was passive or active, instead of applying the tests it had developed throughout the years with respect to family-owned businesses.

If the court intends to apply this test only to investments, and not to family-owned businesses, this differing approach will need to be justified at some point, and the court will have to further define what qualifies as an investment subject to the *O'Brien* analysis. For example, it is unclear whether this investment analysis is limited to bank accounts and other types of fungible assets, or whether it could be applied to any investment activity—such as an art collection, or a hired property manager. In *Lawing*, the court applied the traditional active/passive appreciation analysis to determine that a third person's management of a family-owned business is not within the control of either spouse, and is therefore passive.[156] Whether the situation

154. *See* N.C. GEN. STAT. § 50-6 (1995).

155. *See* Sharp, *supra* note 7 at 2114-16 and accompanying footnotes (discussing illogic of *Truesdale* and manner in which property that does not fall clearly within one of the statutory definitions may come within the *Truesdale* rule).

156. *See supra* notes 67-74 and accompanying text (discussing *Lawing v. Lawing* and

described in *Lawing* would now be treated as an investment activity subject to the *O'Brien* analysis, or whether it would be analyzed as a case of appreciation within the context of a family-owned business is not clear. If *O'Brien* applies to all types of assets, the court will not need to justify treating investment activities differently than other types of assets, or to define further what constitutes an investment activity. The significance of the *O'Brien* analysis will only be fully understood once the court begins to address these lingering questions.

STEPHANIE A. EAKES

the active/passive analysis).

Keith v. Northern Hospital District of Surry County and Rule 9(j): Preventing Frivolous Medical Malpractice Claims at the Expense of North Carolina Courts' Equitable Powers

Rule 9(j) ("the Rule") was added to the North Carolina Rules of Civil Procedure on January 1, 1996.[1] The Rule requires that plaintiffs alleging medical malpractice have a qualified expert review the case prior to filing a complaint.[2] This expert must be willing to testify that the medical care rendered failed to meet the applicable standard of care.[3] Most importantly, Rule 9(j) states that any medical malpractice complaint that does not specifically assert compliance with the expert certification requirement "shall be dismissed."[4] *Keith v. Northern Hospital District of Surry County* represents the first challenge to Rule 9(j).[5]

Judy Ann Keith filed a pro se medical malpractice claim against Northern Hospital District of Surry County (hereinafter the "Hospital" or "Northern Hospital") in October 1996.[6] Keith's complaint failed to assert that she had complied with the expert certification requirements of 9(j).[7] Realizing her mistake, Keith moved to amend her complaint, but her motion was denied.[8] The case was dismissed with prejudice for failing to comply with Rule 9(j).[9]

On appeal, Keith claimed that the trial court abused its discretion in denying her motion to amend.[10] The central issue in

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1. *See* Act of June 20, 1995, ch. 309, 1995 N.C. Sess. Laws 611 (codified at N.C. R. CIV. P. 9(j)).

2. *See* N.C. R. CIV. P. 9(j).

3. *See id.* Rule 9(j) requires that an expert for these certification purposes be qualified under Rule 702 of the North Carolina Rules of Evidence. *See id.* at 9(j)(1).

4. *Id.*

5. *See* Keith v. Northern Hosp. Dist. of Surry County, 129 N.C. App. 402, 499 S.E.2d 200, *cert. denied*, 348 N.C. 693, 511 S.E.2d 646 (1998); Transcript of Motions Hearing at 3, *Keith* (No. COA 97-825) (stating that *Keith* is governed by the "new amendments" enacted to Rule 9).

6. *See id.* at 403, 499 S.E.2d at 201.

7. *See id.*

8. *See id.* at 403-04, 499 S.E.2d at 201. Keith filed for leave to amend on January 23, 1997. *See id.* at 403, 499 S.E.2d at 201. The motion came before the trial court on March 10, 1997, and was considered at the same time as the Hospital's motion to dismiss. *See id.* at 404, 499 S.E.2d at 201.

9. *See id.* at 404, 499 S.E.2d at 201.

10. *See* Plaintiff-Appellant's Brief at 8, *Keith* (No. COA 97-825).

Keith was whether Rule 9(j) required the court, as a matter of law, to dismiss a medical malpractice complaint that failed to meet its expert certification requirements or whether Rule 9(j) allowed amendment under Rule 15 to include the certification.[11] The North Carolina Court of Appeals did not directly answer this question and only held that the trial court did not abuse its discretion when it denied Keith's motion to amend the pleadings.[12]

Although the court of appeals panel agreed on the result, its members failed to reach a consensus on whether Rule 9(j) mandated that the trial judge deny Keith's motion.[13] Granting leave to amend traditionally has been left to the discretion of the courts, but North Carolina's Rules of Civil Procedure state that leave is generally to be granted freely.[14] Rule 9(j) arguably strips North Carolina courts of this traditional equitable power.

This Note examines whether a judge is required, as a matter of law, to dismiss a complaint that fails to comply with Rule 9(j)'s expert certification requirements. First, this Note recounts the essential facts of Keith's case[15] and describes in detail the holding of the three appellate judges who took part in this decision.[16] Next, the Note reviews the judicial standard employed in granting leave to amend[17] and the law governing how the courts are to interpret statutes.[18] This Note then examines the opinions of Judges Greene and Timmons-Goodson regarding whether Rule 9(j)'s language is "clear and unambiguous"[19] before attempting to ascertain how the North Carolina legislature intended the Rule to operate.[20] The Note next compares Rule 9(j) with the statutes of other states that employ expert certification requirements.[21] The Note then analyzes various policy issues involved in taking leave to amend out of the equitable

11. *See Keith*, 129 N.C. App. at 404, 499 S.E.2d at 202.
12. *See id.* at 406, 499 S.E.2d at 203.
13. *See id.*; *see also infra* notes 38-64 and accompanying text (discussing the court of appeals' decision).
14. *See* N.C. R. CIV. P. 15(a) (stating that "leave shall be freely given when justice so requires"); *infra* notes 68-78 and accompanying text; *see generally* Saintsing v. Taylor, 57 N.C. App. 467, 291 S.E.2d 880 (1982) (holding that leave to amend should be freely granted); Carolina Garage, Inc., v. Holston, 40 N.C. App. 400, 253 S.E.2d 7 (1979) (same).
15. *See infra* notes 23-37 and accompanying text.
16. *See infra* notes 38-64 and accompanying text.
17. *See infra* notes 68-78 and accompanying text.
18. *See infra* notes 79-90 and accompanying text.
19. *See infra* notes 91-109 and accompanying text.
20. *See infra* notes 110-34 and accompanying text.
21. *See infra* notes 135-53 and accompanying text.

powers of the court.[22] Finally, this Note concludes that the legislature created a Rule that strips the courts of discretion in granting leave to amend, unwisely requiring judges to dismiss potentially valid medical malpractice claims.

On June 9, 1993, Judy Ann Keith entered Northern Hospital experiencing abdominal cramps and irregular menstrual periods.[23] Keith's doctors ordered a hysterectomy as the method of treatment, and, as is the case with most major medical procedures, an intravenous drip ("I.V.") to deliver fluids and medicine.[24] By Keith's second day in the hospital, her left hand, the site of the I.V. insertion, began to swell.[25] On the third day, the I.V. was moved to her right hand, but upon insertion, Keith complained immediately of pain and mentioned that it felt as if the needle hit bone. Later that day Keith experienced swelling in her right hand.[26] After the I.V. was removed, Keith complained to two nurses that she had no feeling in two fingers of her right hand.[27] Keith obtained counsel in 1995 to handle her malpractice claim.[28]

On June 5, 1996, Keith's counsel filed a motion to extend the statute of limitations for the filing of a medical malpractice claim.[29] The superior court judge granted the motion[30] pursuant to North Carolina Rule of Civil Procedure 9(j).[31] By October 1996 the

22. *See infra* notes 154-56 and accompanying text.

23. *See* Plaintiff-Appellant's Brief at 3.

24. *See id.*

25. *See id.*

26. *See id.*

27. *See id.* at 4.

28. *See id.* The numbness in her right hand never subsided and this injury is the source of her malpractice claim.

29. *See Keith*, 129 N.C. App. at 403, 499 S.E.2d at 201. The statute of limitations for a medical malpractice claim is three years. *See* N.C. GEN. STAT. § 1-15(c) (1996). The incident of which Keith complained occurred on June 12, 1993, causing the statute of limitations to expire in June 1996. *See* Transcript of Motions Hearing at 3. The motion to extend included an averment stating "Complainant believed she had obtained an expert witness to testify on her behalf .... Complainant was made aware during the week of May 20, 1996, that said expert would be unable to testify ... due to a conflict of interest." Plaintiff-Appellant's Brief at 5.

30. *See Keith*, 129 N.C. App. at 403, 499 S.E.2d at 201. Although there was some controversy regarding exactly when the statute of limitations should have run, the trial court's order granting the motion to extend contained a handwritten note at the end of the first paragraph stating "the statute of limitations will expire in this matter on June 9, 1996." Plaintiff-Appellant's Brief at 5.

31. N.C. R. CIV. P. 9(j). Rule 9(j) provides that a potential medical malpractice complainant may file a motion to extend the applicable statute of limitations by a period not to exceed 120 days. *See id.* The complainant must file the motion within the original statute of limitations. *See id.* The motion may be granted upon a determination that there is good cause for the extension and that the ends of justice would thereby be served. *See*

numbness in Keith's hand still had not subsided, and, on October 4, Keith filed her medical malpractice complaint against the defendant Hospital.[32]

The Hospital sought in its answer to have Keith's complaint dismissed on the grounds that it failed to comply with the expert certification requirements of Rule 9(j).[33] The Rule states that a medical malpractice complaint "shall be dismissed" unless a pleading specifically asserts that the medical care at issue has been reviewed by a person who is expected to qualify as an expert witness and that the same person will testify that the standard of care was not met in the instant case.[34] After the Hospital filed its answer, Keith moved to

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id.

32. *See Keith*, 129 N.C. App. at 403, 499 S.E.2d at 201. Keith originally sued three other parties in addition to the Hospital: Kenneth D. Gitt, M.D., Tom J. Vaughn, M.D., and the Mt. Airy OB-GYN Center. *See id.* The trial court dismissed the claims against these three parties for failure to state a claim and failure to comply with the expert certification requirements of Rule 9(j). *See id.* Keith did not appeal these dismissals, leaving the Hospital as the sole defendant. *See id.*

Keith's original attorney withdrew from the case, yet there was no order or other record indicating that her original counsel was allowed to withdraw. *See* Plaintiff-Appellant's Brief at 5 n.2. By the deadline for filing the complaint, Keith was without legal representation and was forced to file pro se. *See* Transcript of Motions Hearing at 15. The Court at the motions hearing recognized that "the problem is Ms. Keith did not have an attorney. And that makes it even more difficult for the Court [to determine] what standard we hold her to." *Id.*

There was some discrepancy over exactly when the 120-day extension took effect. *See* Transcript of Motions Hearing at 7. The motion to extend was filed on June 5, 1996; accordingly, Northern Hospital argued that the 120-day extension should run from that point and end on October 3, 1996, one day before Keith filed her pro se complaint. *See id.* at 6. Keith's new attorney argued that the 120-day extension began on June 9, 1996, the date the trial judge noted as the end of the period for the statute of limitations to run. *See id.* at 7. Under Keith's interpretation, the statute of limitations would not run until October 7, 1996, meaning that she had filed the complaint in a timely fashion. *See id.*

33. *See Keith*, 129 N.C. App. at 403, 499 S.E.2d at 201. The Hospital filed its answer on November 14, 1996. *See* Plaintiff-Appellant's Brief at 2. The Hospital additionally sought dismissal under N.C. Rule of Civil Procedure 12(b)(6) for failure to state a claim. *See id.* This issue was not addressed on appeal, and, therefore, this Note will not examine in depth the validity of that argument. *See Keith*, 129 N.C. App. at 404, 499 S.E.2d at 202 (stating that the dispositive issue at appeal was whether a complaint that fails to comply with Rule 9(j) can subsequently be amended pursuant to Rule 15).

34. N.C. R. Civ. P. 9(j). The relevant part of the rule provides:

> Any complaint alleging medical malpractice by a health care provider as defined in G.S. 90-21.11 in failing to comply with the applicable standard of care under G.S. 90-21.11 shall be dismissed unless:
>
> (1) The pleading specifically asserts that the medical care has been reviewed by a person who is reasonably expected to qualify as an expert witness under Rule 702 of the Rules of Evidence and who is willing to testify that the medical care did not comply with the applicable standard of care;
>
> (2) The pleading specifically asserts that the medical care has been reviewed by a person that the complainant will seek to have qualified as an expert

amend the pleadings to include an allegation that an expert had reviewed the case and was willing to testify that the care rendered failed to comport with the applicable standard of care.[35] The trial court denied Keith's motion to amend and granted the Hospital's motion to dismiss.[36] The court dismissed the case with prejudice.[37]

On appeal, a three-judge panel of the North Carolina Court of Appeals agreed that the dismissal was proper; the judges did not agree, however, on a particular rationale. The court's opinion, written by Judge Greene, was joined by two concurrences in result only. Thus, the holding of the court of appeals was limited to a finding that the lower court did not abuse its discretion by denying Keith's motion for leave to amend.[38]

Judge Greene read Rule 9(j) to require a judge to dismiss a complaint that fails to meet the Rule's expert certification requirements.[39] Judge Greene noted that "although Rule 9(j) mandates the dismissal of the pleading, it does not preclude a dismissal without prejudice."[40] In his opinion, the decision of whether or not to dismiss without prejudice remains within the sound discretion of the trial court.[41] Judge Greene's interpretation focused on a determination that Rule 9(j)'s "shall be dismissed" language was unambiguous.[42] Where statutory language is clear and unambiguous,

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> witness by motion under Rule 702(e) of the Rules of Evidence and who is willing to testify that the medical care did not comply with the applicable standard of care, and the motion is filed with the complaint . . . .

Id.

35. *See Keith*, 129 N.C. App. at 403-04, 499 S.E.2d at 201. Keith made her motion for leave to amend on January 23, 1997, some three months after the filing of her complaint and two months after the other three claims were dismissed for failure to comply with Rule 9(j). *See id.* The motion to amend included an affidavit of a registered nurse with 20 years of experience. *See* Plaintiff-Appellant's Brief at 7. The affidavit stated that the nurse would testify to the standard of care and that it was not met in this case. *See id.*

36. *See Keith*, 129 N.C. App. at 404, 499 S.E.2d at 201.

37. *See id.* The trial court did not state a reason for denying Keith's motion to amend. *See id.*

38. *See id.* at 406, 499 S.E.2d at 203.

39. *See id.* at 405, 499 S.E.2d at 202. Judge Greene wrote that "because the complaint in this case alleged a claim for medical malpractice . . . and did not include the necessary Rule 9(j) certification, the trial court was *required* to dismiss it." *Id.* (emphasis added) (footnotes omitted).

40. *Id.* at 403 n.3, 499 S.E.2d at 202 n.3.

41. *See id.* The statute of limitations had run by June 9, 1996. *See* discussion *supra* note 32. Therefore, when the trial court dismissed the case on March 18, 1997, the decision of whether to dismiss with or without prejudice was essentially irrelevant because even if the dismissal was without prejudice, Keith was barred from refiling by the statute of limitations.

42. *See Keith*, 129 N.C. App. at 404, 499 S.E.2d at 202.

the court is not to indulge in judicial construction, but is to give effect to the statute in accord with its plain and definite meaning.[43]

Judge Greene also examined the objective of Rule 9(j), which was passed in January 1996 as part of a bill that sought to prevent the filing of frivolous medical malpractice claims.[44] Keith asserted that a Rule 9(j) deficiency could be remedied by amending the complaint according to Rule 15(a), adding the 9(j) certification, and having the amendment relate back, under Rule 15(c), to the date of the filing of the complaint.[45] Judge Greene explained, however, that this "file first, review later, relate back" argument would recreate the very situation the legislature sought to eradicate—the "filing of malpractice actions before the plaintiff had ascertained the existence, in fact, of the expert opinion evidence necessary to establish a breach of the applicable standard of care."[46] Judge Greene concluded that Keith's reading of the statute was impermissible because a statutory construction that "defeat[s] or impair[s]" the intent of the legislature

43. *See id.* at 404-05, 499 S.E.2d at 202 (citing Avco Fin. Servs. v. Isbell, 67 N.C. App. 341, 343, 312 S.E.2d 707, 708 (1984)).

44. *See id.* at 405, 499 S.E.2d at 202. Judge Greene listed the title of the session law containing Rule 9(j) as an " 'Act To Prevent Frivolous Medical Malpractice Actions By . . . Requir[ing] Expert Witness Review As A Condition Of Filing A Medical Malpractice Action.' " *Id.*; Act of June 20, 1995, ch. 309, 1995 N.C. Sess. Laws 611, 611 (codified at N.C. R. CIV. P. 9(j)).

45. *See id.* at 406, 499 S.E.2d at 203. Rule 15(a) states that "a party may amend his pleading only by leave of the court." N.C. R. CIV. P. 15(a). Rule 15(c) adds that "[a] claim asserted in an amended pleading is deemed to have been interposed at the time the claim in the original pleading was interposed" as long as the original complaint gave notice of the events to be proved by the amended pleading. *Id.* at 15(c).

Judge Greene rejected Keith's relation back argument on the ground that only claims, and not particular pleadings, relate back. *See Keith* at 406, 499 S.E.2d at 203. Here, Keith only sought leave to amend in order to plead a matter that was to be averred specifically in the complaint. *See id.* Judge Greene reasoned that because Keith was not asserting new claims, she was not permitted to employ the relation back doctrine under Rule 15(c). *See id.*

Judge Greene also rejected Keith's argument that the trial court should be reversed because it failed to state a reason for denying her motion to amend. *See id.* Judge Greene admitted that the denial of leave without a justifying reason is reversible abuse of discretion. *See id.* (citing Coffey v. Coffey, 94 N.C. App. 717, 722, 381 S.E.2d 467, 471 (1989)). Judge Greene pointed out that a justifying reason need not be stated; rather, it can be apparent from the record. *See id.* (citing Banner v. Banner, 86 N.C. App. 397, 400, 358 S.E.2d 110, 111 (1987)). Such " '[j]ustifying reasons' include 'undue delay, bad faith, dilatory motive, repeated failure to cure deficiencies, undue prejudice and futility of the amendment.' " *Id.* (quoting *Coffey*, 94 N.C. App. at 722, 381 S.E.2d at 471). The denial of leave without a stated reason did not constitute reversible error in *Keith* because "the amendment seeking to add the 9(j) certification cannot constitute compliance with Rule 9(j), [therefore] its filing would have been futile." *Id.*

46. *Keith* at 405-06, 499 S.E.2d at 202 (quoting Defendant-Appellee's Brief at 6).

must be avoided where possible.[47]

Writing in concurrence, Judge Walker stated simply that "[a]fter considering plaintiff's motion for leave to amend, the trial court found 'that justice does not require the amendment' under the facts of this case. Therefore, I conclude there was no abuse of discretion by the trial court."[48]

Judge Timmons-Goodson joined the two other judges in upholding the trial court's denial of leave,[49] but she disagreed that Rule 9(j) was immune from the effects of Rule 15.[50] Judge Timmons-Goodson began her analysis with the premise that leave to amend is to be granted freely, unless material prejudice would result.[51] Judge Timmons-Goodson then moved to an examination of claims that are to be pled with particularity.[52] Significantly, she noted that under Rule 9, heightened pleading is required in matters of legal capacity,[53] in allegations of fraud, duress, or mistake,[54] and in denials of performance or occurrence of a condition precedent.[55] Each of these subsections of Rule 9 employs mandatory language, and failure to comply with the pleading requirements may result in a 12(b)(6) dismissal for failure to state a claim.[56] Despite this mandatory language, however, the Judge noted that amendment under Rule 15

47. *Id.* at 405, 499 S.E.2d at 202 (citing State v. Hart, 287 N.C. 76, 80, 213 S.E.2d 291, 295 (1975)) (alteration in original).

48. *Id.* at 406-07, 499 S.E.2d at 203 (Walker, J., concurring in the result) (citation omitted).

49. *See id.* at 407, 499 S.E.2d at 203 (Timmons-Goodson, J., concurring in the result).

50. *See id.* (Timmons-Goodson, J., concurring in the result). Although Judge Timmons-Goodson stated that she "[took] issue with the majority," there was no actual majority holding regarding whether or not Rule 9(j) required dismissal as a matter of law. *Id.*; *see also supra* note 38 and accompanying text (discussing the holding of the case). Judge Walker did not address the issue and Judges Greene and Timmons-Goodson were split on whether Rule 9(j)'s language mandates dismissal. *See Keith*, 129 N.C. App. at 404, 499 S.E.2d at 202; *Id.* at 407, 499 S.E.2d at 203 (Walker, J., concurring in the result); *Id.* (Timmons-Goodson, J., concurring in the result).

51. *See id.* at 407, 499 S.E.2d at 203 (Timmons-Goodson, J., concurring in the result) (citing Saintsing v. Taylor, 57 N.C. App. 467, 471, 291 S.E.2d 880, 883 (1982)).

52. *See id.* (Timmons-Goodson, J., concurring in the result). Rule 9's title is "Pleading Special Matters," and it includes 9(j) in its provisions. N.C. R. CIV. P. 9. These matters require more than mere notice pleading. *See id.*

53. N.C. R. CIV. P. 9(a); *see also Keith*, 129 N.C. App. at 407, 499 S.E.2d at 203 (Timmons-Goodson, J., concurring in the result) (discussing Rule 9(a)).

54. N.C. R. CIV. P. 9(b); *see also Keith*, 129 N.C. App. at 407, 499 S.E.2d at 203 (Timmons-Goodson, J., concurring in the result) (discussing Rule 9(b)).

55. N.C. R. CIV. P. 9(c); *see also Keith*, 129 N.C. App. at 407, 499 S.E.2d at 203 (Timmons-Goodson, J., concurring in the result) (discussing Rule 9(c)).

56. *See Keith*, 129 N.C. App. at 407, 499 S.E.2d at 203-04 (Timmons-Goodson, J., concurring in the result).

has saved numerous defective Rule 9 pleadings.[57]

Judge Timmons-Goodson then took issue with Judge Greene's assertion that the "shall be dismissed" language of Rule 9(j) is clear and unambiguous.[58] She noted that, while the General Assembly passed Rule 9(j) as part of a bill to prevent the filing of frivolous medical malpractice claims, the legislature failed to mention that it intended Rule 9(j) either to preclude amendment under Rule 15 or to be exempt from the operation of the other Rules of Civil Procedure.[59] Thus, "[i]t would constitute a grave injustice to preclude as a matter of law such amendment in light of the lack of any direct evidence that the General Assembly intended by the creation of Rule 9(j) to carve out an exception to the equitable powers of the court under Rule 15."[60] Judge Timmons-Goodson concluded that Rule 15, in her opinion, could be employed to save a 9(j) defect.[61] The Judge claimed that such a reading does not offend the statutory language, but rather it "merely construe[s] the two Rules *in para* [sic] *materia* so as to give meaning to both Rule 9(j) and Rule 15."[62] Even though Judge Timmons-Goodson concluded that the trial court properly dismissed this particular cause of action, she envisioned a situation where amendment under Rule 15 would be needed "to save an otherwise meritorious medical malpractice action."[63] The judge asserted that the discretion to allow such an amendment "is best left in the quarter of the trial court" and should not be dictated by an ambiguous statute.[64]

Before analyzing Rule 9(j) and the holding of *Keith*, it may be helpful to review the two main areas of law upon which the analysis will hinge. Because much of the controversy in *Keith* turns on the granting of leave to amend, this Note will conduct an overview of the

57. *See id.* (Timmons-Goodson, J., concurring in the result). Judge Greene addressed this argument, stating that although "amendments pursuant to Rule 15 have been allowed to correct other Rule 9 deficiencies .... only Rule 9(j) ... specifically states that failure to allege particularities *requires* dismissal of the pleading." *Id.* at 405 n.4, 499 S.E.2d at 202 n.4 (emphasis added) (citations omitted).

58. *See id.* at 408, 499 S.E.2d at 204 (Timmons-Goodson, J., concurring in the result).

59. *See id.* (Timmons-Goodson, J., concurring in the result).

60. *Id.* (Timmons-Goodson, J., concurring in the result).

61. *See id.* (Timmons-Goodson, J., concurring in the result).

62. *Id.* (Timmons-Goodson, J., concurring in the result). Black's Law Dictionary defines "in pari materia" as "[o]f the same matter; on the same subject." BLACK'S LAW DICTIONARY 1115 (6th ed. 1990). Where a statute's meaning is ambiguous, statutes that govern the same subject matter "must be construed with reference to each other." *Id.*

63. *Keith*, 129 N.C. App. at 408, 499 S.E.2d at 204 (Timmons-Goodson, J., concurring in the result).

64. *Id.* (Timmons-Goodson, J., concurring in the result).

standard employed in granting leave.[65] Second, because the opinions of Judges Greene and Timmons-Goodson are each predicated upon opposite findings regarding the legislative intent of the "shall be dismissed" language in Rule 9(j),[66] this Note will explore the standard that courts are supposed to employ in statutory interpretation, specifically focusing on the "clear and unambiguous" test to which both Judges Greene and Timmons-Goodson referred.[67]

Generally speaking, leave to amend is to be granted freely.[68] The court's decision hinges upon whether the grant is required by justice.[69] If so, the matter is left within the discretion of the judge.[70] Nevertheless, amendment should be allowed unless the party objecting to the amendment will suffer material prejudice.[71] The party objecting to the grant bears the burden of demonstrating that he will be prejudiced by allowing the amendment.[72] The philosophy underlying these rules is that decisions are to be made on the merits of each case, not upon mere technicalities.[73]

The trial court is afforded broad discretion in permitting or denying amendments to a complaint.[74] The "[r]easons for justifying denial of an amendment are (a) undue delay, (b) bad faith, (c) undue prejudice, (d) futility of amendment, and (e) repeated failure to cure defects by previous amendments."[75] The trial court is not required to

65. *See infra* notes 68-78 and accompanying text.

66. *See supra* notes 39-64 and accompanying text.

67. *See infra* notes 79-90 and accompanying text.

68. *See* N.C. R. CIV. P. 15(a); *see generally* Saintsing v. Taylor, 57 N.C. App. 467, 291 S.E.2d 880 (1982) (holding that leave to amend should be freely granted); Carolina Garage, Inc., v. Holston, 40 N.C. App. 400, 253 S.E.2d 7 (1979) (same).

69. *See* N.C. R. CIV. P. 15(a) (stating "leave shall be freely given when justice so requires").

70. *See* Galligan v. Smith, 14 N.C. App. 220, 226, 188 S.E.2d 31, 35 (1972); Helson's Premiums & Gifts, Inc. v. Duncan, 9 N.C. App. 653, 657, 177 S.E.2d 428, 431 (1970).

71. *See* Mauney v. Morris, 316 N.C. 67, 72, 340 S.E.2d 397, 400 (1986) (holding that leave to amend should be allowed freely except upon the demonstration of material prejudice); Phillips v. Phillips, 46 N.C. App. 558, 560-61, 265 S.E.2d 441, 443 (1980) (same); Mangum v. Surles, 12 N.C. App. 547, 550, 183 S.E.2d 839, 842 (1971) (same), *rev'd on other grounds*, 281 N.C. 91, 98-99, 187 S.E.2d 697, 702 (1972).

72. *See* Vernon v. Crist, 291 N.C. 646, 654, 231 S.E.2d 591, 596 (1977); Gro-Mar Pub. Relations, Inc. v. Billy Jack Enters., Inc., 36 N.C.App. 673, 678, 245 S.E.2d 782, 785 (1978).

73. *See Mangum*, 281 N.C. at 98-99, 187 S.E.2d at 702; *Phillips*, 46 N.C. App. at 560-61, 265 S.E.2d at 443.

74. *See Galligan*, 14 N.C. App. at 221, 188 S.E.2d at 35; *Helson's Premiums & Gifts, Inc.*, 9 N.C. App. at 657, 177 S.E.2d at 431.

75. United Leasing Corp. v. Miller, 60 N.C. App. 40, 42-43, 298 S.E.2d 409, 411 (1982). This list of justifications was established by the United States Supreme Court in *Foman v. Davis*, 371 U.S. 178, 182 (1962). In the absence of such factors, the Supreme Court stated that amendment is to be given freely at the discretion of the judge. *See id.* "[O]utright refusal to grant the leave [to amend] without any justifying reason appearing for the denial

state a reason for denial of the amendment, and in the absence of a stated reason, the appellate court may examine any apparent reasons for the denial.[76] Generally, denial of a motion to amend is not reviewable on appeal absent a showing of abuse of discretion.[77] Denial of a motion to amend, without a stated justifying reason and with no showing of prejudice to the defendant, is reversible error.[78]

The court's role in interpreting statutes is well established.[79] Where the language is clear and unambiguous "there is no room for judicial construction, and the statute must be given effect in accordance with its plain and definite meaning."[80] In construing a statute, the court's primary goal is to assure that the legislature's intent is achieved.[81] Moreover, the legislature is assumed to comprehend the importance of the words it uses.[82] Thus, "[w]here the words of a statute have not acquired a technical meaning, they must be construed in accordance with their common and ordinary meaning, unless a different meaning is apparent or readily indicated by the context in which they are used."[83] Therefore, the court's primary

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is not an exercise of discretion; it is merely abuse of that discretion with the spirit of the Federal Rules." *Id.* North Carolina has adopted the language as well for its nearly identical state rules of civil procedure. *See, e.g.*, Martin v. Hare, 78 N.C. App. 358, 361, 337 S.E.2d 632, 634 (1985); *Gro-Mar*, 36 N.C. App. at 678, 245 S.E.2d at 785.

76. *See* Banner v. Banner, 86 N.C. App. 397, 400, 358 S.E.2d 110, 111 (1987), *overruled on other grounds*, Stachlowski v. Stach, 328 N.C. 276, 401 S.E.2d 638 (1991); *United Leasing Corp.*, 60 N.C. App. at 42-43, 298 S.E.2d at 411; Kinnard v. Mecklenburg Fair, Ltd., 46 N.C. App. 725, 727, 266 S.E.2d 14, 16, *aff'd*, 301 N.C. 522, 271 S.E.2d 909 (1980); *Gro-Mar*, 36 N.C. App. at 678-79, 245 S.E.2d at 785.

77. *See* Tyson v. Ciba-Geigy Corp., 82 N.C. App. 626, 629, 347 S.E.2d 473, 476 (1986); Carolina Garage, Inc. v. Holston, 40 N.C. App. 400, 403, 253 S.E.2d 7, 9 (1979); *Mangum*, 12 N.C. App. at 550, 183 S.E.2d at 842.

78. *See* Henry v. Deen, 61 N.C. App. 189, 193-94, 300 S.E.2d 707, 710 (1983) (citing Ledford v. Ledford, 49 N.C. App. 226, 233-34, 271 S.E.2d 393, 398-99(1980)), *rev'd on other grounds*, 310 N.C. 75, 310 S.E.2d 326 (1984).

79. *See* Avco Fin. Servs. v. Isbell, 67 N.C. App. 341, 343, 312 S.E.2d 707, 708 (1984). For additional information regarding statutory interpretation, see Stephen Breyer, *On the Uses of Legislative History in Interpreting Statutes*, 65 S. CAL. L. REV. 845, 848-61 (1992); Karen M. Gebbia-Pinetti, *Statutory Interpretation, Democratic Legitimacy and Legal-System Values*, 21 SETON HALL LEGIS. J. 233, 240-315 (1997); Richard A. Posner, *Legislation and Its Interpretation: A Primer*, 68 NEB. L. REV. 431, 431-34 (1989); David A. Strauss, *Why Plain Meaning?*, 72 NOTRE DAME L. REV. 1565, 1565-82 (1997).

80. Williams v. Williams, 299 N.C. 174, 180, 261 S.E.2d 849, 854 (1980).

81. *See* Electric Supply Co. v. Swain Elec. Co., 328 N.C. 651, 656, 403 S.E.2d 291, 294 (1991); *In re* Banks, 295 N.C. 236, 239, 244 S.E.2d 386, 388-89 (1978); D.G. Matthews & Son, Inc. v. State *ex rel.* McDevitt, 131 N.C. App. 520, 522, 508 S.E.2d 331, 333 (1998); *see also* State v. Fulcher, 294 N.C. 503, 520, 243 S.E.2d 338, 350 (1977); State v. Hart, 287 N.C. 76, 80, 213 S.E.2d 291, 294-95 (1975).

82. *See* State v. Baker, 229 N.C. 73, 77, 48 S.E.2d 61, 65 (1948); North Carolina Div. of Sons of Confederate Veterans v. Faulkner, 509 S.E.2d 207, 210 (1998).

83. *D.G. Matthews & Son, Inc.*, 131 N.C. App at 522, 508 S.E.2d at 333 (citing State v.

mode of statutory analysis is to examine the words of the statute to determine whether the meaning is plain and unambiguous.[84] Where there is no ambiguity, there is "no room for judicial construction."[85]

In clear cases, "courts are without power to interpolate or superimpose provisions or limitations not contained in the statute."[86] But when a literal reading of the statute yields either absurd results or contravenes clearly expressed legislative intent, then the literal meaning must be disregarded and a judicially imposed interpretation is appropriate.[87] Thus, where the language of a statute is unclear or ambiguous, the courts are to ascertain the intent of the legislature and construe the statute in a way that effectuates the General Assembly's intention.[88] Where two statutes address a single subject, the courts are to construe the statutes in pari materia,[89] so that, if possible, they can harmonize the statutes into a unified law on the subject that comports with legislative intent.[90]

The court's role in conducting statutory interpretation was at the core of the dispute in *Keith*. The determinative issue was whether Rule 9(j)'s "shall be dismissed" language was clear and unambiguous.[91] A finding that the "shall be dismissed" language of 9(j) is clear and unambiguous almost mechanically leads to the result that the court has no discretion in this area and is required to dismiss claims that are deficient under 9(j). Likewise, only a finding that 9(j)'s language is unclear will allow the court to construe the statute liberally.

In *Keith*, the two judges who considered the issue were split on whether the "shall be dismissed" language was clear and unambiguous.[92] Judge Greene held that the language was clear, thus

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Koberlein, 309 N.C. 601, 605, 308 S.E.2d 442, 445 (1983)).

84. *See* Brown v. Flowe, 349 N.C. 520, 522, 507 S.E.2d 894, 895-96 (1998) (relying on Correll v. Division of Soc. Servs., 332 N.C. 141, 144, 418 S.E.2d 232, 235 (1992)).

85. *Williams*, 299 N.C. at 180, 261 S.E.2d at 854.

86. *Koberlein*, 309 N.C. at 605, 308 S.E.2d at 445 (citing *In re Banks*, 295 N.C. at 239, 244 S.E.2d at 388-89).

87. *See* Mazda Motors v. Southwestern Motors, 296 N.C. 357, 361, 250 S.E.2d 250, 253 (1979); Avco Fin. Servs. v. Isbell, 67 N.C. App. 341, 343, 312 S.E.2d 707, 708 (1984) (citing State v. Barksdale, 181 N.C. 621, 625, 107 S.E. 505, 507 (1921)).

88. *See Brown*, 349 N.C. at 522, 507 S.E.2d at 896; Burgess v. Your House of Raleigh, Inc., 326 N.C. 205, 209, 388 S.E.2d 134, 136-37 (1990).

89. *See* definition *supra* note 62.

90. *See Brown*, 349 N.C. at 523-24, 507 S.E.2d at 896; Board of Adjustment v. Town of Swansboro, 334 N.C. 421, 427, 432 S.E.2d 310, 313 (1993); *Williams*, 299 N.C. at 180-81, 261 S.E.2d at 854.

91. *See Keith*, 129 N.C. App. at 403, 499 S.E.2d at 202.

92. *Keith*, 129 N.C. App. at 404-08, 499 S.E.2d at 201-04. Judge Walker's opinion only concurred in the result and did not address the language of 9(j). *See id.* at 406-07, 499

requiring the trial court to dismiss Keith's claim.[93] Judge Timmons-Goodson, on the other hand, believed that the language was unclear, and thus concluded that the trial court was not required, as a matter of law, to dismiss Keith's case.[94] Judge Timmons-Goodson decided that because of this ambiguity, the proper way to read 9(j) was to construe it as being consistent with Rule 15's order to grant leave to amend freely, as justice requires.[95]

Judge Greene offered little explanation as to why 9(j)'s "shall be dismissed" should be considered clear and unambiguous.[96] In reading the language as it naturally appeared, he concluded that a statute that says an action "shall be dismissed" unless it complies with certain requirements plainly means a trial court is required to dismiss a non-complying action.[97] In contrast, Judge Timmons-Goodson was unwilling to require a trial court to dismiss a 9(j) deficient complaint absent some "direct evidence" that the General Assembly explicitly intended to create an exception to the court's equitable powers under Rule 15.[98]

Of the two opinions, Judge Greene's comports more closely with the traditional rules of statutory construction. Unless the words of a statute are facially unclear or have acquired a technical meaning, the court must give effect to their plain and ordinary meaning.[99] Judge Timmons-Goodson's belief that she could not read "shall be dismissed" as clear without some "direct evidence" on the point is not well grounded in law. The plain reading of "shall be dismissed" is that a deficient claim must be dismissed. To show a lack of clarity, Judge Timmons-Goodson might have demonstrated that the words "shall be dismissed" have a technical meaning, or she could have asserted that there is a plain interpretation of "shall be dismissed" that comports with her argument. She did neither. Thus, when the legislature says a case "shall be dismissed," there is no reason to assume it means otherwise.

S.E.2d at 203 (Walker, J., concurring in result).

93. *See id.* at 404-05, 499 S.E.2d at 202; *supra* notes 39-47 and accompanying text.

94. *See id.* at 408, 499 S.E.2d at 204 (Timmons-Goodson, J., concurring in the result); *supra* notes 49-64 and accompanying text.

95. *See Keith*, 129 N.C. App. at 408, 499 S.E.2d at 204 (Timmons-Goodson, J., concurring in the result).

96. *See id.* at 404-05, 499 S.E.2d at 202.

97. *See id.*

98. *See id.* at 408, 499 S.E.2d at 204 (Timmons-Goodson, J., concurring in the result).

99. *See* State v. Koberlein, 309 N.C. 601, 605, 308 S.E.2d 442, 445 (1983) (holding that words must be given their plain meaning unless they have acquired a technical meaning); D.G. Matthews & Sons, Inc. v. State *ex rel.* McDevitt, 131 N.C. App. 520, 522, 508 S.E.2d 331, 333 (1998) (same).

In addition to relying upon the "direct evidence" argument, Judge Timmons-Goodson made a second point that may have been her most convincing argument had she supported it with relevant case law.[100] This latter argument focused on the rules of statutory interpretation which say that when a literal reading of a statute either conflicts with clearly expressed legislative intent or yields absurd results, then the literal meaning may be disregarded and a judicially imposed reading may be substituted.[101] The legislative intent of Rule 9(j) is not clearly expressed, yet an analysis of the legislative intent indicates that the General Assembly probably did envision that Rule 9(j) would require courts to dismiss defective complaints.[102] Thus, a literal reading of Rule 9(j) probably does not conflict with clearly expressed legislative intent. One could argue, however, that a literal reading of 9(j) requires courts to dismiss defective, yet otherwise meritorious, complaints and thereby diminishes the court's equitable powers. Under such a literal reading, the court could be required to dismiss an otherwise meritorious medical malpractice claim, and, if the complaint was filed at the end of the statute of limitations, the plaintiff could be barred from refiling. Such a result would bring Rule 9(j) into discord with the Rules of Civil Procedure's preference for deciding cases on the merits.[103]

This argument, however, also has flaws. Judge Timmons-Goodson's compared 9(j) to the other Rule 9 pleading requirements that employ the word "shall"[104] and asserted that even though each of these sections use the word "shall," a deficiency in pleading one of these requirements may be saved by a Rule 15 motion for leave to amend.[105] The judge overlooked the fact, however, that while each of these rules uses the word "shall," none uses the phrase "shall be dismissed." In Rules 9(a)-(c), "shall" is used as a filing requirement

100. *Keith*, 129 N.C. App. at 408, 499 S.E.2d at 204 (Timmons-Goodson, J., concurring in the result).

101. *See* Mazda Motors v. Southwestern Motors, 296 N.C. 357, 361, 250 S.E.2d 250, 253 (1979); Avco Fin. Servs. v. Isbell, 67 N.C. App. 341, 343, 312 S.E.2d 707, 708 (1984) (citing State v. Barksdale, 181 N.C. 621, 625, 107 S.E. 505, 507 (1921)).

102. *See infra* notes 110-34 and accompanying text (analyzing the General Assembly's likely intent for the operation of Rule 9(j)).

103. *See* Phillips v. Phillips, 46 N.C. App. 558, 560-61, 265 S.E.2d 441, 443 (1980); Mangum v. Surles, 281 N.C. 91, 98-99, 187 S.E.2d 697, 702 (1972).

104. *See id.* at 407, 499 S.E.2d at 203-04 (Timmons-Goodson, J., concurring in the result); *supra* notes 52-57 and accompanying text (explaining that Rules 9(a), (b), and (c) all use "shall" but that this mandatory language is not understood to require a dismissal in the case of non-compliance).

105. *See Keith*, 129 N.C. App. at 407, 499 S.E.2d at 203-04 (Timmons-Goodson, J., concurring in the result).

and deficiencies may be cured by amendment because nothing in those statutes mandates dismissal.[106] If 9(j) were worded to say that a pleading "shall include expert certification," it would then mirror the phrasing of Rules 9(a)-(c). Comparing the use of "shall" in Rules 9(a)-(c) to that in 9(j) is of low probative value because 9(j) does not state that a pleading "shall include expert certification."[107] Rather, Rule 9(j) uses entirely different language that facially indicates an intent that malpractice cases be treated differently, without forgiveness for defects in the expert pleading requirement.[108] Thus, "[i]t is only Rule 9(j) ... that specifically states that the failure to allege particularities requires dismissal of the pleading," which would seemingly preclude Rule 15 amendment in medical malpractice cases.[109]

As argued above, the "shall be dismissed" language of Rule 9(j) seems clear and unambiguous. However, assuming arguendo that 9(j)'s language is unclear, it is informative to examine the legislative history of the Rule to ascertain the General Assembly's intent in enacting it. The legislature passed Rule 9(j) in 1995 as part of a package of measures designed to prevent frivolous malpractice suits.[110] The legislative history of Rule 9(j) is sparse. When the bill was originally introduced in the N.C. House of Representatives, the initial version read that a complaint "must be dismissed unless" either the complainant pled that an expert was willing to testify at trial that the applicable standard of care was not met or that the pleading alleged facts establishing negligence under res ipsa loquitur.[111] Thus, the earlier draft language supports a conclusion that the legislature, in using the words "shall be dismissed," had in mind that a deficient complaint "must be dismissed."

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106. *See supra* notes 52-57 and accompanying text.

107. N.C. R. CIV. P. 9(j). For the language of Rule 9(j), see *supra* note 34.

108. N.C. R. CIV. P. 9(j); *see also Keith*, 129 N.C. App. at 405 n.4, 499 S.E.2d at 202 n.4 (noting the difference in language).

109. *Keith*, 129 N.C. App. at 405 n.4, 499 S.E.2d at 202 n.4.

110. *See* Act of June 20, 1995, ch. 309, 1995 N.C. Sess. Laws 611 (codified at N.C. R. CIV. P. 9(j)). Chapter 309 is entitled "To Prevent Frivolous Malpractice Actions By Requiring That Expert Witnesses in Medical Malpractice Cases Have Appropriate Qualifications to Testify on the Standard of Care at Issue and to Require Expert Witness Review as a Condition of Filing a Malpractice Action." *Id.* In addition to Rule 9(j)'s pleading requirements, the law also included a provision that modified Rule of Evidence 702, which concerns the testimony of experts. *See* N.C. R. EVID. 702. Under the modified Rule 702, the standards for qualifying an expert witness to testify in a medical malpractice case are more cumbersome than the standards for qualifying experts in other kinds of actions. *See id.*

111. 1995 Daily Bull.: Actions by the N.C. Gen. Assembly (Legis. Reporting Serv., N.C. Inst. Gov't), at 10-11 (Apr. 3, 1995).

The title of the Act that enables Rule 9(j) reads, in pertinent part, that it is an Act to "Require Expert Witness Review as a *Condition* of Filing a Malpractice Action."[112] This title also indicates an intent that the certification be a prerequisite to filing a malpractice complaint.

Further, 9(j) contains a provision allowing for a 120-day extension of the statute of limitations.[113] This extension provision would be unnecessary if the legislature envisioned that the action "could be filed first, with the review and an amendment to the complaint following thereafter."[114] Rather, the extension provision indicates that the legislature intended for the expert certification to be completed prior to filing the complaint.[115] The extension provision evinces that the legislature foresaw that the pre-filing certification requirements could place serious burdens on a plaintiff, especially one who was pressed by the statute of limitations.[116] Moreover, it displays that the legislature understood that some actions might be barred by the statute of limitations if the complaint was dismissed for failure to comply with the expert certification requirements.[117] The legislature seemed willing to take that risk in its efforts to limit the number of medical malpractice suits. The statute of limitations extension would be wholly unnecessary if the legislature intended for a plaintiff to be able to cure a 9(j) expert certification deficiency through amendment of the complaint.[118]

The original version of Rule 9(j), the title of the Act, and the provision allowing for an extension in the statute of limitations all indicate that the legislature intended that the expert certification be completed *before* filing a complaint. A plaintiff's failure to comply with the expert certification requirement prior to filing the complaint results in dismissal. If that dismissal bars the plaintiff from refiling because the statute of limitations has expired, the plaintiff is left without a remedy under Rule 9(j) or any other rule.

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112. Act of June 20, 1995, ch. 309, 1995 N.C. Sess. Laws 611, 611 (codified at N.C. R. CIV. P. 9(j)) (emphasis added).

113. *See* N.C. R. CIV. P. 9(j). A judge "may allow a motion to extend the statute of limitations for a period not to exceed 120 days to file a complaint . . . in order to comply with this Rule." *Id.*

114. Defendant-Appellee's Brief at 5. Here, such an extension of the statute of limitations was granted under Rule 9(j), yet Keith still failed to obtain expert certification during that time. *See Keith*, 129 N.C. App. at 403, 499 S.E.2d at 201.

115. *See* Defendant-Appellee's Brief at 5.

116. *See id.*

117. *See id.*

118. *See id.*

Considering the legislative history, it seems unobjectionable to presume that the legislature intended to make it more difficult to bring medical malpractice claims, frivolous or otherwise.[119] Even assuming that the "shall be dismissed" language is unclear or ambiguous, as suggested by Judge Timmons-Goodson, the court should construe the statute consistently with the legislature's discernable intent.[120] While Judge Timmons-Goodson admitted that the General Assembly "promulgate[d] this Act to avoid the filing of frivolous medical malpractice claims,"[121] she did not dig deeper into the General Assembly's intent. If she had, she would have encountered strong evidence that the legislature intended exactly the result that she disfavors.[122] Instead, Judge Timmons-Goodson stated that to construe Rule 9(j) as requiring a court to dismiss a deficient complaint "would constitute a grave injustice."[123] While her sympathy for potential medical malpractice plaintiffs is understandable, the judge's approach is at odds with both the language of the statute and the traditional method of statutory interpretation.

In her defense, Judge Timmons-Goodson attempted to interpret Rule 9(j) consistently with Rule 15's order to grant leave to amend freely.[124] This approach is in accord with the rule that when two or more statutes address a single subject, the court is to construe them in pari materia so as to effectuate them in a non-contradictory manner.[125] Thus, the court's "task is to give effect, *if possible*, to all sections of each statute and to harmonize them into one law on the

119. At the very least, obtaining expert review prior to filing a complaint has the practical effect of forcing a plaintiff to bear the substantial expense of acquiring an expert's services earlier in the litigation process. This expense applies to all medical malpractice complainants, regardless of the merits of their claims. Many medical malpractice cases are taken on a contingency fee basis, so this may mean that the expense will actually fall on an attorney, and, thus, it may discourage attorney's from taking on potentially meritorious cases. Of course, the Act enabling Rule 9(j) is designed to prevent frivolous filings, so this added expense to attorneys who take close cases on a contingency fee basis seems quite intentional.

120. *See* Brown v. Flowe, 349 N.C. 520, 523, 507 S.E.2d 894, 896 (1998); Burgess v. Your House of Raleigh, Inc., 326 N.C. 205, 209, 388 S.E.2d 134, 136-37 (1990).

121. *Keith*, 129 N.C. App. at 408, 499 S.E.2d at 204. (Timmons-Goodson, J., concurring in the result).

122. *See supra* notes 110-18 and accompanying text.

123. *Keith*, 129 N.C. App. at 408, 499 S.E.2d at 204. (Timmons-Goodson, J., concurring in the result).

124. *See id.* (Timmons-Goodson, J., concurring in the result).

125. *See Brown*, 349 N.C. at 523-24, 507 S.E.2d at 896; Board of Adjustment v. Town of Swansboro, 334 N.C. 421, 427, 432 S.E.2d 310, 313 (1993); *see also supra* note 62 (defining in pari materia).

subject."[126] When it is not possible to read two statutes consistently, the court must give effect to the legislature's intent, even if the court is not pleased with the result.[127]

The intention of the legislature in enacting Rule 9(j) is reasonably evident. The Rule was designed to prevent the filing of frivolous medical malpractice claims.[128] The original version of Rule 9(j) used the words "must be dismissed" instead of "shall be dismissed."[129] In addition, the language allowing for an extension of the statute of limitations indicates a desire on the part of the General Assembly that the expert certification be completed before the complaint is filed.[130] The intent of the legislature was to force potential medical malpractice plaintiffs to obtain expert certification before filing. If they do not, the complaint must be dismissed. Judge Timmons-Goodson, in reading 9(j) as not requiring a dismissal, would effectively render Rule 9(j) meaningless. Under her view, a plaintiff need not bother obtaining expert certification until *after* the complaint is filed: The complaintant could simply file, obtain expert certification (if possible) after filing, and amend the complaint to include the certification. This reading is inconsistent with the legislature's intent.

It seems that the North Carolina General Assembly has, in Judge Timmons-Goodson's words, "carve[d] out an exception to the equitable powers of the court."[131] In removing this discretion from the hands of the court, the legislature has significantly altered the court's traditional equitable powers to grant leave to amend deficient pleadings.[132] The desirability of this change is debatable.

When read as the legislature intended, Rule 9(j) contravenes the judicial policy that cases are to be decided on the merits, not on the basis of a mere technicality.[133] A meritorious medical malpractice

126. *Brown*, 349 N.C. at 524, 507 S.E.2d at 896 (emphasis added) (citing Williams v. Williams, 299 N.C. 174, 180-81, 261 S.E.2d 849, 854 (1980)).

127. *See supra* notes 81-90 and accompanying text (discussing the court's duty in interpreting statutes).

128. *See supra* notes 110-18 and accompanying text (discussing legislative intent in drafting Rule 9(j)).

129. *See supra* note 111 and accompanying text (discussing text of prior versions of Rule 9(j)).

130. *See supra* notes 113-18 and accompanying text (discussing Rule 9(j)'s 120-day statute of limitations extension provision).

131. *Keith*, 129 N.C. App. at 408, 499 S.E.2d at 204 (Timmons-Goodson, J., concurring in the result).

132. *See supra* notes 68-78 and accompanying text (discussing the traditional standard for granting leave to amend).

133. *See* Mangum v. Surles, 281 N.C. 91, 98-99, 187 S.E.2d 697, 702 (1972); Phillips v.

complaint that fails to obtain pre-filing expert certification should not suffer an automatic dismissal. Even if such a dismissal is without prejudice, if the complaint is filed at the end of the statute of limitations, the plaintiff will be barred from refiling. A plaintiff with a valid claim could be barred from pursuing it because she failed to comply with a technical requirement. Moreover, this harsh result is not ameliorated when the plaintiff, like Keith, files pro se, as nothing in Rule 9(j) creates an exception for pro se plaintiffs. Speaking to the severity of 9(j), the trial judge stated, "I think it's a harsh rule, but I think it's a rule. The purpose of the rule was to cut off these things .... I feel sorry for Ms. Keith. She may have a cause of action that may not get litigated."[134]

North Carolina has created a harsh rule that removes discretion in granting leave to amend from the purview of the trial courts. The severity of this rule becomes more apparent when compared to the laws of other states that use the same methodology. While some states require plaintiffs to submit potential claims to expert review panels before they may be filed,[135] many others, like North Carolina, require expert certification as a pre-requisite to filing a medical malpractice claim. Many of these states mandate either that potential medical malpractice plaintiffs obtain expert review as a prerequisite to filing an action or that they procure expert review within a number of days after the defendant's response.[136] The mandatory language is typically phrased along the lines that the plaintiff's complaint "shall include expert certification."[137] Though other states use mandatory

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Phillips, 46 N.C. App. 558, 560-61, 265 S.E.2d 441, 443 (1980).

134. Transcript of Motions Hearing at 16.

135. *See* IND. CODE ANN. § 34-18-8-4 (Michie 1998); LA. REV. STAT. ANN. § 40:1299.47 (West 1992); NEV. REV. STAT. ANN. § 41A.016 (Michie 1997); N.M. STAT. ANN. § 41-5-14 (Michie 1998); V.I. CODE ANN. tit. 27 § 166i (1997); *see also* MASS. GEN. LAWS ch. 231 § 60B (1998) (requiring every medical malpractice action to be heard by a special tribunal consisting of a superior court justice and a licensed physician); WASH. REV. CODE ANN. § 7.70.100 (West Supp. 1998) (requiring health care claims to go through mediation before trial).

136. *See* CONN. GEN. STAT. ANN. § 52-190a (West 1992); FLA. STAT. ANN. § 766.104 (West Supp. 1998); GA. CODE ANN. § 9-11-9.1 (1993 & Supp. 1998); 735 ILL. COMP. STAT. 5/2-622 (West 1992 & Supp. 1998); MD. CODE ANN., CTS. & JUD. PROC. § 3-2A-04(b) (1995); MICH. COMP. LAWS ANN. § 600.2912d (West Supp. 1999); MINN. STAT. § 145.682 (1998); N.J. STAT. ANN. § 2A:53A-27 (West Supp. 1998); N.Y. C.P.L.R. 3012-a (McKinney 1991 & Supp. 1999); OHIO REV. CODE ANN. § 2305.011 (Anderson 1999); TEX. REV. CIV. STAT. ANN. art. 4590i § 13.01 (West 1997). Most of these laws have been enacted within the last 15 years.

137. *See, e.g.*, CONN. GEN. STAT. ANN. § 52-190a (stating that no medical malpractice action "shall be filed ... unless the party filing the action has made a reasonable inquiry ... to determine that there are grounds for a good faith belief that there has been injury." The complaint "shall contain a certificate" of the good faith inquiry, established by

language, the courts of those states have consistently ruled that dismissal is not mandatory, but remains within the discretion of the trial court.[138] Thus, the North Carolina legislature is alone in its decision to strip the court of its traditional discretionary power to grant leave to amend.

North Carolina's Rule 9(j) is also arguably more punitive than comparable rules in Minnesota and Maryland.[139] The Minnesota statute holds that the plaintiff's attorney "must" provide an affidavit stating the attorney has consulted with an expert who has found that the standard of care has not been met.[140] If such review cannot be obtained because of statute of limitations pressures, the plaintiff has ninety days after the commencement of the action to file the certifying affidavit and 180 days to serve affidavits identifying the

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consulting with an expert); 735 ILL. COMP. STAT. 5/2-622 (stating that in a medical malpractice action, the plaintiff "shall file an affidavit" certifying that she consulted an expert, or that she was unable to consult an expert because of statute of limitations constraints or from the defendant's refusal to turn over relevant records); MICH. COMP. LAWS ANN. § 600.2912d (stating that in a medical malpractice action, the plaintiff "shall file with the complaint an affidavit of merit signed by a health professional"); N.J. STAT. ANN. § 2A:53A-27 (stating that in a medical malpractice action the plaintiff shall, within 60 days of defendant's answer, file a certificate verifying consultation with an expert); N.Y. C.P.L.R. 3012-a (stating that in a medical malpractice action the "complaint shall be accompanied by a certificate" declaring that the plaintiff has consulted with an expert, or that she was unable to obtain such a consultation); OHIO REV. CODE ANN. § 2305.011 (stating that in a medical malpractice case, after the responsive pleadings have been filed, the plaintiff "shall file with the court a certificate of merit" affirming that he has consulted with an expert who is willing to testify or that the plaintiff intends to rely on a theory of liability that does not require expert testimony); TEX. REV. CIV. STAT. ANN. art. 4590i § 13.01 (stating that within 90 days after filing a medical malpractice claim, the plaintiff shall either post a $5000 bond for each claim or file an expert report certifying the prima facie validity of the claim).

138. *See, e.g.*, Finnegan v. University of Rochester Med. Ctr., 180 F.R.D. 247, 249 (E.D.N.Y. 1998) (stating proper action for failure to file expert certification is "to afford the [plaintiff] 30 days to comply with the statute"); Lindgren v. Moore, 907 F. Supp. 1183, 1192 (N.D. Ill. 1995) (stating that under Illinois law, whether to dismiss a medical malpractice complaint for failure to obtain expert certification is within the sound discretion of the trial court judge); LeConche v. Elligers, 579 A.2d 1, 7 (Conn. 1990) (noting that dismissal of complaint for filing false certificate of good faith is discretionary, rather than required); Gabrielle v. Hospital of St. Raphael, 635 A.2d 1232, 1232-36 (Conn. App. 1994) (stating that failure to attach certificate is curable by timely amendment); Apa v. Rotman, 680 N.E.2d 801, 804 (Ill. App. 1997) (noting that the decision to dismiss medical malpractice complaint for failure to conform with expert certification requirement is within discretion of the trial court); Lombardo v. Seydow-Webber, 529 N.W.2d 702, 703 (Minn. App. 1995) (stating the court is to exercise discretion in deciding whether or not to dismiss a medical malpractice action for procedural irregularities).

139. These two states are significant because they both contain strong mandatory language that is particularly comparable to 9(j)'s language.

140. MINN. STAT. ANN. § 145.682, subd. 2-3 (West 1998).

experts that will testify at trial.[141] Further, the statute holds that failure to comply with the demand for expert certification requirements "results, upon motion, in *mandatory dismissal with prejudice* of each cause of action as to which expert testimony is necessary to establish a prima facie case."[142] The federal courts have interpreted this requirement strictly, holding that dismissal on procedural grounds follows from failure to comply with certification requirements.[143] Yet even though the statute says the dismissal with prejudice is mandatory, a plaintiff may still avoid dismissal for noncompliance in one of two ways. Upon a showing of excusable neglect, the court may extend the time limit for obtaining the expert certification.[144] Alternatively, if the plaintiff can demonstrate that the prima facie case may be proven without expert testimony, the expert certification requirement can be dispensed with altogether.[145] The Minnesota courts have recognized that "the penalty for noncompliance is harsh," and have held that, if a dismissal is warranted, it must be with prejudice.[146] The courts still retain broad discretion in deciding the preliminary issue, whether or not to dismiss the complaint.[147] Thus, the court may allow a plaintiff a great deal of leeway in complying with the expert certification even after the time

141. *See* MINN. STAT. ANN. § 145.682, subd. 3-4 (West 1998).

142. *Id.* at subd. 6 (emphasis added).

143. *See* Bellecourt v. United States, 784 F. Supp. 623, 636 (D. Minn. 1992). *Bellecourt* involved a former federal inmate who brought an action against his prison officials and the prison doctor alleging medical malpractice, cruel and unusual punishment, and civil rights violations. *See id.* at 626-27. The plaintiff suffered a heart attack and claimed that the prison officials and the physician ignored his requests for treatment. *See id.* at 627. The plaintiff's medical malpractice claim was dismissed with prejudice because he failed to file the expert affidavits in a timely manner, nor could he show that his neglect was excusable or that expert testimony was not necessary to establish negligence. *See id.* at 637.

144. *See id.* at 636.

145. *See id.*

146. Lombardo v. Seydow-Webber, 529 N.W.2d 702, 704 (Minn. App. 1995). In *Lombardo*, the plaintiff alleged medical malpractice for failure to detect fetal distress. *See id.* at 702. Six months after the commencement of the action, the plaintiff had not complied with the expert certification requirements. *See id.* The defendant doctors sought dismissal with prejudice due to the lack of certification compliance; the plaintiff sought a voluntary dismissal without prejudice. *See id.* The trial court granted the plaintiff's motion for dismissal without prejudice, concluding that Minnesota Rule of Civil Procedure 41.01(b), which provides voluntary dismissals are to be without prejudice, superseded the expert certification statute. *See id.* The issue on appeal was whether, in the absence of facts showing excusable neglect, a plaintiff could take a voluntary dismissal in order to avoid the dismissal with prejudice demanded by the expert certification statute. *See id.* The appellate court held that if a case is to be dismissed for failure to comply with the expert certification requirements, by operation of the statute it must be dismissed with prejudice. *See id.* at 705.

147. *See id.* at 704.

for compliance has technically expired.[148]

The Maryland statute also uses strong mandatory language.[149] Specifically, the statute says a medical malpractice claim "shall be dismissed, without prejudice, if the claimant fails to file a certificate of a qualified expert."[150] Unlike Rule 9(j), however, the Maryland statute contains a second mandate, ordering that the panel chairman "shall grant an extension" of 90 days to file the certificate if the statute of limitations has expired or if the failure to file was neither willful nor grossly negligent.[151] Although the courts are required to dismiss a complaint that fails to comply with the expert certification requirements, the Maryland legislature has established a safety net whereby a technical failure will not bar a litigant from pursuing her claim.[152]

While the expert certification statutes of both Minnesota and Maryland contain strong mandatory language, these statutes have been interpreted by the courts to prevent a plaintiff's claim from being decided on the basis of a technicality. Rule 9(j)'s wording simply does not allow for such a result. Although Rule 9(j) permits an extension of the statute of limitations, it states that such an extension may be granted upon a motion by the complainant "*prior* to the expiration of the applicable statute of limitations."[153] A plaintiff must therefore anticipate a statute of limitations problem and file for an extension before such a problem arises; unlike Minnesota and Maryland law, North Carolina's Rule 9(j) does not

148. *See id.* (holding that the court "exercises its discretion in deciding whether to dismiss a medical malpractice action for procedural irregularities"); *see also* Sorenson v. St. Paul Ramsey Med. Ctr., 457 N.W.2d 188, 190 (Minn. 1990) (stating that a trial court's dismissal of an action for procedural irregularity is only reversible upon a showing of abuse of discretion). To claim excusable neglect, the plaintiff must show that: (1) plaintiff has a reasonable case on the merits; (2) plaintiff has a reasonable excuse for his failure to meet the statutory time limits; (3) plaintiff proceeded with due diligence after notice of statutory time limitations; and (4) no substantial prejudice will result to the defendant by an extension. *See Bellecourt*, 784 F. Supp. at 636-37.

149. MD. CODE ANN., CTS. & JUD. PROC. § 3-2A-04(b)(1)(i) (1998).

150. *Id.*

151. *Id.* § 3-2A-04(b)(1)(ii). The Maryland statute requires claimants to file the expert certification to the Director of the State Board of Physician Quality Assurance and to the Medical and Chirurgical Faculty of the State of Maryland. *See id.* § 3-2A-04(a). An arbitration panel then hears the case. *See id.*

152. *See generally* Edward W. McCready Mem. Hosp. v. Hauser, 624 A.2d 1249, 1255-56 (Md. 1993) (holding that the Maryland legislature intended the 90-day extension to be granted automatically in lieu of dismissal).

153. N.C. R. Civ. P. 9(j) (emphasis added). The court should grant an extension to the statute of limitations upon a showing that good cause exists for the extension and the ends of justice would therein be served. *See id.*

provide a process for extending the certification requirements or remedying the defect after the action commences. While Maryland and Minnesota have cast their statutes in a manner that is consistent with the courts' traditional powers of discretion and the policy of liberal amendment, the North Carolina legislature has not followed their example.

Rule 9(j) appears to require North Carolina courts to dismiss complaints that fail to comply with its expert certification requirements. The result is the same when the plaintiff acts pro se, or when a dismissal without prejudice will still result in the claim's termination because the statute of limitations has run. The legislature has constructed Rule 9(j) to require a strict and literal reading,[154] and in so doing, it has stripped the courts of their powers of discretion in granting leave to amend.

This may ultimately be an undesirable result. Because there was no majority holding regarding whether 9(j) mandated dismissal, the question is still open. This Note asserts that plaintiffs who do not comply with Rule 9(j) in their original pleadings must have their cases dismissed entirely. Judge Timmons-Goodson raised valid concerns about the loss of trial court discretion and the injustice that may result from a literal reading of Rule 9(j).[155] All other states that employ malpractice claim procedural requirements have set up safety valves to ensure that a litigant's claim is not decided solely on technical grounds. North Carolina law does not provide a comparable mechanism. This result is contrary to the liberal amendment policy of the North Carolina Rules of Civil Procedure and prevents cases from being heard on the merits. In Judge Timmons-Goodson's words, "[s]uch discretion is best left in the quarter of the trial court."[156]

The General Assembly should revise Rule 9(j). Frivolous medical malpractice suits are a strain on the state's legal system that certainly should be discouraged, but Rule 9(j) does so at great cost. In seeking to prevent frivolous medical malpractice actions, the legislature has established a rule that not only strips the courts of their traditional equitable powers, but may also compromise the rights of individuals who have valid malpractice claims. Rule 9(j) needs a safety valve to assure that potentially meritorious complaints, filed near the end of the statute of limitations, are not permanently

154. *See* discussion *supra* notes 110-34 and accompanying text.

155. *See* discussion *supra* notes 49-64 and accompanying text.

156. *Keith*, 129 N.C. App. at 408, 499 S.E.2d at 204 (Timmons-Goodson, J., concurring in the result).

barred because of a technical 9(j) deficiency. The legislature could allow the courts to exercise their traditional discretionary powers and permit amendment of the complaint under Rule 15. The legislature also might retain the non-discretionary dismissal provision, but stipulate that, where necessary, a mandatory dismissal results in an automatic short term extension of the statute of limitations. Either of these potential solutions would be a vast improvement over the current Rule 9(j), which provides unsuspecting plaintiffs no recourse.

DANIEL BURT ARRINGTON

A Matter of (Statutory) Interpretation: North Carolina Recognizes the Functional Test for Corporate Taxation in *Polaroid Corp. v. Offerman*

In the world of American business, localism is largely a thing of the past. Nation-wide corporate chains have all but replaced neighborhood stores, and multi-state financial conglomerates now stand in the place of local banks.[1] As a result of corporate expansion, regional and national companies that derive income from business conducted in several states are subject to corporate taxation in each state that can claim a connection to the interstate activities.[2] The

1. The emergence of multi-state business in North Carolina, especially in the areas of finance and technology, is evident from both the influx of national corporations into the Research Triangle Park and the expansion of banking institutions in Charlotte to other states. *See* Chris Burritt, *North Carolina's Research Triangle Park: A Pioneer Turns 40*, ATLANTA J. & CONST., Feb. 21, 1999, at D1 ("Cisco, based in San Jose, Calif.; Lucent, based in Murray Hill, N.J.; and Nortel based in Brampton, Ontario, are pouring hundreds of millions of dollars into the Research Triangle region.... The investments ... are ... likely to lure other companies to the Research Triangle seeking to tap into the cutting-edge developments."); Ken Elkins, *Coast-to-Coast or Step-by-Step? Analysts Differ*, BUS. J. (Charlotte, N.C.), Jan. 22, 1999, at 53 (speculating about future out-of-state mergers by the Charlotte-based First Union Corporation); Ken Gepfert & John McKinnon, *Resilient State Economies Defy Gloomy Forecasts*, WALL ST. J., Apr. 7, 1999, at S1 (illustrating the corporate boom in North Carolina by stating that "Charlotte and the Raleigh-Durham area each have more than two million square feet of office space under construction, fueled by vacancy rates in the 7% range"); John Helyar, *Muscling In: Hard-Charging NCNB Seizes a Large Share of Banking in Texas*, WALL ST. J., Aug. 1, 1988, at 1 (discussing one of the early expansions that helped to make Charlotte-based NationsBank Corporation the largest financial institution in the southeast; NationsBank Corporation has since become BankAmerica Corporation); Wendy Hower, *City of Medicine Program Out to Tend Local Needs*, NEWS & OBSERVER (Raleigh, N.C.), Jan. 8, 1998, at 1B (describing how "[v]ideos produced by the City of Medicine Program have helped Durham attract dozens of corporations" and noting that a large Japanese pharmaceutical company "set up shop in Research Triangle Park in November [1997] to make a drug to treat Alzheimer's disease"); Michael E. Kanell, *Industry Is Growing, but Isn't Yet an Economic Force*, ATLANTA J. & CONST., Aug. 14, 1998, at F2 ("In North Carolina, where the Research Triangle Park has vied for status as a high-tech center, the North Carolina Biotechnology Center ... has spent much of its energy luring biotech companies from elsewhere to either move headquarters or do their manufacturing in North Carolina."); Irwin Speizer, *Wall Street, Charlotte-Style*, NEWS & OBSERVER (Raleigh, N.C.), Jan. 15, 1999, at 1D (describing the purchase of Montgomery Securities of San Francisco by BankAmerica Corporation and the merger of First Union with Wheat First Butcher Singer of Richmond).

2. *See* Allied-Signal, Inc. v. Director, Div. of Taxation, 504 U.S. 768, 772 (1992). A state has the power to tax a non-domiciliary corporation's income derived from multi-state activity without violating either the Due Process or Commerce Clauses of the Constitution, so long as there is a " ' "minimal connection" between the interstate

states' ability to tax corporate income to which they are connected can burden a large corporation with severe "multiple taxation."[3] In an effort to address the problem of multiple taxation and to create a uniform method for allocating corporate income among the states entitled to tax a portion thereof, the National Conference of Commissioners on Uniform State Laws and the American Bar Association approved the Uniform Division of Income for Tax Purposes Act ("UDITPA" or "Act")[4] in 1957 and recommended the Act for adoption by the states.[5]

UDITPA establishes a uniform method for allocating and apportioning the income of multi-state corporations. The Act is designed to simplify the reporting of income and the collection of taxes and to make certain that 100% of a multi-state company's income, no more and no less, is taxable by the eligible states.[6] To those ends UDITPA distinguishes between business and non-business income.[7] The Act apportions business income among the states in

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activities and the taxing State.' " *Id.* (quoting Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 436-37 (1980) (quoting Moorman Mfg. Co. v. Bair, 437 U.S. 267, 273 (1978))).

3. *See* Frank M. Keesling & John S. Warren, *California's Uniform Division of Income for Tax Purposes Act*, 15 UCLA L. REV. 156, 156 (1967). The possibility of multiple taxation arises from the fact that, among the states possessing the constitutional power to tax a portion of a particular multi-state corporation's income, "the conceptions of source [of income] and the methods of computing income attributable to sources within the respective states vary greatly." *Id.* at 156 (citing REPORT OF THE SPECIAL SUBCOMMITTEE ON STATE TAXATION OF INTERSTATE COMMERCE OF THE COMMITTEE OF THE JUDICIARY, H.R. DOC. NO. 88-1480 (1964)); *see also* Marissa R. Arrache, Comment, *Factor Representation in the Apportionment of Income from Intangibles*, 36 SANTA CLARA L. REV. 485, 496 (1996) ("The threat of double taxation exists when jurisdictions differ in their approach to taxation, for instance, when allocation or apportionment is used inconsistently across jurisdictions.").

4. 7A U.L.A. 356 (1995) [hereinafter UDITPA].

5. *See* Walter Hellerstein, *Construing the Uniform Division of Income for Tax Purposes Act: Reflections on the Illinois Supreme Court's Reading of the "Throwback" Rule*, 45 U. CHI. L. REV. 768, 769 (1978).

6. *See id.*; Ryan Pace, Note, *A Review of Kansas Tax Law Governing the Allocation and Apportionment of Income for Multistate Corporations Doing Business in Kansas*, 37 WASHBURN L.J. 703, 706-07 (1998); Robert Khuon Wiederstein, Comment, *California and Unitary Taxation: The Continuing Saga*, 3 IND. INT'L & COMP. L. REV. 135, 138 (1992); *see also* Keesling & Warren, *supra* note 3, at 156 (describing California's "almost verbatim" adoption of UDITPA and noting that the objectives of the Act are "(1) to promote uniformity in allocation practices among the 38 states which impose taxes on or measured by the income of corporations, and (2) to relieve the pressure for congressional legislation in [the field of state corporate taxation]").

7. *See* UDITPA § 1; *see also* Keesling & Warren, *supra* note 3, at 163 (noting that "the Uniform Act sharply distinguishes between business income which is to be apportioned by formula and nonbusiness income which is to be allocated specifically to the situs of the property which produces the income or to the commercial domicile of the

which the corporation does business—using a formula based upon the amount of the company's property, payroll, and sales attributable to each state—and allocates non-business income entirely to the state or states "that are considered to be the source of the income, often on the basis of the location of the property that gave rise to the income or on the basis of the taxpayer's commercial domicile."[8] UDITPA defines business income as "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations."[9] The Act broadly defines non-business income as "all income other than business income."[10] Thus, the decision whether to construe income as business or non-business income is an important one for states claiming a connection with a company's activities.[11]

There are two tests for making the determination between business and non-business income: the transactional test and the functional test.[12] State supreme courts have disagreed over whether

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recipient").

8. 1 JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION: CONSTITUTIONAL LIMITATIONS AND CORPORATE INCOME AND FRANCHISE TAXES ¶ 9.02 (3d ed. 1998); *see also* UDITPA §§ 4-9 (governing the allocation of business and non-business income); Peter L. Faber, *State and Local Income and Franchise Tax Aspects of Corporate Acquisitions*, TAX STRATEGIES FOR CORPORATE ACQUISITIONS, DISPOSITIONS, SPIN-OFFS, JOINT VENTURES, FINANCINGS, REORGANIZATIONS & RESTRUCTURINGS at 91, 100-01 (PLI Tax Law & Practice Handbook Series No. J-423, 1998) (noting that states usually allocate non-business income entirely to the corporation's commercial domicile); Keesling & Warren, *supra* note 3, at 164-67 (describing the process of allocation for non-business income and the formula for the apportionment of business income).

9. UDITPA § 1(a).

10. *Id.* § 1(e).

11. *See generally* James H. Peters, *Revised Multistate Tax Commission Regulations Define "Business" and "Nonbusiness" Income*, 40 J. TAX'N 122, 122-24 (1974) (addressing problems in applying the UDITPA definitions of business and non-business income in light of the regulations issued by the Multistate Tax Commission). In order to maximize its revenues, the state in which a multi-state corporation has its commercial domicile will attempt to construe the company's gains as non-business income so that the income will be allocated solely to it, thereby enabling the state to tax the full amount of the gain. *See* 1 HELLERSTEIN & HELLERSTEIN, *supra* note 8, ¶ 9.02. Conversely, a non-domiciliary state will claim that the company's gain is business income so that it can tax the portion of that income attributable to the corporation's activities within its borders. *See id.* ("Under UDITPA and similar taxing regimes, all 'business income' is apportioned; all 'nonbusiness income' is allocated." (citing UDITPA §§ 4, 9)).

12. *See* 1 HELLERSTEIN & HELLERSTEIN, *supra* note 8, ¶ 9.05[2]; Faber, *supra* note 8, at 107; Dan A. Lisonbee, *State of the Law of Nonbusiness Gain*, 7 J. ST. TAX'N. 333, 334 (1989). Under the transactional test, a corporation's gain is characterized as business income if the company "regularly engages in the type of transaction producing the gain."

UDITPA defines business income by using only the transactional test or by employing both the transactional and functional tests.[13] In *Polaroid Corp. v. Offerman*,[14] the North Carolina Supreme Court interpreted the North Carolina version of UDITPA and held, in a matter of first impression, that the statute incorporates both the transactional and functional tests into its definition of business income.[15]

This Note discusses the facts of *Polaroid*, its history in the lower courts, and the opinion of the North Carolina Supreme Court.[16] The Note then examines the history of UDITPA and traces the split among state supreme courts over whether the Act includes the functional test in addition to the transactional test.[17] After summarizing the basic tenets of statutory interpretation,[18] the Note compares the North Carolina Supreme Court's interpretation of UDITPA to the decisions of other states and examines the court's application of the functional test to the facts of *Polaroid*.[19] The Note also briefly considers the court's disposition of Polaroid's constitutional arguments.[20] Finally, the Note emphasizes the potential significance of the court's holding for multi-state corporations doing business in North Carolina.[21]

The tax controversy in *Polaroid* provides the coda to a complex patent dispute that began more than a quarter century ago in Massachusetts between two titans of the photography industry.[22] In 1972, Polaroid Corporation, a company long at the forefront of "one-step photography," introduced the SX-70,[23] the most sophisticated

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Faber, *supra* note 8, at 108. Under the functional test, however, a corporation's gain is treated as business income as long as corporate assets "were used to generate business income, even if their sale is *not* a regular incident of the business." *Id.* at 110 (emphasis added). The functional test, therefore, allows for a broader spectrum of gain to be characterized as business income. *See* Lisonbee, *supra*, at 335 ("The extraordinary nature or infrequency of a transaction is irrelevant under [the functional] test.").

13. *See* Faber, *supra* note 8, at 107-15; *infra* notes 107-48 and accompanying text.

14. 349 N.C. 290, 507 S.E.2d 284 (1998), *cert. denied*, 119 S. Ct. 1576 (1999).

15. *See id.* at 301, 507 S.E.2d at 293.

16. *See infra* notes 22-59 and accompanying text.

17. *See infra* notes 60-99 and accompanying text.

18. *See infra* notes 100-06 and accompanying text.

19. *See infra* notes 107-87 and accompanying text.

20. *See infra* notes 188-91 and accompanying text.

21. *See infra* notes 192-93 and accompanying text.

22. *See Polaroid*, 349 N.C. at 292, 507 S.E.2d at 287 (describing the beginnings of the conflict between Polaroid and Kodak).

23. *See* Polaroid Corp. v. Eastman Kodak Co., 641 F. Supp. 828, 831 (D. Mass. 1985) (describing the SX-70 as "an elegant, highly sophisticated camera and film system").

one-step camera-and-film system on the market at the time.[24] The camera was a major innovation in photography because it allowed the user to obtain a finished color print by simply focusing the camera and taking the snapshot.[25] Throughout the course of developing the SX-70, Polaroid secured patents for numerous innovations pertaining to both the film and camera.[26]

During this period, Polaroid also informed its negative supplier, Eastman Kodak Company, of the "radically new film" that was the prototype of the SX-70.[27] The two companies, which had signed an agreement in 1957 under which Polaroid disclosed certain aspects of its color technology in exchange for Kodak supplying negative material for earlier cameras,[28] discussed but never completed an agreement for licensing and supply of film for the SX-70.[29] In April 1969, Kodak notified Polaroid that it intended to terminate the 1957 agreement.[30]

At the time of the termination notification, Kodak already had begun its own campaign to launch an instant camera-and-film system.[31] In 1972, however, after purchasing large quantities of the new SX-70 for testing purposes, Kodak's management declared that its own product, "as it then existed, was only 'marginally acceptable' " and, thus, should be abandoned in favor of a new design that would approach the standard set by Polaroid.[32] Kodak's change in direction eventually led to the company's unveiling of an instant camera-and-film system in April 1976.[33] Polaroid opposed the new product line,

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24. *See id.* at 830-31. Unlike other cameras at that time, the SX-70 contained a motor and a gear train designed to eject the film after processing. *See id.* In addition, the film used for the camera developed upon exposure to daylight. *See id.*

25. *See id.* at 831.

26. *See id.* Among the numerous filings made by Polaroid in connection with the invention of the SX-70 were patents for a "polymeric acid layer for stabilizing color diffusion transfer film units" and a "detachable spread roller housing arrangement" that comprised part of the SX-70's front-loading film mechanism. *Id.* at 837, 873-74.

27. *Id.* at 831.

28. *See id.* (noting that, until 1963, the two companies periodically conducted research meetings in furtherance of the agreement).

29. *See id.*

30. *See id.*

31. *See id.* Kodak's campaign consisted of many early projects that were abandoned by the company after failing to meet the standard set by the Polaroid products. *See id.* at 831-32 (describing Kodak's failed projects such as the "Lanyard" camera, which required the user to eject the film manually by pulling on a lanyard device).

32. *Id.* at 832 (explaining that Kodak's "Lanyard camera was too large by comparison to that marketed by Polaroid").

33. *See id.* (describing Kodak's introduction of the EK-4 and EK-6 cameras and PR-10 film).

however, and sued Kodak under 35 U.S.C. § 271(a)[34] to recover damages and to enjoin Kodak from infringing Polaroid patents relating to the instant-camera technology.[35]

In 1985, nine years after Polaroid filed its lawsuit, the United States District Court for Massachusetts ruled that several of Polaroid's patents had been violated, and the court enjoined Kodak from further infringement.[36] In 1990, after a separate trial and a complex and lengthy opinion on damages issues, the district court held that Kodak had not willfully infringed the patents and, in accordance with 35 U.S.C. § 284,[37] awarded Polaroid more than $900 million in compensatory damages and interest.[38] Because the court did not find Polaroid's case to be "exceptional" under 35 U.S.C. § 285, it refused to award attorney's fees.[39] The following year, the district court issued a second opinion that acknowledged several mistakes in its prior damage calculations[40] and reduced Polaroid's damages by some $36 million, leaving the company with a final award of $873 million.[41]

Polaroid did not utilize the proceeds from the patent-

34. 35 U.S.C. § 271(a) (1994) (stating that "whoever without authority makes, uses or sells any patented invention, within the United States during the term of the patent therefor [sic], infringes the patent").

35. *See Polaroid*, 349 N.C. at 292, 507 S.E.2d at 287 (describing the lawsuit filed by Polaroid against Kodak in 1976).

36. *See Polaroid*, 641 F. Supp. at 876-78 (describing the judgment of the court as to Polaroid's various patent infringement claims and enjoining Kodak from further infringement by "manufacture, use or sale of PR-10 film and EK-4 and EK-6 cameras"). The court declined to rule on the amount of damages to be awarded, choosing to delay its determination until completion of a subsequent trial on the issue. *See id.*

37. 35 U.S.C. § 284. Section 284 states:

> Upon finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement but, in no event less than a reasonable royalty for the use of the invention made by the infringer, together with interest and costs as fixed by the court.
>
> When the damages are not found by a jury, the court shall assess them. In either event the court may increase the damages up to three times the amount found or assessed.

Id.

38. *See id.*

39. *See id.* Section 285 states that the "court in exceptional cases may award reasonable attorney fees to the prevailing party." *Id.* To award attorney fees under the provision, "the trial court must have found unfairness, bad faith or inequitable or unconscionable conduct on the part of the losing party." Uniflow Mfg. Co. v. King-Seeley Thermos Co., 428 F.2d 335, 341 (6th Cir. 1970).

40. Polaroid Corp. v. Eastman Kodak Co., 17 U.S.P.Q.2d 1711, 1711 (D. Mass. 1991).

41. *See id.* at 1714. The revised award consisted of $240,467,854 in reasonable royalties, $233,055,432 in lost profits, and $435,635,685 in interest. *See id.* Polaroid ultimately collected $924,526,554 in damages because of additional post-judgment interest. *See Polaroid*, 349 N.C. at 292 n.1, 507 S.E.2d at 287 n.1.

infringement award in its regular course of business in North Carolina, but instead used the money to pay taxes, to repay debt, to provide bonuses to its employees, and to redeem shares of its stock.[42] In 1991, Polaroid classified the judgment award as "non-business income" for North Carolina corporate income tax purposes, choosing instead to allocate the entire award to its commercial domicile of Massachusetts.[43] The North Carolina Department of Revenue disagreed with Polaroid's classification of the damages award and characterized it instead as "business income," thereby increasing Polaroid's North Carolina tax liability by nearly $500,000.[44] After the Secretary of Revenue upheld the Department's classification in an administrative hearing, Polaroid paid the increased tax and filed a refund action under North Carolina General Statutes section 105-241.4.[45]

In December 1996, Polaroid and the Secretary of Revenue filed cross motions for summary judgment on the refund issue in Wake County Superior Court, and the trial judge granted the Secretary's motion but denied Polaroid's.[46] Subsequently, the North Carolina Court of Appeals reversed the trial court, holding that because the damages award was properly classified as non-business income, Polaroid was entitled to a refund.[47] In assessing Polaroid's classification of its patent-suit award as non-business income, the court of appeals interpreted North Carolina General Statutes section 105-130.4, which defines business income as "income arising from transactions and activity in the regular course of the corporation's trade or business and includes income from tangible and intangible property if the acquisition, management, and/or disposition of the property constitute integral parts of the corporation's regular trade or business operations."[48] In focusing specifically on the words "and includes," the court anchored its interpretation of section 105-130.4 with the premise that any " 'doubt as to the meaning of a statute levying a tax . . . is to be strictly construed against the State and in

42. *See Polaroid*, 349 N.C. at 292-93, 507 S.E.2d at 287.

43. *See id.*

44. *See id.*

45. *See id.* Section 105-241.4 explains that a "taxpayer who has obtained an administrative review . . . and who is aggrieved by the decision of the Board may . . . pay the tax and bring a civil action for its recovery." N.C. GEN. STAT. § 105-241.4 (1997).

46. *See Polaroid*, 349 N.C. at 293, 507 S.E.2d at 288.

47. *See* Polaroid Corp. v. Offerman, 128 N.C. App. 422, 427, 496 S.E.2d 399, 402, *rev'd*, 349 N.C. 290, 507 S.E.2d 284 (1998), *cert. denied*, 119 S. Ct. 1576 (1999).

48. N.C. GEN. STAT. § 105-130.4(a)(1) (1997); *see also Polaroid*, 128 N.C. App. at 424-26, 496 S.E.2d at 401-02 (discussing the statute).

favor of the taxpayer.' "[49] Drawing upon the North Carolina Supreme Court decision of *Miller v. Johnston*,[50] the court of appeals interpreted "and includes" to mean "and some examples are."[51] Thus, the court concluded that section 105-130.4 posits only one definition of business income—income arising from transactions performed in the regular course of business—and that the language describing income derived from property is merely illustrative.[52] After determining that the parties agreed that the damages award was not gained through Polaroid's regular course of business, the court of appeals held that Polaroid had correctly classified the award under section 105-130.4 and remanded the case for summary judgment in favor of Polaroid.[53]

In April 1998, the North Carolina Supreme Court granted a petition for discretionary review filed by the Secretary of Revenue to determine whether Polaroid's patent-suit award constituted business or non-business income under section 105-130.4.[54] In a unanimous opinion written by Justice Wynn,[55] the court reversed the court of appeals and held that the Secretary properly classified Polaroid's damages award as business income.[56] Because North Carolina's corporate tax provision derives from UDITPA, the court centered its analysis of the North Carolina statute around whether the Act includes both the functional test and the transactional test within its definition of business income.[57] In making its determination on a matter of first impression, the court based its interpretation of section 105-130.4 on the "canons of statutory construction, pertinent administrative rules, and the legislative history surrounding both the

49. *Polaroid*, 128 N.C. App. at 424, 496 S.E.2d at 400 (quoting *In re* Clayton-Marcus Co., 286 N.C. 215, 219, 210 S.E.2d 199, 202 (1974)).

50. 173 N.C. 62, 69, 91 S.E. 593, 597 (1917) (noting that "includes" is not synonymous with the phrase "in addition to").

51. *Polaroid*, 128 N.C. App. at 425, 496 S.E.2d at 401.

52. *See id.*

53. *See id.* at 427, 496 S.E.2d at 402.

54. *See Polaroid*, 349 N.C. at 293, 507 S.E.2d at 288.

55. Judge Wynn served on the North Carolina Court of Appeals from 1990 until he was appointed to the North Carolina Supreme Court in fall 1998 by Governor Jim Hunt to fill the seat vacated by Justice Webb. *See Hunt Fills High-Court Vacancy*, NEWS & OBSERVER (Raleigh, N.C.), Sept. 26, 1998, at A3. Soon after his appointment, however, Justice Wynn lost the November 1998 election by a narrow margin to George Wainright. *See Gaston Glitch Puts Two Court Races in Limbo*, WILMINGTON MORNING STAR, Nov. 6, 1998, at 1B. After the election, the Governor reappointed Judge Wynn to the court of appeals. *See* John Wagner, *Defeated Judges Named to Court*, NEWS & OBSERVER (Raleigh, N.C.), Dec. 24, 1998, at A3.

56. *See Polaroid*, 349 N.C. at 315, 507 S.E.2d at 301.

57. *See id.* at 298, 507 S.E.2d at 290.

Act itself and UDITPA."[58] The court was also guided by the decisions of other state supreme courts that had addressed the issue.[59]

The constitutional issues implicated by apportionment schemes such as UDITPA arise from the general principle that a state may not tax income that is earned beyond its borders.[60] In the case of a company that does business in several states, however, the task of accounting separately for the company's activities within each state claiming the right to tax can be inexact or unfeasible.[61] In an effort to provide a coherent solution to this problem, plans such as UDITPA attribute a portion of a corporation's total income to the taxing state by means of formulae that give reasonable weight to the company's in-state and out-of-state activities.[62] Nevertheless, the measures have been attacked as unconstitutional under both the Commerce Clause[63]

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58. *Id.* at 297, 507 S.E.2d at 290; *see also infra* notes 156-82 and accompanying text (analyzing the court's methodology for interpreting section 105-130.4).

59. *See Polaroid*, 349 N.C. at 297-301, 507 S.E.2d at 290-93 (citing Texaco-Cities Serv. Pipeline Co. v. McGaw, 695 N.E.2d 481, 485 (Ill. 1998); Kewanee Indus. v. Reese, 845 P.2d 1238, 1242 (N.M. 1993); Simpson Timber Co. v. Department of Revenue, 953 P.2d 366, 370 (Or. 1998); Laurel Pipe Line Co. v. Commonwealth Bd. of Fin. & Revenue, 642 A.2d 472, 475 (Pa. 1994)).

60. *See* ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 315 (1981).

61. *See* E. George Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups*, 25 TAX L. REV. 171, 171 (1970); *see also* Jerome R. Hellerstein, *The Unitary Business Principle and Multicorporate Enterprises: An Examination of the Major Controversies*, 27 TAX EXECUTIVE 313, 316-17 (1975) (arguing that separate accounting is defective, inter alia, because it is "fearfully expensive"). The United States Supreme Court has noted that "separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale." Mobil Oil Corp. v. Comm'r of Taxes, 445 U.S. 425, 438 (1980) (citing Butler Bros. v. McColgan, 315 U.S. 501, 508-09 (1942)). Considerations such as these have led the Court to hold that separate accounting among the states, although useful for internal auditing purposes, is not constitutionally required for state taxation of a corporation's multi-state income. *See id.*

62. *See* Rudolph, *supra* note 61, at 171; *see also infra* notes 82-88 and accompanying text (describing the formulae for apportionment and allocation set forth in UDITPA).

63. U.S. CONST. art. I, § 8, cl. 3 (bestowing upon Congress the power to "regulate Commerce with foreign Nations, and among the several States, and with Indian Tribes"). The Commerce Clause pertains to state taxation because of the "dormant Commerce Clause" principle. *See* Kathryn L. Moore, *State and Local Taxation of Interstate and Foreign Commerce: The Second Best Solution*, 42 WAYNE L. REV. 1425, 1437 (1996). Although the Commerce Clause does not place express limitations on the taxing power of the states, the "negative implications" in the clause have often provided a basis for the regulation of state and local taxation of interstate and foreign commerce. *See id.* at 1436. In order to comport with the Commerce Clause, a state tax that applies to interstate commerce must "(1) apply to an activity (property or person) with a substantial nexus to the taxing state; (2) be fairly apportioned; (3) avoid discrimination against interstate or international commerce; and (4) be fairly related to services or benefits provided by the state." RONALD D. ROTUNDA & JOHN E. NOWAK, TREATISE ON CONSTITUTIONAL

and the Due Process Clause.[64]

The United States Supreme Court has answered constitutional challenges to apportionment formulae for the taxation of multi-state corporations by upholding the plans as long as the state establishes "a 'minimal connection' between the interstate activities and the taxing State."[65] The Court has also held that the state must show a rational relationship between the income attributed to it and the intrastate value of the corporate enterprise.[66] The Court's decisions concerning the constitutionality of state taxation of multi-state corporate income describe what has become known as the unitary business principle.[67] This principle prescribes that a state does not violate the Constitution

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LAW: SUBSTANCE AND PROCEDURE § 13.4 (2d ed. Supp. 1999).

64. U.S. CONST. amend. XIV, § 1 ("No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law. . . ."). Courts will often frame their analysis of a state tax on interstate commerce in due process terms when attempting to determine "the question of whether the multistate business' income can be 'fairly' attributed to the in-state business activities in the taxing state." ROTUNDA & NOWAK, *supra* note 63, § 13.4. According to some commentators, however, the Due Process Clause adds "little, if anything," to the Commerce Clause analysis. *Id.* ("The due process requirement of a state having a fair connection to the taxed activity may be seen as merely a part of the basic commerce clause restrictions on state or local taxation of interstate or international commerce.").

65. *Mobil*, 445 U.S. at 436-37 (quoting Moorman Mfg. Co. v. Bair, 437 U.S. 267, 272-73 (1978)); *see also* Walter Hellerstein, *State Taxation of Corporate Income from Intangibles*: Allied-Signal *and Beyond*, 48 TAX L. REV. 739, 745 (1993) (noting that the "minimum connection" requirement is derived from the "virtually axiomatic proposition" that the state's power to tax a multi-state corporation's activities stems from the benefits, opportunities, and protections that the state provides to the company). Professor Hellerstein asserts that in the absence of a link between the state and the corporation's activities, the state lacks the power to tax because "it has not 'given anything for which it can ask return.' " Hellerstein, *supra*, at 745 (quoting Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940)).

66. *See Mobil*, 445 U.S. at 436-37.

67. *See, e.g.*, Allied-Signal, Inc. v. Director, Div. of Taxation, 504 U.S. 768, 778, 781 (1992) (stating that the unitary business principle is necessary because the value of a multi-state corporation stems from "the enterprise as a whole," rather than from the parts of the business "that happen to be located within a State's borders" and noting that the indicia of a unitary business are "(1) functional integration; (2) centralization of management; and (3) economics of scale"); *Mobil*, 445 U.S. at 436-42 (describing Mobil's business as unitary and holding that Mobil's "foreign-source dividends have not been shown to be exempt, as a matter of due process, from apportionment for state income taxation by the State of Vermont"); Butler Bros. v. McColgan, 315 U.S. 501, 509 (1942) (upholding a California apportionment scheme as a proper reflection of the "just proportion of the profits earned by [Butler Brothers] from [its] unitary business"). In the context of a corporation having affiliates in several states, the key factors in determining whether the corporation's business is unitary are the extent to which the related businesses are integrated and the amount of control exerted by the parent corporation over the affiliates. *See The Supreme Court, 1981 Term*, 96 HARV. L. REV. 86, 89-91 (1982).

by taxing a corporation's income—even if that income can be attributed to another state by means of separate accounting—as long as the company's activities inside and outside of the tax-imposing state form part of a "single unitary business."[68] The unitary business principle, therefore, provides the constitutional foundation for apportionment devices such as UDITPA.[69]

In 1957, the National Conference of Commissioners on Uniform State Law and the American Bar Association approved UDITPA and recommended its adoption by the states.[70] The goal of UDITPA is to foster uniformity among the states in the taxation of multi-state businesses.[71] Specifically, the Act seeks to protect multi-state companies from "arbitrary tax assessments" and to minimize double taxation of interstate and foreign commerce.[72] As a means of promulgating the principles of tax uniformity espoused in UDITPA, the National Association of Attorneys General and the National Legislative Conference, working together as the Council of State Governments, enacted the Multistate Tax Compact ("Compact")[73] in 1966.[74]

The Compact reflects the purposes of UDITPA,[75] and its

68. *Mobil*, 445 U.S. at 438. Under the unitary business principal, in order for a company to challenge successfully a state's apportioned tax, the company must prove that the income was derived from a "discrete business enterprise" conducted in a separate state. *Id.* at 439.

69. *See Allied-Signal*, 504 U.S. at 786 (noting that UDITPA "may be quite compatible with the unitary business principle" (citing Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 167 (1983))); Hellerstein, *supra* note 65, at 751-53 (noting that "UDITPA's definition of apportionable business income is no different in substance from the Court's definition of income arising from a unitary business"). *But see* Walter Hellerstein, *State Income Taxation of Multijurisdictional Corporations, Part II: Reflections on* ASARCO *and* Woolworth, 81 MICH. L. REV. 157, 184-87 (1983) (describing two of the Court's pre-*Allied-Signal* decisions that overturned state apportionments under UDITPA because the apportionments overstepped the unitary business principle).

70. *See* Hellerstein, *supra* note 5, at 769; Arthur D. Lynn, Jr., *The Uniform Division of Income for Tax Purposes Act*, 19 OHIO ST. L.J. 41, 41 (1958).

71. *See* Wiederstein, *supra* note 6, at 138; Lynn, *supra* note 70, at 42 (noting that UDITPA might be viewed as a "step forward" by persons concerned about state tax uniformity).

72. *See* Wiederstein, *supra* note 6, at 138.

73. 1 All St. Tax Guide (CCH) ¶¶ 701-783 (1994) [hereinafter Tax Guide]; UDITPA §§ 1-9.

74. *See* Tax Guide ¶ 551.

75. The MTC declares that its purposes are to:

1. Facilitate proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.

2. Promote uniformity or compatibility in significant components of tax systems.

guidelines for allocation and apportionment of a corporation's multistate income reproduce the UDITPA mandates almost verbatim.[76] In fact, the Compact provides the corporate taxpayer with the option of using the UDITPA formulae to apportion or allocate income between states.[77] The Multistate Tax Commission oversees and coordinates the Compact,[78] and states that choose to adopt the Compact as part of their statutory law comprise the membership of the Commission.[79] In addition, states that have not formally adopted the Compact in their statutes but that support its goal of uniformity in apportionment may join the Commission as associate members.[80] Indeed, the majority of states have demonstrated their support of the principles set forth in UDITPA through their affiliation with the Multistate Tax Commission.[81]

UDITPA centers the choice between allocation and apportionment of income on the question of whether the income at issue is business or non-business income. The Act defines business income as "income arising from transactions and activity in the regular course of the taxpayer's trade or business ... includ[ing] income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations."[82] UDITPA broadly defines non-business income as "all income other than business income."[83] The Act apportions business income between eligible states by using a formula based upon the company's property,[84] payroll,[85] and sales[86] both inside and outside of the taxing

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3. Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.

4. Avoid duplicative taxation.

Id. ¶ 701.

76. *See id.* ¶ 559.

77. *See id.* ¶ 556.

78. *See id.* ¶ 554.

79. *See id.* ¶ 564. At present, 20 states, as well as the District of Columbia, have joined the Commission as members. *See id.*

80. *See id.* ¶ 565. Nineteen states, including North Carolina, form the associate membership of the Commission. *See id.*

81. *See* 1 HELLERSTEIN & HELLERSTEIN, *supra* note 8, ¶ 9.05[1][a].

82. UDITPA § 1(a).

83. *Id.* § 1(e).

84. *See id.* § 10 (stating that the property factor is represented by a fraction with a numerator composed of "the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period" and a denominator derived from "the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period").

85. *See id.* § 13 (stating that the payroll factor is a fraction in which the numerator represents the total amount of compensation paid by the company to its employees in the

state.[87] UDITPA allocates non-business income, however, solely to the state to which the income is most closely associated, which is often the state of the company's commercial domicile.[88] Thus, for states claiming the right to tax the income of a multi-state company, the classification of the income as business or non-business takes on primary importance.[89]

Two tests have emerged for determining whether a corporation's income should be classified as business or non-business income for purposes of UDITPA. Under the transactional test, the corporation's gain is business income if it was produced by a type of transaction in which the company regularly engages in its normal course of business.[90] A variety of factors influence the determination concerning whether the enterprise from which the income was derived is a regular part of the company's business.[91] Whereas the

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taxing state and in which the denominator represents the total compensation paid by the company in its operation as a whole).

86. *See id.* § 15 ("The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in [the taxing] state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.").

87. *See generally* Lynn, *supra* note 70, at 46-52 (describing the apportionment formulae for business income under UDITPA).

88. *See* UDITPA §§ 4-8; *see also* Lynn, *supra* note 70, at 43-46 (discussing the allocation formulae for non-business income derived from rents, tangible royalties, capital gains, interest, dividends, and patent and copyright royalties). A corporation's commercial domicile—as opposed to its legal domicile, which is the business's "jurisdiction of incorporation"—is the state where the company has its "principal place of business." HARRY G. HENN, LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 81 (2d ed. 1983); *see also* 1 HELLERSTEIN & HELLERSTEIN, *supra note* 8, ¶ 9.03[2] ("In the context of state corporate income taxation, the corporation's 'commercial domicile'—the principal place from which the corporation's business is directed—gradually replaced the corporation's 'legal domicile'—the state of its incorporation—as the situs to which income was assigned under the *mobilia* principle." (citing UDITPA § 1(g))). The concept of allocating income to a corporation's commercial domicile originates from the ancient legal doctrine of *mobilia sequunter personam*, or " 'movables follow the person,' " which required that movable property, whether tangible or intangible, be taxed at the owner's domicile. *Id.* ¶ 9.03[1]. In fact, the *mobilia* rule underpins the commercial domicile doctrine, which states that where a corporation merely keeps its formal corporate documents in its state of incorporation while managing the corporate business in another state, the latter state should have the power to tax the corporation's intangibles. *See id.* ¶ 9.03[2] (citing Wheeling Steel Corp. v. Fox, 298 U.S. 193, 211-12 (1936)).

89. *See supra* note 11 and accompanying text (describing the importance of the distinction between non-business and business income).

90. *See* Faber, *supra* note 8, at 108.

91. The factors considered in applying the transactional test include: (1) whether sale of the property was part of the company's primary business activity; (2) whether similar sales by the company were common, although not a normal business activity; (3) whether the sales were frequent or infrequent; (4) whether the proceeds from the sale were dispersed in liquidation or reinvested in the company; (5) whether the sale was instigated under extraordinary circumstances; and (6) whether the size of the transaction was

transactional test is a relatively narrow test that examines the nature of the income-producing transaction based upon the company's general business practices, the functional test is a broader test that classifies gain as business income based on the nature of the asset from which the gain was derived.[92] Consequently, the functional test characterizes gain as business income, regardless of whether the transaction was a regular part of the corporation's business, as long as the asset was used by the company to generate business income.[93]

Proponents of the transactional and functional tests both claim that the tests are derived from the definition of business income found in UDITPA.[94] The transactional test is based upon the first clause of the business income definition.[95] Those who interpret UDITPA to contain only the transactional test view the second clause, beginning after the "and includes" language, as merely illustrative of the first.[96] Advocates of the functional test, however, argue that the second clause of the definition establishes an alternative, independent test for business income.[97] State supreme courts that have reviewed their state's version of the UDITPA definition of business income have differed in their interpretations,[98] with some courts holding that the statute contains only the transactional test and other courts holding that the statute embodies both the transactional and functional tests.[99]

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congruous with the normal transactions of the business. *See id.* at 109-10.

92. *See id.* at 110.

93. *See id.*

94. *See* UDITPA § 1(a) (stating that business income "means income arising from transactions and activity in the regular course of the taxpayer's trade or business *and includes* income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations" (emphasis added)).

95. *See id.*

96. *See Polaroid*, 349 N.C. at 295, 507 S.E.2d at 289; *see also* Lisonbee, *supra* note 12, at 335 (describing the second clause of the business income definition as "clarifying language of the transactional test, which must be satisfied along with the transactional test"); Maxwell A. Miller & Randy M. Grimshaw, *Reach Out and Tax Someone: State Taxation of Income from the Sale of Intangibles*, UTAH B.J., June-July 1995, at 12, 15 (criticizing the functional test as being contrary to the wording of the UDITPA and praising the transactional test for its "fidelity to statutory language").

97. *See* Faber, *supra* note 8, at 111 ("States adopting this interpretation hold that income will be business income if it meets either the transactional or the functional test.").

98. *See generally* Larry D. Schaefer, Annotation, *Construction and Application of Uniform Division of Income for Tax Purposes Act*, 8 A.L.R.4th 934, 939-43 (1981 & 1998 Supp.) (comparing different state courts' interpretations of UDITPA and the Act's definition of business income).

99. *Compare* Phillips Petroleum Co. v. Iowa Dep't of Revenue & Fin., 551 N.W.2d 608, 610 (Iowa 1993) (holding that the test for business income under an Iowa statute "is

Before comparing the differing state interpretations of UDITPA, it is helpful to review briefly the fundamental principles of statutory interpretation.[100] The cardinal principle of statutory interpretation is to give effect to the meaning and intent of the legislature.[101] The proper starting point for this endeavor is a reading of the statutory language itself.[102] Furthermore, as long as such an interpretation is

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basically transactional"), *In re* Appeal of Chief Indus., Inc., 875 P.2d 278, 286 (Kan. 1994) (holding that a Kansas uniform taxation statute applies only the transactional test for determining business income), *and* Federated Stores Realty, Inc. v. Huddleston, 852 S.W.2d 206, 210 (Tenn. 1992) (stating that the functional test is "contrary to the plain language" of the Tennessee statutory definition of business income and holding that the statute embodies only the transactional test), *with* Dover Corp. v. Department of Revenue, 648 N.E.2d 1089, 1097 (Ill. 1995) (applying both the functional and transactional tests in order to classify a corporation's royalties as business income), *Polaroid*, 349 N.C. at 304, 507 S.E.2d at 294 (holding that the North Carolina legislature "adopted the functional test as part of its definition of business income" in addition to the transactional test), *and* Simpson Timber Co. v. Department of Revenue, 953 P.2d 366, 381 (Or. 1998) (Durham, J., concurring) (stating that a condemnation award qualified as business income under "both the transactional and functional tests").

100. *See generally* HENRY M. HART, JR. & ALBERT M. SACKS, THE LEGAL PROCESS 1111-1380 (William N. Eskridge, Jr. & Philip P. Frickey eds., 1994) (discussing the role of the courts in statutory interpretation); Carlos E. Gonzalez, *Reinterpreting Statutory Interpretation*, 74 N.C. L. REV. 585, 594-633 (1996) (describing several different theories of statutory interpretation); Judith S. Kaye, *Things Judges Do: State Statutory Interpretation*, 13 TOURO L. REV. 595, 599-611 (1997) (evaluating the differences between statutory interpretations performed by state and federal courts); Jane S. Schacter, *The Confounding Common Law Originalism in Recent Supreme Court Statutory Interpretation: Implications for the Legislative History Debate and Beyond*, 51 STAN. L. REV. 1, 10-37 (1998) (discussing an empirical analysis of the Supreme Court's October 1996 Term designed to gauge the Court's use of legislative history in statutory interpretation).

101. *See* 27 STRONG'S NORTH CAROLINA INDEX, *Statutes* § 29 (4th ed. 1994) ("The intent of the legislature controls the interpretation of a statute."); EARL T. CRAWFORD, THE CONSTRUCTION OF STATUTES 245 (1940) ("If the courts were permitted to ignore the expressed intent of the legislature, they would invade the province of the legislature and violate the tri-parte theory of government. The legislature would become a nonentity. Legislative power would in fact be wielded by the judiciary."); Gonzalez, *supra* note 100, at 605 (stating that intentualists "attempt to interpret statutory law in accord with the intentions of the enacting legislature"). *But see* SIR RUPERT CROSS, STATUTORY INTERPRETATION 30 (Dr. John Bell & Sir George Engle eds., 2d ed. 1987) (noting that under the English legal system "the intention of Parliament is not to be a dominant ingredient in the formulation of our basic rules of interpretation"); Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COLUM. L. REV. 527, 539 (1947) ("We are not concerned [when interpreting a statute] with anything subjective. We do not delve into the mind of the legislators or their draftsmen, or committee members."); Antonin Scalia, *Common-Law Courts in a Civil-Law System: The Role of United States Federal Courts in Interpreting the Constitution and Laws, in* A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW 3, 16-18 (Amy Gutmann ed., 1997) (disagreeing with the argument that the primary goal of statutory interpretation is to give effect to the intention of the legislature).

102. *See* STRONG'S, *supra* note 101, § 30 ("While a statute must be construed to carry out the legislative intent, that intent must be found from the language of the act, its

reasonable, a court should accord undefined words their plain meaning.[103] A court should also evaluate the statute as a whole and should not construe individual sections "in a manner that renders another provision of the same statute meaningless."[104] Lastly, when interpreting tax statutes, any ambiguities should be strictly construed in favor of the taxpayer and against the state.[105] It is within the

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legislative history, and circumstances surrounding its adoption . . . ."); CRAWFORD, *supra* note 101, at 256 (noting that "before the court can resort to any other source for assistance, it must first seek to find the legislative intention from the words, phrases and sentences which make up the statute subject to construction"); Gonzalez, *supra* note 100, at 603 (stating that under a textualist-intentualist view the "inscribed words of the statute . . . are viewed as the most reliable predictor, and, by some, the only legitimate indicia of an enacting legislature's intentions"); Scalia, *supra* note 101, at 22 ("The text is the law, and it is the text that must be observed."). Justice Scalia criticizes intent-based statutory interpretation that is "divorced from text," arguing that the practice is merely a "subterfuge" used by judges to revise laws improperly. Scalia, *supra* note 101, at 21-22. Justice Scalia, instead, promotes a philosophy of statutory interpretation known as textualism. *See id.* at 23-25. The Justice posits that under a textualist view a court should construe a statute reasonably, giving the words and phrases of the legislature the meanings they fairly contain, without expanding on the limited range of meaning that can be attributed to the words. *See id.* at 23-24 (citing the dissenting opinion in *Smith v. United States*, 508 U.S. 223, 241-47 (1993) (Scalia, J., dissenting), as an example of proper textualist interpretation and explaining that in that case the phrase "uses a gun" should have been limited to use of a gun for what guns are normally used for, that is, as weapons).

103. *See* STRONG'S, *supra* note 101, § 28 ("Where the language of a statute is clear and unambiguous, there is no room for judicial construction and the courts must give it its plain and definite meaning, and are without the power to interpolate, or superimpose provisions and limitations not contained therein." (citations omitted)); CRAWFORD, *supra* note 101, at 256-57 ("If the meaning of the language of the statute is plain, then according to the rule announced in enumerable [sic] cases, there is really no need for construction as the legislative intention is revealed by the apparent meaning, that is, the meaning clearly expressed by the language of the statute."). *But see* Mary L. Heen, *Plain Meaning, the Tax Code, and Doctrinal Incoherence*, 48 HASTINGS L.J. 771, 771-72 (1997) (warning that a strict plain meaning approach, focusing only on the language of the statute and not on the legislative history or intent, "poses special dangers for tax law because of the rich range of contextual and policy considerations that inform the Internal Revenue Code").

104. *Polaroid*, 349 N.C. at 297, 507 S.E.2d at 290; *see also* STRONG'S, *supra* note 101, § 36 (explaining that statutory words "may not be interpreted out of context so as to render [them] inharmonious to the intent and tenor of the act" and noting that "individual expressions must be construed as a part of the composite whole"); CRAWFORD, *supra* note 101, at 258-59 (stating that because the language of a statute constitutes "the depository or reservoir of the legislative intent, in order to ascertain or discover that intent, the statute must be considered as a whole, just as it is necessary to consider a sentence in its entirety in order to grasp its true meaning."); CROSS, *supra* note 101, at 112 (noting that it "is scarcely necessary to cite authority for the proposition that Acts must be construed as a whole").

105. *See* NORMAN J. SINGER, SUTHERLAND ON STATUTES & STATUTORY CONSTRUCTION § 66.01 (5th ed. 1992) (noting that "it is a settled rule that tax laws are to be strictly construed against the state and in favor of the taxpayer" and stating that "[w]here there is reasonable doubt of the meaning of a revenue statute, the doubt is resolved in favor of those taxed"); *see also Polaroid*, 349 N.C. at 297, 507 S.E.2d at 290

context of these basic tenets of statutory interpretation that the state supreme courts have analyzed the UDITPA definition of business income.[106]

In *General Care Corp. v. Olsen*,[107] the Supreme Court of Tennessee formally adopted the transactional test as the sole measure of determining business income under the Tennessee version of UDITPA.[108] The court based its holding on the plain language of the statutory definition of business income,[109] stating that, in the absence of textual ambiguity, precedent commands Tennessee courts to restrict their interpretation of statutes to the "natural and ordinary meaning of the language" used.[110] Additionally, the court emphasized that a statute must be viewed as a whole, with each word possessing independent significance.[111] In applying these principles to the Tennessee corporate-taxation provision, the court explained that the statute's use of the words "transactions and activity in the regular course of the taxpayer's trade or business"[112] plainly incorporates the transactional test into its business-income definition.[113] The court also construed the "or earnings from tangible and intangible property if the acquisition, use, management, or disposition"[114] language as merely modifying the substantive portion of the definition contained

(stating that "an ambiguous tax statute shall be strictly construed against the state").

106. *See Polaroid*, 349 N.C. at 297-98, 507 S.E.2d at 290 (setting forth the rules of statutory interpretation described above as its methodology for analyzing the North Carolina definition of business income); *see also* Roy Pulvers & Wendy Willis, *Revolution and Evolution: What Is Going on with Statutory Interpretation in the Oregon Courts?*, OR. ST. BAR BULL., Jan. 1996, at 13, 13-14 (describing the adoption by the Oregon Supreme Court of a formal system of statutory interpretation that is strikingly similar to the informal methodology used by the North Carolina Supreme Court).

107. 705 S.W.2d 642 (Tenn. 1986). The case involved a merger between two corporations that was facilitated in part by the liquidation sale of several subsidiaries of the target company. *See id.* at 643.

108. *See id.* at 648 (holding that "nothing in the language of the statute itself ... indicate[s] that the General Assembly intended to create alternative tests [for defining business income]").

109. The Tennessee Supreme Court explained that business earnings were defined under state statute as " 'earnings arising from transactions and activity in the regular course of the taxpayer's trade or business and includes earnings from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayers regular trade or business operations.' " *Id.* at 644 (quoting TENN. CODE ANN. § 67-4-804(a)(1)).

110. *Id.* at 648.

111. *See id.* at 646 (explaining the court's presumption that "every word used in a statute was intended by the General Assembly to convey meaning and purpose").

112. TENN. CODE ANN. § 67-4-804(a)(1).

113. *See General Care Corp.*, 705 S.W.2d at 644.

114. TENN. CODE ANN. § 67-4-804(a)(1).

in the first clause.[115] Accordingly, the court applied the transactional test to the case before it, holding that the liquidation sale of the plaintiff's hospital management subsidiaries did not constitute business income because such sales were not a regular part of the company's business.[116]

Similarly, in *In re Appeal of Chief Industries, Inc.*,[117] the Kansas Supreme Court refused to overrule an earlier case in which it had interpreted the Kansas statutory definition of business income to include only the transactional test.[118] In *Western Natural Gas Co. v. McDonald*,[119] the same court had construed the Kansas corporate tax provision[120] to embody a "narrowly-defined transactional test."[121] In upholding its previous interpretation, the *Chief Industries* court addressed a regulation adopting the functional test[122] by stating that

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115. *See General Care Corp.*, 705 S.W.2d at 645.

116. *See id.* at 648; *see also* Union Carbide Corp. v. Huddleston, 854 S.W.2d 87, 92 (Tenn. 1993) ("In determining whether corporate income is 'business earnings' or 'nonbusiness earnings,' this Court has applied what is referred to as the 'transactional test.' "); Federated Stores Realty, Inc. v. Huddleston, 852 S.W.2d 206, 212 (Tenn. 1992) (reaffirming the transactional test approach adopted in *General Care Corp.* and holding that proceeds from a real estate development company's liquidation of several shopping centers were non-business income). In both *Federated Stores* and *General Care Corp.*, the court noted that the company's use of the proceeds from the sale was a significant factor in determining whether the earnings were business income under the transactional test. *See Federated Stores*, 852 S.W.2d at 212 (stating that the company "did not use the proceeds of liquidation of its interests in regional shopping centers to acquire new assets for use in that business" and noting that "[u]nder the transactional test, this use of proceeds is a factor that indicates that the income derived from such liquidation should be classified as non-business income"); *General Care Corp.*, 705 S.W.2d at 644 ("Under the transactional test, earnings held for use in the regular course of on-going business operations or expended to acquire assets to be used in the regular course of future business activities, have been held to be properly apportionable as business income.").

117. 875 P.2d 278 (Kan. 1994).

118. *See id.* at 286 (upholding Western Natural Gas Co., v. McDonald, 446 P.2d 781 (Kan. 1968)).

119. 446 P.2d 781 (Kan. 1968).

120. Kansas Statutes Annotated section 79-3271 reflects UDITPA in stating that business income means "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." KAN. STAT. ANN. § 79-3271(a) (1997). Kansas also follows UDITPA in bestowing non-business income with the expansive definition of "all income other than business income." KAN. STAT. ANN. § 79-3271(e).

121. *Western*, 446 P.2d at 783 ("It is not the use of the property in the business which is the determining factor under the statute. The controlling factor by which the statute identifies business income is the nature of the particular transaction giving rise to the income.").

122. Kansas Administrative Regulation 92-12-73 adopts the functional test in providing the following rules for distinguishing between business and non-business income:

the "[a]dministrative regulations do not supplant statutory law nor do they preempt judicial statutory construction."[123] The court explained that the legislature could have modified its earlier interpretation of section 79-3271 by amending the statute; the court characterized the legislative silence over the twenty-six years between *Western* and *Chief Industries* as an implicit ratification of the transactional-test-only view.[124] Lastly, the court emphasized that the functional test is contrary to the plain language of the statute because the functional test ignores the requirement that the income constitute an "integral" part of the taxpayer's business.[125]

Drawing support from the decisions in Tennessee and Kansas, the Iowa Supreme Court also declared its allegiance to the transactional test in *Phillips Petroleum Co. v. Iowa Department of Revenue and Finance*.[126] The *Phillips Petroleum* court held that the proper test for determining business income under Code of Iowa section 422.32[127] was "basically transactional" and explained that the last clause of the definition, upon which the Department of Revenue had based its argument in favor of the functional test, was added merely to "include transactions involving disposal of fixed assets by taxpayers who emphasize the trading of assets as an integral part of

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> Gain or loss from the sale, exchange or other disposition of real or tangible or intangible personal property constitutes business income if the property while owned by the taxpayer was used in the taxpayer's trade or business. However, if such property was utilized for the production of nonbusiness income or otherwise was removed from the property factor before its sale, exchange or other disposition, the gain or loss will constitute nonbusiness income.

KAN. ADMIN. REGS. 92-12-73 (1992).

123. *Chief Industries*, 875 P.2d at 284-85 (stating that "[e]ven if the definition of business income set forth by statute was unclear as to whether the functional test exists in Kansas, the Board, like a reviewing court may not simply devise its own interpretation of the statute because here, a valid administrative interpretation exists").

124. *See id.* at 284 (stating that legislative " ' "failure to act amounts to a ratification of the interpretation placed upon [an] act by this court" ' " (quoting Lees Adm'r v. White, 415 P.2d 255, 258 (Kan. 1966) (quoting State v. One Bally Coney Island No. 21011 Gaming Table, 258 P.2d 225, 228 (Kan. 1953)))).

125. *See id.* at 285-86. The court also stressed the fact that the functional test is contrary to the requirement in the statute that the "disposition" of the property be an integral part of the business. *See id.*; Lisonbee, *supra* note 12, at 335-36.

126. 511 N.W.2d 608 (Iowa 1993).

127. At the time *Phillips Petroleum* was decided, Section 422.32.2 borrowed from the UDITPA in stating that business income " 'means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.' " IOWA CODE ANN. § 422.32.2 (1998) (quoting the pre-1995 version of section 422.32.2 in the Historical and Statutory Notes).

regular business" within the transactional test.[128] Thus, the supreme courts of Tennessee, Kansas, and Iowa all based their rejections of the functional test on the fact that the test was either unsupported by or contrary to the text of the statutes being construed. However, the legislatures in all three states subsequently amended their respective statutes in order to include explicitly the functional test in the definition of business income.[129]

Conversely, several state supreme courts have pointed to plain language and legislative history in interpreting their state's version of UDITPA to include both the transactional and functional tests.[130] In *Texaco-Cities Service Pipeline Co. v. McGaw*,[131] the Illinois Supreme Court acknowledged the coexistence of the transactional and functional tests within the definition of business income set forth in 35 Illinois Compiled Statutes 5/1501[132] and held that proceeds from the sale of pipeline assets by a multi-state corporation were apportionable to Illinois as business income.[133] The court based its recognition of the functional test in part on its reading of the plain language of the statute.[134] The court concluded that the second clause

128. *Phillips Petroleum*, 511 N.W.2d at 610.

129. *See* IOWA CODE ANN. § 422.32.2 (1998) (" 'Business income' means . . . gain or loss resulting from the sale, exchange or other disposition of real property or of tangible or intangible personal property, if the property while owned by the taxpayer was operationally related to the taxpayer's trade or business carried on in Iowa . . . ."); KAN. STAT. ANN. § 79-3271 (1997) ("[F]or taxable years commencing after December 31, 1995, a taxpayer may elect that all income derived from the acquisition, management, use or disposition of tangible or intangible property constitutes business income."); TENN. CODE. ANN. § 67-4-804(a)(1) (1998) (" 'Business earnings' means . . . earnings from tangible and intangible property if the acquisition, use, management or disposition of the property constitutes an integral part of the taxpayer's regular trade or business operations."); *see also Polaroid*, 349 N.C. at 295, 507 S.E.2d at 289 (noting the amended laws).

130. *See supra* note 99; *see also* District of Columbia v. Pierce Assocs., 462 A.2d 1129, 1130 (D.C. App. 1983) (stating that the business income definition sets forth two independent and alternative tests); Dover Corp. v. Department of Revenue, 648 N.E.2d 1089, 1097 (Ill. App. Ct. 1995) ("There are two alternative tests to be applied in determining whether an item of income is business income. . . . These two tests are referred to as the 'transactional' and 'functional' tests."); Ross-Araco v. Commonwealth Bd. of Fin. & Revenue, 674 A.2d 691, 693 (Pa. 1996) (holding that the income of a multi-state corporation can be classified as business income for purposes of apportionment if either the functional or transactional test is met).

131. 695 N.E.2d 481 (Ill. 1998).

132. The definition of business income found in 35 Illinois Compiled Statutes 5/1501 was taken directly from the UDITPA and states that business income is "income arising from transactions and activity in the regular course of the taxpayer's trade or business . . . and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." 35 ILL. COMP. STAT. ANN. 5/1501(a)(1) (West 1993).

133. *See Texaco-Cities*, 695 N.E.2d at 486-87.

134. *See id.* at 485 (noting that statutory interpretation "properly begins with an

of the statute creates a second test for business income by enlarging the definition to encompass income received from the sale of property so long as that property—not the sale—was an integral part of the company's business.[135] Furthermore, the court looked at the legislative history of UDITPA, from which the Illinois statute was derived, to support its holding that the definition encompassed the functional test in addition to the transactional test.[136]

Similarly, in *Simpson Timber Co. v. Department of Revenue*,[137] the Oregon Supreme Court used the plain-language approach to validate both the transactional and functional tests as part of the Oregon multi-state taxation statute.[138] In holding that a multi-state timber company received business income as a result of a condemnation award from the government,[139] the *Simpson* court sought to determine the legislative intent behind the Oregon definition of business income[140] by focusing on the text and context of the statute.[141] Employing the functional test, the court held that the statute's plain language commanded that income derived from the disposition—albeit involuntary—of property constituting an integral

examination of the statutory language" and that "[e]ach undefined word in the statute must be ascribed its ordinary and popularly understood meaning").

135. *See id.*

136. The *Texaco-Cities* court drew support from the comment to UDITPA § 1, which states that " '[i]ncome from the disposition of property used in a trade or business of the taxpayer is includible within the meaning of business income.' " *Id.* at 486 (quoting UDITPA § 1, cmt. (1966)).

137. 953 P.2d 366 (Or. 1998).

138. *See id.* at 368-69.

139. *See id.* at 370. The federal government had condemned 7654 acres of Simpson's timberland, and 10 years after the taking, the government awarded the company $49,846,000 in just compensation for the condemned property, in addition to a $79,160,218 delayed compensation award representing "an assumed investment return on the $49 million during the years that it was owed but not yet paid." *Id.* at 367. The delayed compensation award was the income at issue in the case. *See id.* Justice Durham, in a concurring opinion, stated that "the condemnation that occurred here satisfies both the transactional and functional tests." *Id.* at 372 (Durham, J., concurring).

140. The Oregon definition is taken from UDITPA and follows the wording of the Model Act almost verbatim, except that the Oregon statute includes "use or rental" as part of the second clause. *See* OR. REV. STAT. § 314.610(1) (1987) (stating in the second clause that business income includes income "from tangible and intangible property if the acquisition, the management, *use or rental*, and the disposition of the property constitute integral parts of the taxpayer's regular trade or business operations" (emphasis added)). The additional language, however, does not affect an analysis of the clause under the functional test. *See Polaroid*, 349 N.C. at 299 n.4, 507 S.E.2d at 291 n.4.

141. *See Simpson*, 953 P.2d at 368-69 ("We seek to determine legislative intent initially by a review of the statutory text and context.... In this step we apply the statutory command that we neither omit anything from, nor add anything to, the words of a statute." (citing OR. REV. STAT. § 174.010 (1987); Portland Gen. Elec. v. Bureau of Labor & Indus., 859 P.2d 1143 (Or. 1993))).

part of the company's business be classified as business income.[142]

The Supreme Court of Pennsylvania also has recognized that the Pennsylvania definition of business income encompasses both the transactional and functional tests.[143] In *Laurel Pipe Line Co. v. Commonwealth Board of Finance and Revenue*,[144] the court acknowledged that business income, as defined in 72 Pennsylvania Consolidated Statutes section 7401,[145] contains "two alternative tests."[146] In assessing whether the plaintiff was correct in classifying the proceeds from its liquidation of a pipeline division as non-business income, the court stated that "[i]ncome meets the functional test if the gain arises from the sale of an asset which produced business income while it was owned by the taxpayer."[147] Although the idle pipeline had once been an integral part of the company's business, the court ruled that the property in its current state was not integral and, thus, that the liquidation sale did not produce business income.[148]

Like the statutes described above, North Carolina's Corporate Income Tax Act and its definition of business income are derived from UDITPA.[149] The second clause of the North Carolina statute, however, differs from UDITPA in a potentially significant way in that it uses alternative conjunctions—"and/or" instead of the single conjunction "and"—when describing the uses necessary to establish

142. *See id.* at 369-70. The court explained that "[n]othing in the statutory definition of 'business income' suggests that a disposition that is involuntary is any less a disposition, or that the income therefrom is any less 'business income.' We cannot read into the statutory definition of 'business income' the additional word 'voluntary' before the word 'disposition.' " *Id.*

143. *See, e.g.*, Ross-Araco Corp. v. Commonwealth Bd. of Fin. & Revenue, 674 A.2d 691, 693 (Pa. 1996).

144. 642 A.2d 472 (Pa. 1994).

145. The definition of business income found in the Pennsylvania statute was taken directly from UDITPA. *See* 72 PA. CONS. STAT. § 7401(3)2.(a)(1)(A) (1990).

146. *Laurel Pipe Line*, 642 A.2d at 474.

147. *Id.* at 475.

148. *See id.* (disagreeing with the lower court's conclusion that "a singular disposition of an unprofitable pipeline is an integral part of the company's regular business because, if not sold, the company's other business would suffer financially").

149. *See* National Serv. Indus., Inc. v. Powers, 98 N.C. App. 504, 506, 391 S.E.2d 509, 511 (1990). North Carolina General Statutes section 105-130.4 states that business income "means income arising from transactions and activity in the regular course of the corporation's trade or business and includes income from tangible and intangible property if the acquisition, management, *and/or* disposition of the property constitute integral parts of the corporation's regular trade or business operations." N.C. GEN. STAT. § 105-130.4(a)(1) (1997) (emphasis added). The statute also follows UDITPA in defining non-business income as "all income other than business income." *Id.* § 105-130.4(a)(5).

property as an "integral" part of the company's business.[150] Thus, under the second clause of North Carolina General Statutes section 105-130.4(a)(1), the disposition of the property at issue does not have to be an integral part of the company's business, so long as the acquisition or management of the property "constitute[s an] integral part[] of the corporation's regular trade or business operations."[151] The North Carolina statute, therefore, is arguably more broad in its definition of business income than even UDITPA.

The North Carolina Supreme Court in *Polaroid* also had to contend with a section of the North Carolina Administrative Code dealing with business and non-business income.[152] Although the North Carolina Court of Appeals had previously addressed the issue of whether the courts, under North Carolina General Statutes section 105-264,[153] are bound by administrative interpretations,[154] the *Polaroid* court was nevertheless forced to address the Administrative Code provision because of its relevance to patent royalties.[155] Thus, it was within the context of these North Carolina rules and statutes, along with the rulings of the other state supreme courts, that the *Polaroid* court interpreted section 105-130.4 to determine whether the statute embraced the functional test in addition to the transactional test.

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150. *See id.* § 105-130.4(a)(1).

151. *Id.*

152. *See Polaroid*, 349 N.C. at 301, 507 S.E.2d at 293-94. The regulation states:

> (2) A gain or loss from the sale, exchange or other disposition of real or personal property constitutes business income if the property while owned by the taxpayer was used to produce business income. However, the gain or loss will constitute nonbusiness income providing:
>
> (a) such property was subsequently utilized principally for the production of nonbusiness income for a period of at least three years prior to the disposition; and
>
> (b) such property was reflected as nonbusiness income on the corporate income tax returns filed for those years.
>
> ....
>
> (5) *Patent and copyright royalties are business income if the patent or copyright was created or used as an integral part of a principal business activity of the taxpayer.*

N.C. ADMIN. CODE tit. 17, r. 5C.0703 (June 1998) (emphasis added).

153. The statute mandates that "[i]t shall be the duty of the Secretary to interpret all laws administered by the Secretary" and declares that an "interpretation by the Secretary is prima facie correct." N.C. GEN. STAT. § 105-264 (1997).

154. *See National Serv. Indus.*, 98 N.C. App. at 507, 391 S.E.2d at 511 ("A reading of the entire statute indicates that only the Secretary's decisions to initiate or propose regulations that modify, change, alter or repeal existing regulations are prima facie correct. This prima facie correct standard does not apply to administrative interpretations.").

155. *See Polaroid*, 349 N.C. at 302-03, 507 S.E.2d at 293-94.

In addressing as a matter of first impression whether the North Carolina definition of business income encompasses both the transactional and functional tests, the North Carolina Supreme Court based its analysis on "the canons of statutory construction, pertinent administrative rules, and the legislative history surrounding both the Act and the UDITPA."[156] Although the *Polaroid* court was at odds with textualist notions of statutory interpretation[157] when it asserted that "the cardinal principle [of statutory interpretation] is to ensure accomplishment of legislative intent,"[158] the court's views on the primacy of legislative intent were supported by legal scholarship and North Carolina authority.[159] Furthermore, the court's view that legislative intent should be derived, if possible, from a reading of the statute's plain language finds support from both academics[160] and other state supreme courts.[161]

In holding that North Carolina General Statutes section 105-130.4 supports the functional test, the North Carolina Supreme Court achieved a result consistent with the plain-meaning framework of statutory interpretation.[162] Under the functional test, a multi-state corporation's gain is considered business income "if the assets were used to generate business income, even if their sale is not a regular incident of the business."[163] Section 105-130.4 expands the second

156. *Id.* at 297, 507 S.E.2d at 290.

157. *See* Scalia, *supra* note 101, at 16-18 (arguing against the idea that the primary goal of statutory interpretation is faithfulness to legislative intention).

158. *Polaroid*, 349 N.C. at 297, 507 S.E.2d at 290.

159. *See, e.g.*, State v. Fulcher, 294 N.C. 503, 520, 243 S.E.2d 338, 350 (1978); L.C. Williams Oil Co. v. NAFCO Capital Corp., 130 N.C. App. 286, 289-90, 502 S.E.2d 415, 417 (1998); STRONG'S, *supra* note 101, § 29; *see also* CRAWFORD, *supra* note 101, at 244-45 (recognizing the importance of maintaining faithfulness to the "expressed intent of the legislature").

160. *See* CRAWFORD, *supra* note 101, at 256 (explaining that before a court looks to outside sources to uncover legislative intention it must first examine the language of the statute itself); Gonzalez, *supra* note 100, at 603-605 (describing the textualist-intentionalist school and its adherence to the principle that the text is the best source from which to glean the intent of the legislature).

161. *See, e.g.*, *In re* Appeal of Chief Indus., Inc., 875 P.2d 278, 282 (Kan. 1994) (stating that non-technical words in a statute should be given their normal meaning in common usage); General Care Corp. v. Olsen, 705 S.W.2d 642, 646 (Tenn. 1986) (stating that the court "will presume that every word used in a statute was intended by the General Assembly to convey meaning and purpose").

162. *See Polaroid*, 349 N.C. at 297, 507 S.E.2d at 290 ("Under the preceding rules of statutory construction [including the plain-meaning rule], we cannot agree with Polaroid's contention that the second clause of N.C.G.S. § 105-130.4(a)(1) simply modifies that section's first clause by providing examples of business income.").

163. Faber, *supra* note 8, at 110.

clause of the UDITPA definition[164] by stating that business income "includes income from tangible and intangible property if the acquisition, management, *and/or* disposition of the property constitute integral parts of the corporation's regular trade or business operations."[165] The statute makes it clear that the asset from which the income is derived does not have to be property that is normally sold in the regular course of the company's business, so long as the acquisition or management of the property is an integral part of the taxpayer's operations.[166] By substituting the "and/or" for the "and" used in the UDITPA definition, the North Carolina legislature incorporated the functional test into the plain language of the second clause of the definition of business income found in section 105-130.4.[167] Therefore, although the North Carolina Supreme Court paralleled the transactional-test-only states by stressing the plain language method of statutory interpretation,[168] the court properly arrived at the opposite result from those other states' courts because of the clear language deviation in the North Carolina statute.[169]

Although the result arising from the plain meaning of the statute would have ended the inquiry under a textualist interpretation,[170] the North Carolina Supreme Court's reliance on the administrative regulations lent additional support to its interpretation. The North Carolina Administrative Code recognizes the functional test by

164. *See* UDITPA § 1(a) (stating that business income "includes income from tangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations").

165. N.C. GEN. STAT. § 105-130.4(a)(1) (1997) (emphasis added).

166. *See id.*; *see also* 1 HELLERSTEIN & HELLERSTEIN, *supra* note 8, ¶ 9.05[2][c] (noting that, under the standard UDITPA language, which does not use alternate conjunctions, the statute plainly "requires that the 'disposition' ... of the property constitute an integral part of the taxpayer's trade or business"). The North Carolina Supreme Court correctly pointed out that the definition of business income contained in section 105-130.4 "utilizes a compound predicate to illustrate that 'business income' includes the definitions set forth in both the first and second clauses." *Polaroid*, 349 N.C. at 298, 507 S.E.2d at 290-91.

167. *See* Faber, *supra* note 8, at 115 (citing North Carolina as a state that has "adopted statutory language that clearly incorporates the functional test (by replacing the word 'and' before 'disposition' with the word 'or')"); *see also* 1 HELLERSTEIN & HELLERSTEIN, *supra* note 8, ¶ 9.05[2][c] (arguing that "[a]s a matter of state tax policy, there is much to be said for adoption of the functional test."). *Compare* UDITPA § 1(a) (requiring that "the acquisition, management, and disposition of the property constitute integral parts" of the business), *with* N.C. GEN. STAT. § 105-130.4(a)(1) (requiring that "the acquisition, management, and/or disposition of the property constitute integral parts of the corporation's regular trade or business").

168. *See supra* notes 109-29 and accompanying text.

169. *See* Faber, *supra* note 8, at 114-15.

170. *See* Scalia, *supra* note 101, at 23-25.

stating that business income includes gain from property used to produce business income, even if such property is not typically disposed of in the company's normal course of business.[171] The court was also correct in applying the rule set forth in North Carolina General Statutes section 105-264 that an "interpretation by the Secretary is prima facie correct."[172] Because the Secretary's interpretation of business income is embodied in a valid administrative regulation, it is entitled to the presumption of prima facie correctness, thereby making *National Service Industries, Inc. v. Powers*[173] distinguishable.[174] Unlike *National Service Industries*, where the Secretary had manifested Department policy only through an interoffice memorandum,[175] the Department's decision to apply the functional test to patent royalties was "promulgated" in a regulation.[176] Furthermore, unlike the Kansas case, *In re Appeal of Chief Industries, Inc.*,[177] the North Carolina court properly gave due consideration to the regulation because it did not contradict the definition of business income found in the statute or in a previous interpretation by the court.[178]

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171. *See* N.C. ADMIN. CODE tit. 17, r. 5C.0703(2) (June 1998) ("A gain or loss from the sale, exchange or other disposition of real or personal property constitutes business income if the property while owned by the taxpayer was used to produce business income."). In a clause pertinent to Polaroid's claim, the regulation also states that "[p]atent and copyright royalties are business income if the patent or copyright was created or used as an integral part of a principal business activity." *Id.* r. 5C.0703(5). Thus, the regulation clearly applies the functional test to patent royalties.

172. N.C. GEN. STAT. § 105-264 (1997).

173. 98 N.C. App. 504, 391 S.E.2d 509 (1990).

174. *See id.* at 507, 391 S.E.2d at 511 ("Since defendant has not proposed or promulgated a regulation regarding the treatment of these federal tax benefits in the context of state corporate income taxation, G.S. 105-264 does not apply."). In *National Service*, the defendant sought to apply the prima facie correctness standard not to a regulation but rather to an administrative policy regarding safe harbor leases that was "memorialized in an interoffice memo." *Id.*

175. *See id.*

176. *See* N.C. ADMIN. CODE tit. 17, r.5C.0703(5).

177. 875 P.2d 278 (Kan. 1994); *see also supra* notes 117-25 (discussing *Chief Industries*).

178. *See Polaroid*, 349 N.C. at 303, 507 S.E.2d at 294 (stating that "the legislature is always presumed to act with full knowledge of prior and existing law and that where it chooses not to amend a statutory provision that has been interpreted in a specific way, we may assume that it is satisfied with that interpretation"). In *Chief Industries*, the Kansas court held that a regulation interpreting the business income definition to include the functional test was not properly relied upon because that administrative interpretation conflicted with the express interpretation of the court that the definition contained only the transactional test. *See Chief Industries*, 875 P.2d at 285 ("Administrative regulations do not supplant statutory law nor do they preempt judicial statutory construction."). *Chief Industries* is distinguishable from *Polaroid*, however, because the North Carolina court was interpreting the business income definition as a matter of first impression. *See Polaroid*, 349 N.C. at 296-97, 507 S.E.2d at 290.

Although it probably did not need further analysis to prove that the North Carolina definition of business income includes the functional test, the court also found support for that position in the legislative history of UDITPA.[179] The court began by stating that "it is well established that the North Carolina Corporate Income Tax Act was based upon UDITPA and prefaced upon meeting the goals of the Multistate Tax Compact."[180] The court's statement is easily supported by the near verbatim use of UDITPA language in the North Carolina statute and by the fact that section 105-130.4 was created shortly after the adoption of the UDITPA.[181] The court next pointed out that UDITPA "finds its origins in early California jurisprudence," a fact which supported the court's adoption of the functional test because that is the test propounded by the California courts.[182]

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179. Furthermore, the court's use of UDITPA history to support its functional test analysis is in accord with the methodology of other state supreme courts. *See* District of Columbia v. Pierce Assocs., Inc., 462 A.2d 1129, 1131 (D.C. App. 1983) (drawing upon California case law to support the recognition of the functional test in the UDITPA definition of business income); Texaco-Cities Serv. Pipeline Co. v. McGaw, 695 N.E.2d 481, 486 (Ill. 1998) (concluding that the plain language of the Illinois definition of business income supports its functional test interpretation); McVean & Barlow, Inc. v. New Mexico Bureau of Revenue, 543 P.2d 489, 491 (N.M. Ct. App. 1975) (acknowledging California case law to the contrary but holding that liquidation proceeds do not qualify as business income under UDITPA).

180. *Polaroid*, 349 N.C. at 304, 507 S.E.2d at 294.

181. *See id.* at 305, 507 S.E.2d at 295 ("Moreover, the timing of the adoption of the North Carolina Corporate Income Tax Act—effective 1 July 1967—illustrates that North Carolina was reacting to the nationwide trend of adopting legislation which increased the uniformity and compatibility of state income-tax laws with respect to interstate commerce.").

182. *Id.* at 304, 507 S.E.2d at 294-95 (citing *In re* Appeal of Borden, Inc., 1977 WL 3818, at *2 (Cal. St. Bd. Eq. Feb. 3, 1977)); *see also* Faber *supra* note 8, at 113-14 (stating that the functional test is a valid interpretation of UDITPA-based statutes because UDITPA is derived from California case law which held that "the fact that property was used in the business was sufficient to make gain on its sale business income" (citing *In re* Appeal of Velsicol Chem. Corp., 1965 WL 1377 (Cal. St. Bd. Eq. Oct. 5, 1965); *In re* Appeal of W.J. Voit Rubber Corp., 1964 WL 1453 (Cal. St. Bd. Eq. May 12, 1964); *In re* Appeal of American President Lines, Ltd., 1961 WL 1396 (Cal. St. Bd. Eq. Jan. 5, 1961); *In re* Appeal of American Airlines, Inc., 1952 WL 390 (Cal. St. Bd. Eq. Dec. 18, 1952)). California's definition of business income is taken directly from UDITPA. *See* CAL. REV. & TAX CODE § 25120(a) (West 1992) (stating that business income is "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations"). There is no dispute, however, among the California courts about the existence of the functional test as an independent counterpart to the transactional test. *See* Robert Half Int'l, Inc. v. Franchise Tax Bd., 66 Cal. App. 4th 1020, 1024 (1998) (noting the presence of the two separate tests within the definition of business income); *Borden*, 1977 WL 3818, at *3 (holding that the business-income definition "authorizes a functional

Finally, the *Polaroid* court's application of the functional test to the lost profit award, reasonable royalties payments, and interest sum was both correct and constitutional under the unitary business principle.[183] In *Polaroid*, the parties did not dispute that the patents at issue were business assets used as an integral part of the company's business.[184] Thus, gain derived from the patents would qualify as business income under the functional test, whereby "gain is treated as business income if assets were used to generate business income, even if their sale is not a regular incident of the business."[185] The fact that the gain was realized through litigation instead of through the normal course of business was of no consequence because under the functional test, "once a corporation's assets are found to constitute integral parts of the corporation's regular trade or business, income resulting from the acquisition, management, and/or disposition of those assets constitutes business income *regardless of how that income is received.*"[186] Accordingly, the damages award received by Polaroid was income resulting from the company's management of its patents and, therefore, constituted business income under the functional test.[187]

The court also held that "North Carolina can constitutionally tax Polaroid's recovery from the Kodak lawsuit under the unitary

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test" in addition to the transactional test). In support of the functional test, the *Borden* court drew upon pre-UDITPA California decisions concerning "unitary income." *Borden*, 1977 WL 3818, at *2. The underlying theme of pre-UDITPA cases was that "any income from assets which are integral parts of the unitary business is unitary income." *Voit Rubber*, 1964 WL 1453, at *1; *see also In re* Appeal of Wesson Oil and Snowdrift Sales Co., 1957 WL 1162, at *2 (Cal St. Bd. Eq. Feb. 5, 1957) (holding that proceeds from a partial liquidation sale by a multi-state business yielded unitary income); *In re* Appeal of IBM Corp., 1954 WL 581, at *2 (Cal. St. Bd. Eq. Oct. 7, 1954) (holding that gains from a multi-state company's patent royalties were unitary income); *American Airlines*, 1952 WL 390, at *3 (holding that money received by a multi-state corporation from the forced sale of aircraft to the government constituted unitary income). Thus, the pre-UDITPA case law in California created an even broader taxing power than the functional test for business income under UDITPA. *Cf. McVean*, 543 P.2d 489, 492 (N.M. Ct. App. 1975) (holding that proceeds from liquidation sales cannot be apportioned as business income under New Mexico's version of UDITPA).

183. *See supra* notes 60-69 and accompanying text (discussing the unitary business principle).

184. *See Polaroid*, 349 N.C. at 306, 507 S.E.2d at 295-96.

185. Faber, *supra* note 8, at 110.

186. *Polaroid*, 349 N.C. at 306, 507 S.E.2d at 296 (emphasis added). The court's holding reflects a decision by the Oregon Supreme Court which held that the functional test required that gain from a condemnation award be computed as business income because the condemnation award, although involuntary, was gain derived from a business asset. *See* Simpson Timber Co. v. Department of Revenue, 953 P.2d 366, 370 (Or. 1998).

187. *Polaroid*, 349 N.C. at 308, 507 S.E.2d at 297 (holding that Polaroid's award "fits squarely within the functional test and this state's definition of business income").

business principle."[188] According to the United States Supreme Court, a state may tax corporate income without offending the Constitution—regardless of whether the income could be allocated to another state through separate accounting methods—as long as the income is attributable to the company's unitary business performed both inside and outside of the taxing state.[189] Furthermore, the Court has held that gain realized outside of the taxing state is still taxable under the unitary business principle as long as the gain is allocated by the company to "working capital" that is used, in part, to support the company's operations in the state imposing the tax.[190] Thus, because "the monies received from the Kodak lawsuit were used as part of Polaroid's working capital and therefore constitute part of Polaroid's unitary business," the North Carolina Supreme Court properly held that taxing the damage award in North Carolina was permitted by the Constitution.[191]

The North Carolina Supreme Court's holding in *Polaroid* that the definition of business income set forth in North Carolina General Statutes section 105-130.4 contains the functional test was correct both in its use of statutory interpretation and in its application of the functional test to Polaroid's damages award.[192] The court's holding is significant because it provides the state with a tool for increasing revenues from multi-state companies doing business in North Carolina. In light of the dramatic influx of multi-state corporations to Charlotte and Research Triangle Park in the last decade, the taxation power provided by the functional test may prove to be very valuable indeed.[193]

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188. *Id.* at 314, 507 S.E.2d at 300.
189. *See* Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 438 (1980).
190. *See* Allied-Signal, Inc. v. Director, Div. of Taxation, 504 U.S. 768, 777-78 (1992).
191. *Polaroid*, 349 N.C. at 314-15, 507 S.E.2d at 301.
192. *See supra* notes 159-69 and accompanying text.
193. *See supra* notes 1-2 and accompanying text.

Hog Farms and Nuisance Law in *Parker v. Barefoot*: Has North Carolina Become a Hog Heaven and Waste Lagoon?

Traditionally, North Carolina farmers raised hogs as part of larger, independently owned and operated family farms, where the pigs served not only as a source of fertilizer, but as a source of food and as a trading commodity.[1] That tradition has eroded in recent years as corporate-run hog facilities have forced many independent hog farms out of business.[2] The dramatic decline in independent hog farms, however, has not prevented the hog industry from flourishing in North Carolina.[3] The success of the industry stems from the

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1. *See* JIM MASON & PETER SINGER, ANIMAL FACTORIES: WHAT AGRIBUSINESS IS DOING TO THE FAMILY FARM, THE ENVIRONMENT AND YOUR HEALTH 149 (2d ed. 1990); SWINE ODOR TASK FORCE, NORTH CAROLINA GENERAL ASSEMBLY, MARCH 1, 1995 REPORT: OPTIONS FOR MANAGING ODOR 12 (1995) [hereinafter TASK FORCE].

2. There is a direct correlation between the rapid decline of independent hog farms and the vertical integration of the pork industry. *See* Ken Silverstein, *Meat Factories*, SIERRA, Jan./Feb. 1999, at 28, 31. Vertical integration has occurred as large corporate hog producers have gained "control [over] every phase of [hog] production," from supplying feed, to managing production facilities, through processing, and finally to wholesale distribution. *Id.* at 31. Hog farmers contract with these large corporations, agreeing to raise the hogs, provide the land, build the hog houses and waste lagoons, and assume the risks associated with raising the hogs, including liability for nuisance claims. *See* TASK FORCE, *supra* note 1, at 9; John T. Holleman, *In Arkansas Which Comes First, the Chicken or the Environment?*, 6 TUL. ENVTL. L.J. 21, 25 (1992) (analogizing vertical integration to "franchisor-franchisee relationship"); Silverstein, *supra*, at 31. In turn, the corporations supply the hogs, feed, and medicine, and eventually take the hogs to the slaughterhouses. *See* Holleman, *supra*, at 25. Poultry magnate Frank Perdue pioneered vertical integration in the livestock industry; hog producers followed his lead. *See* Silverstein, *supra*, at 31. Today, North Carolina "leads the country in the movement towards concentration and vertical coordination of the entire [hog] industry." Raymond B. Palmquist et al., *Hog Operations, Environmental Effects, and Residential Property Values*, 73 LAND ECON. 114, 114 (1997).

Since vertical integration first began in 1983, the number of hog farms in the United States has decreased nearly 75%, from 600,000 to 157,000 in 1998. *See* Silverstein, *supra*, at 28, 31. In North Carolina, the rate of decline mirrors the national trend. In 1983, two million hogs were raised on over 23,000 farms, but by 1998, less than 6000 farms produced more than 10 million hogs. *See* Dennis Rogers, *The Gospel According to Boss Hog*, NEWS & OBSERVER (Raleigh, N.C.), Nov. 7, 1998, at 1B. On average, the establishment of one new corporate hog facility forces 10 independent or family operated farms out of business. *See id.* This decline occurs because vertical integration causes the price of pork to fall by significantly increasing the supply of hogs without a corresponding increase in demand. This in turn forces less efficient farms out of business. *See* Silverstein, *supra*, at 32 (noting that vertical integration has forced hog prices to plunge to their lowest point in 25 years, providing less than half of what independent hog farmers need to break even).

3. Hog farming is now the leading agribusiness in North Carolina, surpassing even

industrialization of hog farming operations, which has created massive, high-tech farm facilities throughout eastern North Carolina. The state encouraged this expansion by using various incentives to attract corporate hog producers beginning in 1979 and continuing through most of the 1980s.[4]

Unfortunately, North Carolina's regulatory structure was ill-equipped to handle the rapid growth of the hog industry and the adverse environmental impacts associated with that growth.[5] The state legislature only began to retreat from its support of the hog industry after a devastating hog waste spill occurred in June 1995,

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tobacco. *See* Joby Warrick & Pat Stith, *Corporate Takeovers*, NEWS & OBSERVER (Raleigh, N.C.), Feb. 21, 1995, at 1A. Moreover, North Carolina has become the second largest hog producer in the United States, raising more than 10 million hogs annually. *See Hog Farmers Liken Crisis to Depression*, GREENSBORO NEWS & REC. (N.C.), Jan. 10, 1999, at B8; Silverstein, *supra* note 2, at 33.

4. *See* Eric Voogt, *Pork, Pollution, and Pig Farming: The Truth About Corporate Hog Production in Kansas*, KAN. J.L. & PUB. POL'Y, Spring 1996, at 219, 228. Politicians who possessed a personal stake in the success of North Carolina's hog industry sponsored most of these incentives. During his 10 years as a North Carolina state legislator, Wendell Murphy, the largest hog producer in the United States, sponsored and supported a series of laws providing for various advantages to corporate hog producers. *See Murphy's Laws*, NEWS & OBSERVER (Raleigh, N.C.), Feb. 22, 1995, at 6A. For example, in 1985, North Carolina reduced the tax on gas used by feed delivery trucks by four cents per gallon. *See id.* A year later, construction materials related to hog farming were exempted from North Carolina's sales tax. *See id.* In 1988, the largest hog producers were exempted from a 12 cents per ton inspection fee on hog feed. *See id.* Also in 1988, the North Carolina legislature eliminated the tax on feed. *See id.* Finally, in 1991, the North Carolina legislature clarified an ambiguity in the state's right-to-farm statute by expressly defining the statutory term "bona fide farm" to include hog farming, thereby effectively prohibiting counties from using their zoning authority to regulate hog farms. *See id.*

Wendell Murphy is not the only North Carolina politician with personal ties to the hog industry. Former United States Senator Lauch Faircloth is a major stockholder in Lundy Packing, a hog processor in Clinton, North Carolina. *See* Silverstein, *supra* note 2, at 32-33. He owns a total of $19 million in numerous hog operations and his campaign donors included the North Carolina Pork Producers Association, the American Meat Institute, the National Pork Producers Association, and corporate hog producers, such as ConAgra, Carroll's Foods, and Lundy Packing. *See id.*

5. *See generally* TASK FORCE, *supra* note 1, at 5 (noting that "[n]o industry [in North Carolina] had ever grown so large so fast" as the hog industry, which doubled in only four years). The rapid increase in hog production and the greater density of industrialized hog operations have produced large amounts of waste and dead animals in a relatively small area, thereby increasing the strain on the environment in eastern North Carolina counties where most large hog operations are located. *See id.* at 7-13. By 1993, North Carolina's 10 million hogs produced 9 million tons of fresh manure. *See id.* at 13. Despite the problems involved in managing so much waste, North Carolina's right-to-farm statute has prevented counties from taking steps to address related environmental and health issues. *See* N.C. GEN. STAT. § 106-701(d) (1995); *see also* Charles W. Abdalla & John C. Becker, *Jurisdictional Boundaries: Who Should Make the Rules of the Regulatory Game?*, 3 DRAKE J. AGRIC. L. 7, 25 (1998) (discussing the effect of North Carolina's right-to-farm statute); *infra* notes 84-94 (same).

when an eight-acre manure lagoon at Oceanview Farms in Onslow County broke through its dam and spilled more than twenty-five million gallons of hog manure into the New River.[6] Following that spill, the North Carolina General Assembly passed legislation allowing counties to use their zoning authority to regulate hog farms,[7] while also establishing a temporary moratorium on the construction or expansion of hog farms, waste lagoons, and animal waste management systems so that counties could develop and implement the new regulations.[8] Despite these recent efforts, however, odor and other effects of corporate hog farming remain contentious issues between corporate hog facilities and neighboring landowners, as illustrated by the recent case *Parker v. Barefoot*.[9]

In *Parker v. Barefoot*, the North Carolina Court of Appeals reviewed a nuisance claim brought by several neighbors of a hog farm operated by Terry and Rita Barefoot. The issue on appeal was whether the trial court had committed a reversible error by refusing the plaintiffs' request to instruct the jury that the law does not recognize the use of the state-of-the-art technology[10] as a defense to a nuisance claim.[11] The court of appeals held for the plaintiff-appellants and granted a retrial.[12] *Barefoot* is noteworthy in two respects. First, it is the first hog farming case to reach the appellate court since the vertical integration of North Carolina's hog industry that deals with the issue of whether hog odors constitute a nuisance.[13]

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6. *See* John D. Burns, Comment, *The Eight Million Little Pigs—A Cautionary Tale: Statutory and Regulatory Responses to Concentrated Hog Farming*, 31 WAKE FOREST L. REV. 851, 851 (1996).

7. *See* Act of Aug. 26, 1997, ch. 458, sec. 2.1, 1997 N.C. Sess. Laws 1938 (codified at N.C. GEN. STAT. § 153A-340(b)(3) (Supp. 1998)); *infra* notes 93-94 and accompanying text (discussing passage of the statute).

8. *See* Act of Aug. 26, 1997, ch. 458, sec. 1.1, 1997 N.C. Sess. Laws 1938, *as amended* by Act of Oct. 16, 1998, ch. 188, sec. 2, 1998 N.C. Adv. Legis. Serv. 72 (extending temporary moratorium until September 1, 1999).

9. 130 N.C. App. 18, 502 S.E.2d 42, *disc. rev. denied*, 349 N.C. 362 (1998).

10. The term "state-of-the-art" was used synonymously with the term "best available technology" in *Barefoot*. 130 N.C. App. at 23, 502 S.E.2d at 46. The terms are used interchangeably throughout this Note.

11. *See id.* at 18-19, 502 S.E.2d at 44.

12. *See id.* at 26, 502 S.E.2d at 48.

13. Prior to *Barefoot*, only two cases involving hog farms had reached the appellate level. *See* Durham v. Britt, 117 N.C. App. 250, 254-55, 451 S.E.2d. 1, 3-4 (1994) (addressing whether a farm that was converted from turkey production to hog production remains shielded from nuisance suits under North Carolina's right-to-farm statute); Mayes v. Tabor, 77 N.C. App. 197, 200-01, 334 S.E.2d 489, 490-91 (1985) (recognizing that the type of unreasonableness that must be shown to prove that hog farm odors are a nuisance varies with the remedy sought). Although *Mayes* was decided in 1985, the factual dispute was based on events in the early 1980s before the vertical integration of North Carolina's

Second, it confirms the potential liability of hog facilities even if they conform with applicable regulations and use the best available technology for odor control and waste management.[14]

This Note begins with a synopsis of the North Carolina Court of Appeals decision in *Barefoot*.[15] The Note then discusses nuisance law in North Carolina and pertinent state legislation.[16] Next, the Note briefly discusses the state-of-the-art defense.[17] After examining the state of the hog industry and its waste problems in North Carolina,[18] the Note considers the design of the Barefoots' farm and the current state of the art for hog operations.[19] Finally, the Note examines the propriety of the decision in *Barefoot* and the case's probable impact on future nuisance claims against hog farms.[20]

In 1991, Terry and Rita Barefoot constructed a ninety-five acre industrial hog farm.[21] The facility, designed by the U.S. Soil Conservation Service,[22] consisted of four hog houses used to raise approximately 2880 hogs.[23] As part of the facility, the defendants constructed an open-pit anaerobic lagoon to store hog waste for later use as fertilizer.[24] After the farm began operations, twenty-seven

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hog industry. 77 N.C. App. at 198, 334 S.E.2d at 490; *see also supra* note 2 (discussing vertical integration).

14. *See Barefoot*, 130 N.C. App. at 26, 502 S.E.2d at 48.

15. *See infra* notes 21-45 and accompanying text.

16. *See infra* notes 46-103 and accompanying text.

17. *See infra* notes 104-20 and accompanying text.

18. *See infra* notes 121-34 and accompanying text.

19. *See infra* notes 135-45 and accompanying text.

20. *See infra* notes 146-58 and accompanying text.

21. *See Barefoot*, 130 N.C. App. at 19, 502 S.E.2d at 44.

22. The Soil Conservation Service administers several federal programs relating to the use, protection, and development of land, including research and technical assistance to farmers and community conservation, land-use planning, and watershed management control groups. *See* 7 C.F.R. § 15b, app. A (1999) (listing the programs and activities administered by the Soil Conservation Service).

23. *See Barefoot*, 130 N.C. App. at 19, 502 S.E.2d at 44.

24. *See id.* The construction or operation of an animal waste management system requires the operator to obtain a permit from the North Carolina Environmental Management Commission if the "animal operation" has 250 or more hogs. *See* N.C. GEN. STAT. §§ 143-215.1(a)(12), -215.10B(1) (1999). An "[a]nimal waste management system" is defined as "a combination of structures and nonstructural practices serving a feedlot that provide for the collection, treatment, storage, or land application of animal waste." *Id.* § 143-215.10B(3). When applying for a permit, the operator must submit a plan discussing the animal waste management practices or combination of practices that will be implemented for the specific feedlot. *See id.* § 143-215.10C(d). These practices must meet either the minimum standards and specifications contained in the U.S. Department of Agriculture Soil Conservation Service's Field Office Technical Guide or the minimum standard of practices developed by the state Soil and Water Conservation Commission before a permit can be issued. *See* N.C. ADMIN. CODE tit. 15A, r. 2H.0217(a)(1)(H)(i) (June 1998).

neighbors sued the Barefoots in Johnston County Superior Court, claiming that the odor from the hog farm constituted a nuisance.[25] At trial, the plaintiffs claimed that the odor from the open-pit lagoon was so strong that it burned their eyes and noses, often significantly impairing their vision and respiration.[26] In response, the defendants argued that occasional odors from their farm did not amount to a nuisance,[27] and presented evidence at trial that their hog facility was " 'operated with the most careful, prudent and modern methods known to science.' "[28] After the presentation of evidence, the plaintiffs asked the trial judge to instruct the jury that North Carolina law does not recognize the state-of-the-art technology defense in a nuisance suit.[29] The judge denied the plaintiffs' request, and the jury found for the defendants.[30] The plaintiffs appealed, arguing that the judge's ruling was reversible error.[31]

The North Carolina Court of Appeals accepted the plaintiff-appellants' argument and remanded the case for a new trial.[32] In an opinion written by Judge Wynn, the court reiterated the well-established rule that neither the use of state-of-the-art technology in the operation of a facility nor the absence of negligence in a facility's

25. *See Barefoot*, 130 N.C. App. at 18-19, 502 S.E.2d at 43-44.

26. *See id.* at 19, 502 S.E.2d at 44.

27. *See id.* The defendants also argued that the plaintiffs' claim was barred by North Carolina's right-to-farm statute, *see* Defendants' Answer and Motions to Dismiss at 1-2, Parker v. Barefoot (No. 92 CVS 02092), but that argument was rejected by the trial court at the summary judgment phase. *See* Parker v. Barefoot, No. 92 CVS 02092 (Johnston County May 31, 1994) (order denying summary judgment). Because the issue was not addressed in the trial court record or the appeals court decision, this Note does not discuss it further. For a general discussion of North Carolina's right-to-farm statute, see *supra* notes 84-94 and accompanying text.

28. *Barefoot*, 130 N.C. App. at 19, 502 S.E.2d at 44 (quoting Defendants' Answer & Motions to Dismiss at 5, *Barefoot* (No. 92 CVS 02092)).

29. *See id.* The plaintiffs requested the following jury instruction:

> The law does not recognize as a defense to a claim of nuisance that defendants used the best technical knowledge available at the time to avoid or alleviate the nuisance, and therefore the defendants may be held liable for creating a nuisance even though they used the latest known technical devices in their attempts to control the condition. The use of technical equipment and control devices may be considered by you as evidence bearing upon the magnitude of a nuisance but not as to its existence. Indeed, if defendants created a nuisance they are liable for the resulting injuries, regardless of the degree of skill they used to avoid or alleviate the nuisance.

Id. at 20-21, 502 S.E.2d at 45.

30. *See id.* at 19-20, 502 S.E.2d at 44.

31. *See id.* at 20, 502 S.E.2d at 44.

32. *See id.* at 18-19, 26, 502 S.E.2d at 44, 48. The decision was 2-1, with Judge Martin dissenting. *See id.* at 26-27, 502 S.E.2d at 48 (Martin, J., dissenting).

design is an absolute defense to a nuisance claim.[33] Therefore, because the plaintiffs' proposed instruction correctly summarized North Carolina's nuisance law, the appeals court held that the trial judge's failure to provide the substance of the plaintiffs' instruction was reversible error.[34]

On appeal, the neighbors argued that the Barefoots' main defense at trial had been that they could not be held liable under the law because their hog facility was " 'state-of-the-art' " and " 'operated with the most careful, prudent and modern methods known to science.' "[35] The Barefoots disputed this claim, stating that they had submitted the descriptions only to rebut the neighbors' allegation that the hog farm was a " 'shoddy, second-rate affair.' "[36] Instead, the Barefoots contended that the only defense they presented at trial was a factual one, specifically that their facility did not constitute a nuisance because it was reasonably designed and equipped with technology sufficient to alleviate odor.[37] Despite the Barefoots' contentions, the appellate court held that their testimony and argument at trial "could have reasonably been viewed by the jury as an affirmative attempt . . . to make out a 'state-of-the-art' defense."[38] Consequently, the appeals court determined that the evidence in the case required that the trial judge present the substance of the neighbors' requested instruction.[39]

The court concluded that the trial court's instruction did not clearly inform the jury that the Barefoots still could be found liable under North Carolina nuisance law if they substantially and unreasonably interfered with the neighbors' use of their property, regardless of whether the farm used state-of-the-art technology.[40] The court emphasized that the presentation of state-of-the-art evidence at trial was likely to confuse a jury about a defendant's

33. *See id.* at 21, 502 S.E.2d at 45; *see also* Watts v. Pama Mfg. Co., 256 N.C. 611, 616, 124 S.E.2d 809, 813 (1962) (holding that "[a] person who intentionally creates or maintains a private nuisance is liable for the resulting injury to others regardless of the degree of care or skill exercised by him to avoid such injury"); Morgan v. High Penn Oil Co., 238 N.C. 185, 194, 77 S.E.2d 682, 689 (1953) (same). For a discussion of the state-of-the-art defense, see *infra* notes 104-20 and accompanying text.

34. *See Barefoot*, 130 N.C. App. at 23, 502 S.E.2d at 46.

35. *Id.* (quoting Defendants' Answer & Motions to Dismiss at 3, 5, *Barefoot* (No. 92 CVS 02092)).

36. *Id.* (quoting Brief of Defendants-Appellees at 33, Parker v. Barefoot, 130 N.C. App. 18, 502 S.E.2d 42 (1998) (No. COA97-713)).

37. *See id.*

38. *Id.*

39. *See id.* at 24, 502 S.E.2d at 47.

40. *See id.* at 26, 502 S.E.2d at 48.

potential liability unless the trial judge specifically instructed the jury about the limited weight of such evidence.[41] The *Barefoot* court ruled that the trial judge's refusal to give this type of instruction constituted reversible error and granted the neighbors a new trial.[42]

Judge Martin dissented from the decision, although he agreed with the majority's articulation of North Carolina's nuisance law.[43] The primary difference between the majority and the dissent revolved around the interpretation of the Barefoots' statements and arguments regarding the construction and operation of their hog farm. Judge Martin believed that the discussion of the farm's design was only a minor part of the case.[44] He concluded that the neighbors' proposed instruction was not justified by the evidence and that they had failed to prove that they were prejudiced by the trial judge's ruling.[45]

The central issue in *Barefoot* was whether the farmers' use of their property amounted to a nuisance. Nuisance law attempts to balance two competing interests: the right of one individual to put his land to productive use[46] and the right of nearby property owners to be free from physical invasions that substantially interfere with the use

41. *See id.*

42. *See id.*

43. *See id.* at 26-27, 502 S.E.2d at 48 (Martin, J., dissenting).

44. *See id.* (Martin, J., dissenting) (accepting the Barefoots' factual characterization of the evidence). Judge Martin perceived the Barefoots' brief testimony regarding the general design of the facility as a mere rebuttal to the neighbors' denigrating characterizations of the farm. *See id.* (Martin, J., dissenting). He argued that what the majority interpreted as a state-of-the-art defense actually was "an insignificant aspect of the case." *Id.* (Martin, J., dissenting). Since the neighbors' charge contained issues irrelevant to the case, Judge Martin believed that the trial judge acted within his discretion when he denied the request for special instructions. *See id.* at 27, 502 S.E.2d at 48 (Martin, J., dissenting) (citing State v. Agnew, 294 N.C. 382, 395, 241 S.E.2d 684, 692 (1978)).

45. *See id.* at 26-27, 502 S.E.2d at 48 (Martin, J., dissenting). Judge Martin relied on the notion that a jury instruction will be upheld as long as " 'it presents the law of the case in such manner as to leave no reasonable cause to believe the jury was misled or misinformed.' " *Id.* at 27, 502 S.E.2d at 49 (Martin, J., dissenting) (quoting Jones v. Satterfield Dev. Co., 16 N.C. App. 80, 86-87, 191 S.E.2d 435, 440 (1972)). He argued that the appellant has the burden of showing that the instruction given by the trial judge misled the jury or that the omitted instruction affected the jury's verdict. *See id.* (Martin, J., dissenting) (citing Robinson v. Seaboard Sys. R.R., 87 N.C. App. 512, 524, 361 S.E.2d 909, 917 (1987)). According to Judge Martin, the trial court's instruction adequately depicted the law of the case, and the majority's conclusion that the jury was misled, misinformed, or otherwise confused by the trial court's refusal to provide the proposed instruction was pure speculation. *See id.* (Martin, J., dissenting).

46. The landowner's right to put land to productive use is one of the bundle of rights associated with property ownership. *See generally* Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 1027-28 (1992) (recognizing that states have a limited ability to restrict the "bundle of rights" that landowners acquire concomitant with property ownership and that a state may not completely restrict a landowner's productive use of her land without just compensation).

and enjoyment of their property.[47] Consequently, the precise boundaries of an individual's " 'right to do as he pleases with his own property are difficult to define.' "[48] Nuisance law requires that the particular use be reasonable under the circumstances.[49] Ultimately, the reasonableness of a property owner's conduct is determined by the factfinder.[50]

The seminal case of *Morgan v. High Penn Oil Co.*[51] established the fundamental elements of nuisance. The Morgan family purchased property in 1945 in Guilford County, North Carolina, and built their home, a restaurant, and mobile home hook-ups on the site.[52] Five years later, High Penn Oil built an oil refinery nearby.[53] Once completed, the refinery remained in constant operation, emitting noxious fumes and gases.[54] The issue in *Morgan* was whether these emissions constituted a nuisance even though High Penn had used all available methods to reduce the fumes and gases.[55]

In addressing that issue, the North Carolina Supreme Court recognized the basic principle that "any substantial nontrespassory invasion of another's interest in the private use and enjoyment of land ... is a private nuisance."[56] The court held that a person could be liable for a private nuisance regardless of whether the invasion was intentional or unintentional.[57] The court defined both terms, stating

47. *See* Watts v. Pama Mfg. Co., 256 N.C. 611, 616, 124 S.E.2d 809, 813 (1962); Morgan v. High Penn Oil Co., 238 N.C. 185, 193, 77 S.E.2d 682, 689 (1953); *see also* Louise A. Halper, *Untangling the Nuisance Knot*, 26 B.C. ENVTL. AFF. L. REV. 89, 101-02 (1998) (discussing the use of the common law doctrine of nuisance "as an all-purpose tool of land use regulation" and dispute resolution); Alexander A. Reinert, Note, *The Right to Farm: Hog-Tied and Nuisance-Bound*, 73 N.Y.U. L. REV. 1694, 1699-1703 (1998) (discussing the use of nuisance law to settle land-use disputes between hog farmers and their neighbors).

48. *Watts*, 256 N.C. at 617, 124 S.E.2d at 814 (quoting 39 AM. JUR. *Nuisances* § 16 (1942)).

49. *See id.* at 618, 124 S.E.2d at 814.

50. *See id.*

51. 238 N.C. 185, 77 S.E.2d 682 (1953).

52. *See id.* at 186-87, 77 S.E.2d at 684.

53. *See id.* at 186-87, 77 S.E.2d at 684-85.

54. *See id.* at 187-88, 77 S.E.2d at 685.

55. *See id.* at 190, 77 S.E.2d at 687.

56. *Id.* at 193, 77 S.E.2d at 689. The court noted that private nuisances could be classified into two distinct categories: (1) nuisances per se, or at law, and (2) nuisances per accidens, or in fact. *See id.* at 191, 77 S.E.2d at 687. The court defined the former as "an act, occupation, or structure which is a nuisance at all times and under any circumstance, regardless of location or surroundings." *Id.* By contrast, the latter only becomes a nuisance "by reason of [its] location, or by reason of the manner in which [it is] constructed, maintained, or operated." *Id.* A lawful enterprise that is neither constructed nor operated in a negligent manner, however, may still constitute a nuisance per accidens. *See id.* at 191, 77 S.E.2d at 687-88.

57. *See id.* at 193, 77 S.E.2d at 689. The court recognized that private nuisances per

that an unintentional nuisance stems from conduct that "is negligent, reckless, or ultrahazardous," while an intentional nuisance results from conduct that is deliberate and "unreasonable under the circumstances."[58] The court explained that unreasonable conduct occurs when a person: (1) purposefully causes the nuisance; (2) knows the nuisance will result; or (3) knows with substantial certainty that a nuisance will result.[59] Therefore, the court held, someone who "intentionally creates or maintains a private nuisance is liable for the resulting injury to others regardless of the degree of care or skill exercised by him to avoid such injury" because such conduct is manifestly unreasonable.[60] Under these principles, the court held that there had been ample evidence presented at trial to establish that the constant emission of fumes and gases onto the Morgans' property significantly impaired their use and enjoyment of the land so as to constitute a nuisance.[61]

Watts v. Pama Manufacturing Co.[62] built on the foundation of *Morgan*. In *Watts*, the plaintiff-appellees purchased a home in Gaston County, North Carolina, in 1957.[63] The property was located close to a hosiery manufacturer.[64] Two years later, the Pama Manufacturing Company took control of the hosiery factory and converted it to manufacture raw textiles.[65] As part of the conversion, the company replaced the original equipment with heavier and larger machinery and installed an additional industrial air-conditioning unit.[66] The company operated this new equipment almost continuously.[67] The issue presented to the court in *Watts* was whether the operation of the industrial mill, which caused continuous vibration of the Watts' property, amounted to unreasonable conduct constituting a nuisance.[68] Relying on the principles enunciated in *Morgan*, the *Watts* court held that although the operation of a lawful enterprise does not constitute a private nuisance as a matter of law,

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accidens could result from either intentional or unintentional conduct, but that most "are intentionally created or maintained, and are redressed by the courts without allegation or proof of negligence." *Id.* at 191, 77 S.E.2d at 688.

58. *Id.* at 193, 77 S.E.2d at 689.
59. *See id.* at 194, 77 S.E.2d at 689.
60. *Id.*
61. *See id.* at 194-95, 77 S.E.2d at 690.
62. 256 N.C. 611, 124 S.E.2d 809 (1962).
63. *See id.* at 613, 124 S.E.2d at 810-11.
64. *See id.* at 613, 124 S.E.2d at 811.
65. *See id.*
66. *See id.*
67. *See id.* at 614, 124 S.E.2d at 811.
68. *See id.* at 615-16, 124 S.E.2d at 812.

noise and vibrations may constitute a private nuisance in fact.[69]

The court explained the general principles of nuisance law, stating that a "*substantial* non-trespassory invasion of another's interest in the private use and enjoyment of property" is a nuisance if it substantially " 'affect[s] the health, comfort or property of those who live near[by].' "[70] According to the court, a substantial invasion is one "that involves more than slight inconvenience or petty annoyance."[71] Nevertheless, the court cautioned that the intentional character of an invasion does not necessarily render the invasion unreasonable, explaining that "[w]hat is reasonable in one locality and in one set of circumstances may be unreasonable in another."[72] Therefore, the proper test is "whether reasonable persons generally, looking at the whole situation impartially and objectively, would consider [the defendant's conduct] unreasonable."[73] The court remanded the case with a list of several factors for the jury to consider in evaluating the reasonableness of a defendant's actions.[74]

The North Carolina Court of Appeals elaborated on the reasonableness test in a hog farming context in *Mayes v. Tabor*,[75] in which the owner of a summer camp brought a nuisance action seeking permanent injunctive relief against neighboring hog farmers.[76] The court of appeals noted that a conclusion that a hog farmer operated his farm without negligence in an agricultural area does not end the

69. *See id.* at 617, 124 S.E.2d at 813.

70. *Id.* at 617, 124 S.E.2d at 813-14 (quoting Pake v. Morris, 230 N.C. 424, 426, 53 S.E.2d 300, 301 (1949), and citing Duffy v. E.H. & J.A. Meadows Co., 131 N.C. 31, 33-34, 42 S.E. 460, 461 (1902)).

71. *Id.* at 619, 124 S.E.2d at 815.

72. *Id.* at 618, 124 S.E.2d at 814.

73. *Id.*

74. *See id.* These factors include: the conditions and nature of the location and operation, the severity and nature of the invasion, the social values of each party's land-use, which party had earlier occupancy, "and other considerations arising upon the evidence." *Id.* The court noted that "[n]o single factor is decisive [but that] all the circumstances in the particular case must be considered." *Id.* Finally, the court emphasized that even if " 'a person voluntarily comes to a nuisance by moving into the sphere of its injurious effect, or by purchasing adjoining property or erecting a residence or building in the vicinity after the nuisance is created,' " a person can still recover damages for any injuries she sustains as a result of the nuisance. *Id.* at 618-19, 124 S.E.2d at 815 (quoting 39 AM. JUR. *Nuisances* § 197 (1942)). *See generally* Reinert, *supra* note 47, at 1700-01 (discussing the shift away from fault-based evaluations of nuisance claims and concomitant shift away from the rule that barred relief for plaintiffs moving to a nuisance).

75. 77 N.C. App. 197, 334 S.E.2d 489 (1985). This was the only nuisance case involving hog farms and focusing on the reasonableness of the defendant's conduct to reach the appellate level before *Barefoot*. Search of WESTLAW, NC-SC database (July 12, 1999) (using "hog farms" and "nuisance" as search terms).

76. *See Mayes*, 77 N.C. App. at 198, 334 S.E.2d at 489-90.

inquiry as to whether or not the operation of that hog farm constitutes a nuisance.[77] Instead, the type of unreasonableness must be assessed in order to determine the appropriate remedy for an intentional private nuisance.[78] The court of appeals explained that the type of unreasonableness determines whether a plaintiff can obtain damages, injunctive relief, or both.[79] According to the court, the "[u]nreasonable interference with another's use and enjoyment of land is grounds for damages."[80] Thus, in order to recover damages, "the defendant's conduct, in and of itself, need not be unreasonable" as long as the alleged nuisance unreasonably interferes with another's use and enjoyment of her land.[81] Injunctive relief, however, requires "proof that the defendant's conduct itself is unreasonable; [that] the gravity of the harm to the plaintiff ... outweigh[s] the utility of the conduct of the defendant."[82] Because the trial court failed to apply the appropriate reasonableness standard, the court of appeals reversed and remanded the case so that the propriety of injunctive relief could be determined.[83]

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77. *See id.* at 200, 334 S.E.2d at 491.

78. *See id.* at 200, 334 S.E.2d at 490.

79. *See id.* at 200, 334 S.E.2d at 490-91.

80. *Id.* at 200, 334 S.E.2d at 490 (citing Kent v. Humphries, 303 N.C. 675, 677-78, 281 S.E.2d 43, 45 (1981); Pendergrast v. Aiken, 293 N.C. 201, 217-18, 236 S.E.2d 787, 797 (1977)).

81. *Id.* (citing W. PAGE KEETON ET AL., PROSSER & KEETON ON THE LAW OF TORTS § 87, at 623 (5th ed. 1984)).

82. *Id.* at 200, 334 S.E.2d at 490-91 (citing *Pendergrast*, 293 N.C. at 217-18, 236 S.E.2d at 797). According to the court, " '[r]easonableness is a question of fact to be determined in each case by weighing the gravity of the harm to the plaintiff against the utility of the conduct of the defendant.' " *Id.* at 200, 334 S.E.2d at 491 (quoting *Pendergrast*, 293 N.C. at 217, 236 S.E.2d at 797). In determining the gravity of the harm, the court must consider: (1) the extent and character of the harm to the plaintiff; (2) the social value that the law attaches to the type of use invaded; (3) the suitability of the locality for that use; (4) the burden on the plaintiff to minimize the harm; and (5) other relevant considerations arising from the evidence. *See id.* (quoting *Pendergrast*, 293 N.C. at 217, 236 S.E.2d at 797). Similarly, when determining the utility of defendants' conduct, the court must consider: (1) the purpose of the defendant's conduct; (2) the social value that the law attaches to that purpose; (3) the suitability of the locality for defendant's use; and (4) other relevant considerations pertinent to the evidence presented. *See id.* (quoting *Pendergrast*, 293 N.C. at 217, 236 S.E.2d at 797).

83. *See id.* at 200, 334 S.E.2d at 491. The defendants also contended that North Carolina's right-to-farm statute entitled them to summary judgment. *See id.* at 201, 334 S.E.2d at 491. The court of appeals disagreed, interpreting the statute as precluding nuisance suits in situations where land-use patterns change around existing farming operations. *See id.*; *see also infra* notes 84-94 and accompanying text (discussing North Carolina's right-to-farm statute in more detail). In *Mayes*, the court noted that the plaintiff summer camp had operated for nearly 60 years, while the hog farm had operated for just 15 years; thus, it was not a situation where non-agricultural activities had extended into an agricultural area. 77 N.C. App. at 198, 201, 334 S.E.2d at 489-90, 491.

Within this framework of general nuisance law, North Carolina's agricultural operations often receive special protection because the General Assembly has passed a right-to-farm statute that makes it harder to bring nuisance suits against farmers.[84] As the state court of appeals recognized in *Baucom's Nursery Co. v. Mecklenburg County*,[85] "[i]t is the public policy of North Carolina to encourage farming, farmers, and farmlands."[86] To this end, the right-to-farm law "limit[s] the circumstances under which an agricultural . . . operation may be deemed to be a nuisance."[87] Under the statute, a farm that has been in lawful operation for at least one year and that was not a nuisance when it commenced cannot become either a public or private nuisance "by any changed conditions in or about the locality thereof."[88] While external changes to the locality surrounding a hog farm fall within the purview of the statute, the North Carolina Court of Appeals has interpreted the law to exclude situations in which a farmer fundamentally alters the nature of her agricultural activity.[89] Thus, if a farming operation exists for more than one year and then significantly changes its form of agricultural use or its hours of operation, the statute does not provide blanket protection to the farm owner.[90] Instead, the new agricultural use or hours must exist for one year before coming within the scope of the right-to-farm law.[91]

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84. *See* N.C. GEN. STAT. §§106-700 to -701 (1995). Commentators have called North Carolina's law, which was enacted in 1979, "one of the earliest and most influential right to farm laws" in the United States. Margaret Rosso Grossman & Thomas G. Fischer, *Protecting the Right to Farm: Statutory Limits on Nuisance Actions Against the Farmer*, 1983 WIS. L. REV. 95, 119. At least 19 states modeled their right-to-farm statutes on North Carolina's law. *See id.*

85. 62 N.C. App. 396, 303 S.E.2d 236 (1983).

86. *Id.* at 398, 303 S.E.2d at 238.

87. N.C. GEN. STAT. § 106-700 (1995).

88. *Id.* § 106-701(a). Section 106-701(b) defines an "agricultural operation" as "any facility for the production for commercial purposes of . . . livestock . . . [or] livestock products." *Id.* Therefore, hog farms fall within the statutory protections against nuisance claims.

89. *See* Durham v. Britt, 117 N.C. App. 250, 254-55, 451 S.E.2d 1, 3 (1994); *cf.* Mayes v. Tabor, 77 N.C. App. 197, 201, 334 S.E.2d 489, 491 (1985) (observing that sections 106-700 and 106-701 of the North Carolina General Statutes apply only in situations where a non-agricultural use extends into an agricultural area, not where there is a pre-existing non-agricultural use situated in a particular locality prior to the initial operation of an agricultural facility). *Mayes* is discussed *supra* notes 75-83 and accompanying text.

90. *See Britt*, 117 N.C. App. at 255, 451 S.E.2d at 3. In *Britt*, the court held that the alteration of the agricultural facility from turkey to hog production constituted a fundamental change not protected by section 106-701. *See id.* at 255, 451 S.E.2d at 4. The court also held that defendant's compliance with federal law did not bar a nuisance claim where the federal law does not specifically preempt state law. *See id.*

91. *See* N.C. GEN. STAT. § 106-701(a).

The right-to-farm statute originally declared null and void any local ordinance that would make any farming activity or the operation of a farm a nuisance.[92] The scope of this restriction was limited in 1997, however, when the General Assembly passed a package of hog farm and clean water provisions in reaction to a major hog waste spill.[93] Under the 1997 amendments, section 153A-340 of the North Carolina General Statutes now authorizes counties to adopt zoning regulations for hog farms with a designed capacity of about 4000 hogs or more.[94] The relationship between North Carolina's right-to-farm statute and the 1997 provisions is not yet clear, but these zoning amendments are significant because for the first time since the adoption of the right-to-farm statute in 1979, counties have some ability to regulate industrial hog farms and to allow private nuisance suits against them.

A recent case from another major hog-producing state[95] suggests that North Carolina's right-to-farm statute could be further weakened by a constitutional challenge. In *Bormann v. Board of Supervisors*,[96] the plaintiff-appellants facially challenged Iowa's right-to-farm law,[97]

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92. *See id.* § 106-701(d).

93. *See* Act of Aug. 26, 1997, ch. 458, 1997 N.C. Sess. Laws 1938 (codified in scattered sections of North Carolina General Statutes Chapters 106, 143 and 153); *supra* notes 5-8 and accompanying text. The bill was enacted in response to the divisive environmental and nuisance issues caused by North Carolina's thriving hog industry. *See* Abdalla & Becker, *supra* note 5, at 25.

94. *See* N.C. GEN. STAT. § 153A-340(b)(3) (1997). Because hogs are considered ready for processing at the early age of six months, the amount of turnover in an industrialized facility is tremendous and causes continual fluctuation in the actual aggregate weight of the hogs at the site. Despite this constant change, the average weight of the hogs (whether calculated on a daily, weekly, or monthly basis) can be used to determine whether the facility is subject to section 153A-340 of the North Carolina General Statutes. If the average weight amounts to 600,000 pounds or more, then the facility does not receive the benefits of the right-to-farm statute. *See id.* § 153A-340. If, however, the average weight is less than 600,000 pounds and the facility has been in existence for one year or more, the facility is shielded from nuisance suits and zoning regulations. *See id.* § 106-701(a); § 153A-340. A farm with 600,000 liveweight capacity has room for about 4000 hogs. *See* Abdalla & Becher, *supra* note 5, at 25.

95. Iowa is the only state to produce more hogs than North Carolina. It raises more than 14.5 million hogs annually. *See* Silverstein, *supra* note 2, at 31.

96. 584 N.W.2d 309 (Iowa 1998), *cert. denied sub nom.* Girres v. Bormann, 119 S. Ct. 1096 (1999). *See generally* Mindy Larsen Poldberg, *A Practioner's Guide to Iowa Manure Laws, Manure Regulations, and Manure Application Agreements*, 3 DRAKE J. AGRIC. L. 433, 456-61 (1998) (discussing the Iowa Supreme Court's decision in *Bormann* and its potential effect on other statutes that provide nuisance protection to farmers).

97. *See* IOWA CODE ANN. § 352.11(1)(a) (West 1994) ("A farm or farm operation located in an agricultural area shall not be found to be a nuisance regardless of the established date of operation or expansion of the agricultural activities of the farm or farm operation."). An agricultural area was defined under the statute as an area designated by a county with the consent of the property owners where the use of the land was limited to

claiming not only that it constituted a per se taking of their property,[98] but also that the provision gave certain private property owners in designated agricultural areas legal permission to foist a nuisance onto neighboring property, thereby generating an easement.[99] The Iowa Supreme Court agreed, holding that the statutory immunity from nuisance claims allowed certain property owners to engage in conduct, which, absent the establishment of an easement, would constitute a nuisance.[100] Moreover, since easements are subject to the Takings Clause of the Fifth Amendment,[101] the court held that the State could not "regulate property so as to insulate the users from potential private nuisance claims without providing just compensation to persons injured by the nuisance."[102] The court concluded that the "legislature exceeded its authority by authorizing the use of property in such a way as to infringe on the rights of others by allowing the creation of a nuisance without the payment of just compensation" in violation of the Fifth Amendment.[103]

As the scope North Carolina's right-to-farm statute shrinks, hog farmers may turn instead to the state-of-the-art defense for protection from nuisance suits. The defense developed initially in products liability law, where courts felt it was unjust to hold manufacturers liable when older products did not live up to modern safety standards.[104] In products liability cases, the defense is used to assert that a manufacturer should not be liable when it uses state-of-the-art safety features in a product and instead should be liable only if it fails to warn consumers of an inherently dangerous product characteristic when the manufacturer had actual or constructive knowledge of the danger.[105] Most jurisdictions recognize this defense, but apply it in

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farming. *See id.* § 352.6. The statute delineated several exceptions to the prohibition against nuisance claims; a plaintiff could bring a nuisance suit if the defendant's farming operation was (1) unlawful; (2) negligent; (3) a nuisance prior to the agricultural area designation; or (4) caused a "change in condition of the waters of a stream, the overflowing of the person's land, or excessive soil erosion." *Id.* § 352.11(1)(b).

98. *See Bormann*, 584 N.W.2d at 313.

99. *See id.*

100. *See id.* at 316.

101. *See id.* (citing United States v. Welch, 217 U.S. 333, 339 (1910)). The Fifth Amendment states that private property shall not "be taken ... without just compensation." U.S. CONST. amend. V.

102. *Bormann*, 584 N.W.2d at 319-320 (citing Richards v. Washington Terminal Co., 233 U.S. 546, 553 (1914)).

103. *Id.* at 321.

104. *See, e.g.*, Bruce v. Martin-Marietta Corp., 544 F.2d 442, 447 (10th Cir. 1976) ("A consumer would not expect a Model T to have the safety features which are incorporated in automobiles made today.").

105. *See* Matthew William Stevens, Survey, *Strictly No Strict Liability: The 1995*

different ways.[106] For example, courts disagree over whether state-of-the-art defenses may be asserted in strict liability cases.[107] Similarly, jurisdictions differ regarding whether a state-of-the-art defense functions as an absolute defense or whether it operates as a mitigating factor to be weighed along with a variety of other circumstances.[108] The recent *Restatement (Third) of Torts* effectively abolished the defense and replaced it with a broader, more generic standard.[109] Under the Restatement, a product is designed defectively if the plaintiff establishes that a safer alternative design could have been adopted, even though such a design had not been "adopted by any manufacturer, or even considered for commercial use."[110] The ramifications of the Restatement's have not yet been clear because the change is too recent to have affected court holdings.

Despite the uncertainty over the state-of-the-art defense in products liability cases, the defense remains a significant factor in nuisance suits. The North Carolina Supreme Court has recognized that although the state-of-the-art defense does not erect a complete bar to nuisance claims, it can be used as a mitigating factor in

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Amendments to Chapter 99B, the Products Liability Act, 74 N.C. L. REV. 2240, 2249-50 (1996) (quoting Charles C. Marvel, Annotation, *Strict Products Liability: Liability for Failure to Warn as Dependent on Defendant's Knowledge of Danger*, 33 A.L.R. 4th 369, 371 (1984)). Since scientific and technological knowledge is limited, certain risks and safety measures remain unknown until an injury occurs. *See* David G. Owen, *Defectiveness Restated: Exploding the "Strict" Products Liability Myth*, 1996 U. ILL. L. REV. 743, 782. Often, manufacturers sued for product-related injuries will claim that their product was designed or manufactured according to the best available technology or was state of the art at the time of production. *See id.* at 783.

106. *See* Geraint G. Howells & Mark Mildred, *Is European Products Liability More Protective Than the* Restatement (Third) of Torts: Products Liability?, 65 TENN. L. REV. 985, 1021 (1998).

107. *Compare* Hayes v. Ariens Co., 462 N.E.2d 273, 277 (Mass. 1984) (noting that a state-of-the-art defense is not relevant for strict liability purposes), *with* Anderson v. Owens-Corning Fiberglas Corp., 810 P.2d 549, 550 (Cal. 1991) (holding that a defendant in a strict liability case is permitted to present evidence to support a state-of-the-art defense).

108. *Compare* KY. REV. STAT. ANN. § 411.310(2) (Michie 1992) (creating a presumption that if a product conforms to generally recognized and prevailing standards or the state-of-the-art in existence at the time the design was prepared, it is not defective), *and* IOWA CODE ANN. § 668.12 (West 1987) (stating that conformance with the state of the art at the time the product was designed is an absolute defense), *with* O'Brien v. Muskin Corp., 463 A.2d 298, 305 (N.J. 1983) ("[S]tate-of-the-art evidence is relevant to, but not necessarily dispositive of, risk-utility analysis."), *and* Sumnicht v. Toyota Motor Sales, U.S.A., Inc., 360 N.W.2d 2, 17 (Wis. 1984) ("A product may be defective and unreasonably dangerous even though there are no alternative, safer designs available.").

109. *See* RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 2 cmt. d, at 20 (1997); Larry S. Stewart, *A New Frontier: Design Defects Cases and the New Restatement*, TRIAL, Nov. 1998, at 20, 21.

110. RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 2 cmt. d, at 20.

assessing the reasonableness of a party's conduct.[111] As such, a defendant has the ability to show that the use of such technology effectively eliminates a nuisance. The difficulty with asserting the defense, however, is that the use of the best available technology is not conclusive or controlling.[112] Instead, the technology used will be assessed, along with a variety of other factors,[113] to determine whether the operation of the facility is reasonable under all the circumstances.[114] Thus, asserting that one's hog facility has implemented the best available technology will only provide a full defense against a nuisance claim if that technology completely abates the nuisance. Otherwise, a plaintiff's nuisance claim can succeed despite the presentation of evidence showing that the defendant used state-of-the-art technology provided the plaintiff can show that the defendant substantially interfered with the reasonable use and enjoyment of the plaintiff's property.[115]

Another problem with applying the state-of-the-art defense in nuisance claims is that it focuses on the knowledge of the defendant, which is important in products liability but is not an essential element in nuisance law. Traditionally, the state-of-the-art defense precluded manufacturer liability unless the manufacturer had failed to warn consumers of the inherently dangerous aspects of a product where the manufacturer either knew or should have known of the product's dangerousness.[116] Even though *Restatement (Third) of Torts* eliminated the term "state of the art," its drafters still adopted the rationale that a manufacturer is liable only for foreseeable risks and is required to adopt only those risk avoidance measures that are "reasonably knowable and otherwise commercially feasible at the time of sale."[117] The difficulty in applying a state-of-the-art defense in hog farm odor nuisance suits, however, is that the defense only applies if the defendant's knowledge is a prerequisite to recovery,[118] but knowledge is *not* essential to liability in a nuisance claim.[119] A

111. *See* Watts v. Pama Mfg. Co., 256 N.C. 611, 618, 124 S.E.2d 809, 814 (1962).

112. *See id.* at 616, 124 S.E.2d at 813.

113. *See supra* note 74 (listing the factors used to determine the reasonableness of defendants' actions in nuisance suits).

114. *See Watts*, 256 N.C. at 618, 124 S.E.2d at 814.

115. *See id.*; Morgan v. High Penn Oil Co., 238 N.C. 185, 193, 124 S.E.2d 682, 689 (1953); *Barefoot*, 130 N.C. App. at 26, 502 S.E.2d at 48.

116. *See* Stevens, *supra* note 105, at 2249-50.

117. Owen, *supra* note 105, at 783; *see also* RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 2, cmt. d, at 19-20 (explaining that liability attaches only to foreseeable risks).

118. *See* T & E Indus., Inc. v. Safety Light Corp., 587 A.2d 1249, 1260 (N.J. 1991).

119. *See Watts*, 256 N.C. at 616, 618, 124 S.E.2d at 813, 814. The test of what constitutes

hog farmer can be liable for creating a nuisance even though he is ignorant of the odor's existence. Thus, unless a defendant can show that using state-of-the-art technology completely abated the alleged nuisance, the defense will only be useful as a factor in determining the reasonableness of the defendant's conduct weighed against various other factors.[120]

The state-of-the-art defense also raises issues with respect to what constitutes the cutting edge in modern hog farming operations. Today's industrialized hog farms raise a significantly larger number of hogs on roughly the same amount of land as traditional, family-owned hog farms.[121] This change has increased the volume of hog waste and has intensified related odors. North Carolina raises more than ten million hogs annually,[122] producing over nine million tons of waste[123] which is commonly stored in open-pit "lagoons" where the waste remains until it eventually is used as fertilizer.[124] Hog farms use one of two types of waste lagoons: aerobic lagoons or anaerobic lagoons.[125] Lagoon systems are designed to convert the organic

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a nuisance is whether an actor's conduct substantially and unreasonably interferes with the use and enjoyment of a person's property. *See id.* at 618, 124 S.E.2d at 814; *Morgan*, 238 N.C. at 193, 77 S.E.2d at 689; *Barefoot*, 130 N.C. App. at 26, 502 S.E.2d at 48.

Knowledge is a factor, however, in determining whether certain conduct constitutes an intentional nuisance. *See Morgan*, 238 N.C. at 194, 77 S.E.2d at 689. According to *Morgan*, liability for an intentional nuisance attaches when someone either knows or is substantially certain that his conduct is causing a nuisance. *See id.* The problem is that even if a hog farmer claims that she implemented the best available technology at the time of design and construction of her facility, it is difficult to argue that she did not know or did not have constructive knowledge that her hog farm would generate odor. Odors are a natural and expected byproduct of hog farms. Therefore, the state-of-the-art defense does not insulate hog farmers from intentional nuisances because of the inherent nature of hog farms and their unavoidable creation of odors. *Cf. id.* (stating that actual or constructive knowledge that a nuisance will result from a person's conduct is sufficient to constitute an intentional nuisance).

120. *See supra* note 115 and accompanying text.

121. *See* TASK FORCE, *supra* note 1, at 5 (noting that the tremendous growth in North Carolina's hog production has occurred on farms that already housed hundreds or even thousands of hogs at one site.

122. *See* Silverstein, *supra* note 2, at 33. Iowa is the nation's leading hog producer, raising more than 14.5 million hog annually. *See id.* at 31.

123. *See* Rogers, *supra* note 2, at 1B. For updates on the amount of waste deposited by North Carolina hogs since January 1, 1999, see Environmental Defense Fund, *Hogwatch* (visited Apr. 22, 1999) <http://www.hogwatch.org/resourcecenter/counter.html>.

124. *See* Brian Feagans, *New Ways to Handle Hog Waste Sought*, SUNDAY STAR-NEWS (Wilmington, N.C.), Feb. 28, 1999, at Supp. 19.

125. *See* Richard E. Nicolai, *Managing Odors from Swine Waste*, AGRIC. ENGINEERING UPDATE (Dep't of Biosys. & Agric. Eng'g, Univ. of Minn., St. Paul, Minn.), June 30, 1995, at 3. Aerobic lagoons need oxygen for the waste-decomposing microorganisms to thrive, while anaerobic lagoons are not oxygen dependent. *See id.*

matter in manure into stable products.[126] While the relatively mild odor produced by aerobic lagoons is a benefit from using such systems, the substantial cost of installing and operating aerobic facilities is a drawback.[127] As a result, most hog farms, including the Barefoots' farm, use anaerobic waste lagoons.[128]

Whether hog waste decomposes aerobically or anaerobically, the odors that emanate from these lagoons are comprised of a mixture of gas, vapor, and dust.[129] The odors from anaerobic lagoons, however, often are more offensive than the odors from aerobic lagoons.[130] Anaerobic lagoons release a variety of gases—including ammonia and hydrogen sulfide, which create that familiar rotten-egg stench—as well as pungent fatty acids and 150 other volatile compounds.[131] Dust and other airborne particles originating in hog pens not only contain pathogens and physical irritants, but also transport many of the compounds produced by waste lagoons.[132] The type of gaseous mixture created depends upon the location of the hog facility, the size and type of the operation, particular production practices, as well as meteorological conditions.[133] Consequently, it is difficult to determine which compound or combination of compounds is responsible for the offensive odors emanating from a particular hog farm and, thus, to target and alleviate the noxious odors.[134]

Because the Barefoots chose to install an anaerobic lagoon system to treat hog waste on their farm, the odors emanating from

126. *See id.* Lagoon systems treat waste by converting it into carbon dioxide, methane, ammonia, and other gaseous compounds; organic acids; and cell tissue. *See* Act of Oct. 16, 1998, ch. 188, sec. 2, 1998 N.C. Adv. Legis. Serv. 72. (detailing the various stable products produced through both the aerobic and anaerobic decomposition process).

127. *See* Nicolai, *supra* note 125, at 3.

128. *See* Mark Sobsey, *Human Health Issues* (visited Apr. 22, 1999) <http://www.hogwatch.org/resourcecenter/onlinearticles/sos/sobsey.html>; *see also Barefoot*, 130 N.C. App. at 19, 502 S.E.2d at 44 (describing the Barefoots' lagoon). The North Carolina legislature has recently directed the state Department of Agriculture to develop a plan to phase out the use of anaerobic lagoons and sprayfields as the primary methods of disposing of animal waste at hog farms. *See* Act of Aug. 27, 1997, ch. 458, sec. 12.4, 1997 N.C. Sess. Laws 1959.

129. *See* TASK FORCE, *supra* note 1, at 15.

130. *See id.* at 19.

131. *See id.* at 15. These other compounds are the result of biological reactions within the waste lagoon. They include "organic acids, alcohols, aldehydes, fixed gases, carbonyls, esters, amines, sulphides, mercaptans, and nitrogen heterocycles." *Id.*

132. *See id.*

133. *See id.*

134. Hog farm odors generally originate from four areas: (1) buildings and holding facilities; (2) manure storage and treatment areas; (3) areas on which lagoon liquids and sludge have been applied; and (4) carcass disposal areas. *See id.* at 16-19 (providing a detailed discussion regarding how odors occur in each of these sources).

their lagoon were more intense and more constant than if they had installed an aerobic lagoon system. Perhaps anticipating problems, the Barefoots attempted to alleviate their lagoon's odor by encircling it with acres of crops, trees, and forest.[135] In addition, they used the expertise of the Soil Conservation Service in designing and constructing their facility.[136] Finally, the Barefoots not only installed an underground irrigation system, but also built the lagoon twenty percent larger than required in a further attempt to reduce odor.[137]

The question remains: What more could the Barefoots have done to alleviate the nuisance? Various technologies have been developed to address the chronic problem of hog-farm odors.[138] For example, two devices quantitatively measure odor: the Scentometer™ and the Odor Monitor™.[139] Although each device has its limitations, the two instruments generally correspond in their measurement and rankings of tested odors, and each device provides farmers with a means of detecting an increase in the intensity of noxious fumes.[140] In addition, several odor-reducing techniques have been developed. First, farmers can alter their hogs' diets, decreasing the amount of ammonia, nitrogen, and other odorous compounds produced.[141] Farmers can also use odor-controlling additives to treat or prevent odors in hog-storage houses and waste lagoons.[142]

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135. *See Barefoot*, 130 N.C. App. at 19, 502 S.E.2d at 44.

136. *See id.*

137. *See id.*

138. There is no precise method available to measure odors objectively, particularly since the offensiveness of an odor does not necessarily correspond to its intensity. *See* TASK FORCE, *supra* note 1, at 38. Odors produced by hog farms often are intermittent and usually are difficult to detect simply by measuring airborne concentration of compounds. *See id.*

139. *See id.* at 39-40. The Scentometer™ Model SCC requires the user to inhale through two nostril inserts. *See id.* "The user first receives odor-free air and then a sequence of increasingly odorous samples, and a threshold is established when the user first detects the odor. An odor's magnitude is determined by the number of dilutions required to reach the threshold." *Id.* at 40. Unlike the Scentometer™, the Odor Monitor™ does not require the use of human subjects, but instead evaluates odors by measuring the odor-causing molecules in the air. *See id.*

140. *See id.*

141. *See id.* at 41. There are several approaches available regarding feed conversion and odor control to make effective dietary improvements for hogs. One approach to improve the diet of hogs in order to decrease nitrogen production is the substitution of synthetic amino acids in place of traditional protein sources. *See id.* at 42. A second approach is to use proteolytic enzymes to increase the digestibility of protein. *See id.* Other options include the addition of odor absorbers, plant extracts, or enzymes to hog feed in order to aid in the control of odors generated by hogs. *See id.*

142. *See id.* at 43-44. A number of additives are available to neutralize odors. Aromatic oils, used either as masking agents or as counteractants, are one option to control odors. *See id.* at 43. In addition, digestive deodorants, external odor absorbents,

Another option is to install mechanical technologies, including biological filters, catalytic converters, condensers, incinerators, and scrubbers.[143] As a final option, farmers can install an effective ventilation system to diminish the intensity of hog-related odors.[144] Notwithstanding the availability of a wide selection of odor-reducing technologies and techniques, however, the most effective method to control odors is the overall design, siting, and management of the hog farm to maintain control over the cleanliness of both the hogs and the facilities.[145]

While these factual and legal issues call into question the utility of the state-of-the-art defense in nuisance suits against hog farms, the *Barefoot* court's ruling suggests that the defense may now become an issue every time the parties introduce evidence regarding a hog farm's design. Accordingly, *Barefoot* is significant in several ways. The first significant aspect of the case stems from the difference between the majority's and the dissent's interpretations of whether the evidence presented by the defendant-appellees constituted a state-of-the-art defense. The majority emphasized that the jury could have reasonably interpreted the Barefoots' case as an affirmative state-of-the-art defense.[146] The dissent, however, viewed the defendant-appellees' claims that their hog farm was a state-of-the-art facility as simply a rebuttal to the plaintiff-appellants' claims that the substandard design of the farm caused noxious odors.[147] The dissent argued that the Barefoots were not advancing a state-of-the-art defense and, therefore, that the trial court was not required to instruct the jury about the substantive law of such a defense.[148] The majority's opinion creates a relatively low threshold for determining whether the evidence and testimony presented at trial constitute a state-of-the-art affirmative defense. According to the court of

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and a variety of chemical deodorants provide viable options to mitigate odors. *See id.* at 43-44.

143. *See id.* at 56. All of these options pose significant financial costs, so the hog industry has been reluctant to embrace them. *See id.*

144. *See id.* at 45-47. Proper ventilation prevents the accumulation of noxious gases that result from decomposing manure. *See id.* at 46. As a result, the design of the ventilation system is crucial in determining whether the dispersion of odorous fumes will be released in a constant, diluted manner or whether those fumes will be emitted in occasional, but highly concentrated, doses. *See id.*

145. *See id.* at 74; *see also* Nicolai, *supra* note 125, at 2 (noting that management practices and common sense are key determinants in controlling hog farm odors).

146. *See Barefoot*, 130 N.C. App. at 23, 502 S.E.2d at 46.

147. *See id.* at 27, 502 S.E.2d at 49 (Martin, J., dissenting).

148. *See id.* at 27, 502 S.E.2d at 48 (Martin, J., dissenting) (citing State v. Agnew, 294 N.C. 382, 395, 241 S.E.2d 684, 692 (1978)).

appeals, the introduction of almost any evidence about the design and construction of the hog farm, regardless of the subjective motive for its introduction, is sufficient to constitute a state-of-the-art defense.[149] Consequently, once such evidence is introduced, a trial court is now required to instruct the jury, at least in substance, that the use of state-of-the-art or best-available technology does not absolve liability in a nuisance claim.[150] Failure to provide this instruction is reversible error.[151]

Barefoot is also significant because it affirms that hog farm owners cannot avoid nuisance liability simply by using the best technology available, maintaining and operating their farms in compliance with government regulations, using a reasonable design, and implementing state-of-the-art technology.[152] While these factors may be used to weigh the evidence and the severity of the interference with neighboring landowners' use of their properties, they do not bar the claim itself.[153]

Barefoot, in combination with the recent legislative efforts to curb the impacts associated with the corporate hog industry, provides the first incremental gains in decades for those communities that have had to absorb the financial and environmental burdens of the vertical integration of hog farming. Of course, the ultimate decision as to whether certain conduct constitutes a nuisance remains in the hands of the jury,[154] and determining whether the new instructions will affect juries' decisions must await the results of subsequent cases. While *Barefoot* emphasizes that the use of state-of-the-art technology in the operation and design of a hog facility is not a complete defense to a nuisance suit,[155] the trajectory of that rule may be relatively flat. The most significant barrier to these types of lawsuits is that they

149. *See id.* at 23-24, 502 S.E.2d at 46-47.

150. *See id.* at 26, 502 S.E.2d at 48.

151. *See id.* at 20, 502 S.E.2d at 44; *see also* Bass v. Hocutt, 221 N.C. 218, 219, 19 S.E.2d 871, 872 (1942) (holding that a trial court's failure to provide the substance of the state of the law in a jury instruction as requested by a party is reversible error); Calhoun v. State Highway and Public Works Comm., 208 N.C. 424, 424, 181 S.E. 271, 272 (1935) (same); Parks v. Security Trust Co., 195 N.C. 453, 453, 42 S.E. 473, 473 (1928) (same); Michaux v. Paul Rubber Co., 190 N.C. 617, 619, 130 S.E. 306, 307 (1925) (same); Marcom v. Durham & S.R. Co., 165 N.C. 259, 259-60, 81 S.E. 290, 291 (1914) (same); Irvin v. Southern R.R. Co., 164 N.C. 5, 17-18, 80 S.E. 78, 83 (1913) (same); Faeber v. E.C.T. Corp., 16 N.C. App. 429, 430, 92 S.E.2d 1, 2 (1972) (same).

152. *See Barefoot*, 130 N.C. App. at 26, 502 S.E.2d at 48.

153. *See id.* at 22-23, 502 S.E.2d at 46.

154. *See id.*; *see also* Watts v. Pama Mfg. Co., 256 N.C. 611, 618, 124 S.E.2d 809, 814 (1962) (listing several factors to be considered by a jury in determining the reasonableness of a defendant's conduct).

155. *See Barefoot*, 130 N.C. App. at 22, 502 S.E.2d at 45.

inevitably are brought in counties whose residents are heavily dependent upon the hog industry for their employment and livelihood. Combine demographics, geography, and economics with the commonly held view that a person should be free to use her property as she chooses, and the outcomes of these types of lawsuits may not change, despite *Barefoot*.[156]

Although *Barefoot* illustrates the viability of nuisance claims to combat the emission of hog odors and other related hog farm impacts, a more prudent approach for future plaintiffs may be the one taken by the plaintiffs in *Bormann v. Board of Supervisors*, who successfully argued that Iowa's right-to-farm laws constituted an unconstitutional taking of property without just compensation by allowing farmers easements over their neighbors' property.[157] A successful constitutional challenge to North Carolina's right-to-farm statutes could have several significant effects. A successful suit would require the state either to pay just compensation to those potentially affected by hog-farm odors or to invalidate the right-to-farm statute.[158] Under either scenario, neighboring property owners of hog farms would benefit because they could bring nuisance claims regardless of the size of the farm. Although the potential cost to the hog industry is significant, hog farming's cost to tourism, public health, and the environment in North Carolina has already proven expensive.

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156. A year before the trial court decision in *Barefoot*, another Johnston County jury determined that there was "nothing patently unreasonable" with having to reside near a hog farm. Joby Warrick, *Jury Rejects Claim Against Hog Operation*, NEWS & OBSERVER (Raleigh, N.C.), Aug. 31, 1996, at 3A (providing background on hog farming litigation after the *Barefoot* trial). Former United States Senator Robert Morgan observed, as long as " '[p]eople . . . still have this feeling that, "[i]t's my land, and . . . I'll do whatever I want with it," ' " there will not be " 'a sympathetic jury in Johnston County.' " *Id.* (quoting Robert Morgan). Mr. Morgan served as the plaintiffs' attorney in *Barefoot*. *See id.*

157. 584 N.W.2d 309 (Iowa 1998), *cert. denied sub nom.* Girres v. Bormann, 119 S. Ct. 1096 (1999). For a discussion of *Bormann*, see *supra* notes 96-103 and accompanying text.

158. Invalidation of the statute would not necessarily avoid the compensation issue. *See, e.g.*, First English Evangelical Lutheran Church of Glendale v. County of Los Angeles, 482 U.S. 304, 318 (1987) (holding that regulations which temporarily deprive a landowner of all use of her property require compensation under the Fifth Amendment even if the government later abandons those regulations).

Too Far Too Fast? The North Carolina Supreme Court Eliminates the Common Law Distinction Between Invitees and Licensees in *Nelson v. Freeland*

Consider the following scenario: Aaron and Leslie are neighbors in Chapel Hill, North Carolina. While gardening one Saturday afternoon, Aaron realizes he needs a particular garden tool which he has previously borrowed from Leslie on several occasions. Unannounced, Aaron walks over to ask Leslie if he may borrow the tool. While on Leslie's property, Aaron steps into a small hole that Leslie had dug that morning intending to plant a flower there. Aaron's ankle twists and he falls, sustaining injuries. As it turns out, Leslie is out buying fertilizer for the flower and is not home when the incident occurs. Is Leslie liable in negligence[1] for the injuries to Aaron?

For over a century in North Carolina, well-established common law rules have governed the answer to this question.[2] Under these judicially created rules, the extent of the landowner's[3] (Leslie's) duty

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1. The tort of negligence consists of four elements:

> [F]irst, a duty imposed on defendant by law to conform to a certain standard of conduct in respect of the interests of the others (and his own interests, in the case of contributory negligence); second, breach of that duty; third, an injury or damages to the plaintiff; and fourth, a sufficient factual and legal connection between the defendant's breach of duty and the plaintiff's harm.

CHARLES E. DAYE & MARK W. MORRIS, NORTH CAROLINA LAW OF TORTS § 16.10, at 134 (1991).

Negligence with respect to landowners and entrants, such as that in the hypothetical, is a subset of general negligence law. *See id.* at 132. For further discussion of negligence in the context of premises liability, see Charles E. Daye, *Judicial Boilerplate Language as Torts Decisional Litany: Four Problem Areas in North Carolina*, 18 CAMPBELL L. REV. 359, 359-71 (1996); Norman S. Marsh, *The History and Comparative Law of Invitees, Licensees, and Trespassers*, 69 LAW Q. REV. 182 (1953); Kathryn E. Eriksen, Comment, *Premises Liability in Texas—Time for a "Reasonable" Change*, 17 ST. MARY'S L.J. 417 (1986); John Ketchum, Note, *Missouri Declines an Invitation to Join the Twentieth Century: Preservation of the Licensee-Invitee Distinction in* Carter v. Kinney, 64 UMKC L. REV. 393 (1995); Linda Sayed, Note, *Assault on the Common Law of Premises Liability: What Duty of Care Does an Owner or Occupier of Land Owe to a Police Officer Who Enters the Premises of Another by Authority of Law?* Newton v. New Hanover County Board of Education, 19 CAMPBELL L. REV. 579 (1997); Michael Sears, Comment, *Abrogation of the Traditional Common Law of Premises Liability*, 44 U. KAN. L. REV. 175 (1995).

2. *See* Nelson v. Freeland, 349 N.C. 615, 617, 507 S.E.2d 882, 883 (1998) (noting that the common law approach has been used for more than 100 years), *reh'g denied*, 350 N.C. 108 (1999).

3. Throughout this Note the term "landowner" will refer to both owners and

to ensure the safety of the entrant (Aaron) depends primarily on the status of the entrant at the time of the injury.[4] There are three categories of entrants: invitees, licensees, and trespassers.[5] Under this "trichotomy," a landowner's duty of care is greatest toward an invitee and least toward a trespasser.[6] Landowners owe licensees a greater duty of care than that owed to trespassers but lesser than that owed to invitees.[7] Thus, using the common law rules in the example above, the extent of Leslie's duty toward Aaron, and her concomitant liability, will depend on whether Aaron's status is that of an invitee, licensee, or trespasser.

Both courts and commentators have criticized the common law trichotomy.[8] Some jurisdictions have substantially modified the law by abolishing the distinction between invitees and licensees.[9] Others have abandoned the trichotomy altogether, establishing in its place a duty on landowners simply to maintain their premises in a reasonably safe condition to protect all visitors, including trespassers.[10] Nevertheless, despite this criticism, a significant number of courts have refused to abandon completely the common law, even when squarely presented with an opportunity to do so.[11]

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occupiers of land or other real property. Also, to avoid confusion, the term "entrant" will refer to any person who enters another's premises for any reason.

4. *See* Newton v. New Hanover County Bd. of Educ., 342 N.C. 554, 559, 467 S.E.2d 58, 63 (1996); DAYE & MORRIS, *supra* note 1, § 17.30, at 220; Sayed, *supra* note 1, at 579.

5. *See Newton*, 342 N.C. at 559, 467 S.E.2d at 63. Invitees enter another's premises by an express or implied invitation in order to confer some direct and substantial benefit on the landowner; licensees enter the premises for their own lawful purposes; trespassers enter another's land without permission or for no lawful purpose. *See infra* notes 79-97 and accompanying text (discussing the entrant classifications).

6. *See infra* notes 98-109 (discussing the varying levels of care).

7. *See* Hood v. Queen City Coach Co., 249 N.C. 534, 540, 107 S.E.2d 154, 158 (1959).

8. *See, e.g.*, Sheets v. Ritt, Ritt & Ritt, Inc., 581 N.W.2d 602, 604 (Iowa 1998) (noting the court's "disenchantment" with the common-law approach); Moody v. Manny's Auto Repair, 871 P.2d 935, 945 (Nev. 1994) (criticizing the common-law approach as based on "antiquated" rules); Ouelette v. Blanchard, 364 A.2d 631, 632 (N.H. 1976) (noting that the United States Supreme Court has criticized the trichotomy); Daye, *supra* note 1, at 371 (suggesting that the categories be abolished altogether and replaced with a reasonable-care standard); Ketchum, *supra* note 1, at 394 (suggesting that the common-law approach is based on outdated principles of land ownership).

9. *See, e.g.*, *Sheets*, 581 N.W.2d at 606 ("[W]e abrogate the distinction in premises liability cases between invitees and licensees."); *infra* note 140 (listing jurisdictions that have abolished the distinction between invitees and licensees).

10. *See, e.g.*, Rowland v. Christian, 443 P.2d 561, 568 (Cal. 1968) ("[A]dherence to the common law distinctions can only lead to injustice."); *infra* note 138 (listing jurisdictions that have imposed a general duty of reasonable care).

11. *See, e.g.*, Nicoletti v. Westcor, Inc., 639 P.2d 330, 332 (Ariz. 1982) ("The particular duty owed to the entrant on the land is defined by the entrant's status."); *infra* notes 142, 144 (listing jurisdictions that have not abrogated the common law categories).

In a recent case, *Nelson v. Freeland*,[12] the North Carolina Supreme Court joined the growing number of courts that have abolished the distinction between licensees and invitees.[13] Citing the "complexity, confusion, and harshness" of the common law rules,[14] a four-justice majority in *Nelson* imposed a duty on landowners to "exercise reasonable care in the maintenance of their premises for the protection of [all] lawful visitors."[15] Consequently, the status of an entrant is no longer relevant in determining a landowner's duty of care in North Carolina,[16] except in the case of trespassers who, unlike invitees and licensees, do not enter land "under color of right."[17]

This Note first discusses the facts of *Nelson*, its history in the lower courts, and the North Carolina Supreme Court's resolution of the issues presented by the case.[18] The Note then briefly discusses the three common law classifications[19] and the duty of care associated with each, as enunciated by North Carolina courts.[20] The Note also examines the evolution of these common law premises-liability principles, both in North Carolina[21] and in other jurisdictions.[22] Next, the Note analyzes the majority opinion in *Nelson* and the holding's significance.[23] In light of that discussion, the Note suggests ways the court might have clarified and improved North Carolina premises-liability law without abolishing the existing common law framework.[24] Finally, the Note concludes that, although *Nelson* was correctly decided as to the individual litigants, the court improvidently abolished decades of existing law, leaving it to the North Carolina General Assembly to decide whether to reinstate portions of the

12. 349 N.C. 615, 507 S.E.2d 882 (1998), *reh'g denied*, 350 N.C. 108 (1999).
13. *See id.* at 631-32, 507 S.E.2d at 892.
14. *Id.* at 629, 507 S.E.2d at 891.
15. *Id.* at 632, 507 S.E.2d at 892.
16. In the hypothetical involving Aaron and Leslie, under the new rules, Leslie has a duty to exercise reasonable care in maintaining her premises for the protection of Aaron, a lawful visitor. As with other negligence cases, a jury would determine whether Leslie has fulfilled that duty. *See* DAYE & MORRIS, *supra* note 1, § 16.30, at 136. Whereas under the common law system, Aaron's purpose for coming onto Leslie's land was part of the threshold inquiry into Aaron's status, that factor would now be taken into account only if the jury chose to consider it. *See infra* notes 146-51 and accompanying text (discussing the significance of *Nelson*).
17. *Nelson*, 349 N.C. at 632, 507 S.E.2d at 892.
18. *See infra* notes 26-73 and accompanying text.
19. *See infra* notes 74-97 and accompanying text.
20. *See infra* notes 98-109 and accompanying text.
21. *See infra* notes 110-31 and accompanying text.
22. *See infra* notes 132-45 and accompanying text.
23. *See infra* notes 146-202 and accompanying text.
24. *See infra* notes 203-12 and accompanying text.

common law.[25]

Much like the scenario between Leslie and Aaron, *Nelson* involved parties on friendly terms. For more than twenty years, Greensboro resident John Nelson considered Daryl Dean Freeland and his wife Belinda to be his good friends.[26] Apparently, the feeling was mutual. Nelson and Freeland "did a lot of things together."[27] They also helped each other out when one of them had car trouble and occasionally gave each other rides.[28] On January 23, 1995, Nelson drove over to Freeland's house—allegedly at Freeland's request—and, like many times before, waited for Freeland to come out to the car.[29] According to Nelson, the two men planned to meet a mutual friend to discuss an employment opportunity.[30] When Freeland did not come out, Nelson got out of his car, walked onto Freeland's porch, and knocked on the door.[31] Hearing no answer, Nelson turned to go back to his car.[32] As he turned, he stepped on a stick lying on a mat on the porch.[33] Nelson's feet "shot out from under" him and he fell, sustaining numerous injuries.[34]

Nelson sued the Freelands, alleging that they were negligent for failing to maintain the porch in a reasonably safe manner and for not warning Nelson about the stick.[35] The Freelands moved for summary judgment, which the superior court granted.[36] Nelson appealed, and the North Carolina Court of Appeals, in an unpublished opinion, affirmed the trial court's ruling.[37] The court of appeals used the common law trichotomy and held that, as a matter of law, Nelson was

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25. *See infra* note 213 and accompanying text.

26. *See* Excerpts from Deposition of John Harvey Nelson at 24, Nelson v. Freeland, No. COA97-1120, slip op. at 4-5 (N.C. Ct. App. Apr. 30, 1998) [hereinafter Deposition].

27. *Id.*

28. *See id.*

29. *See id.* at 21.

30. *See id.* at 22-23.

31. *See id.* at 21.

32. *See id.*

33. *See id.* at 25. Freeland had left the stick on the porch earlier that morning after using it to remove a wasp's nest from the porch railing. *See* Affidavit of John Harvey Nelson at 18, *Nelson* (No. COA97-1120) (attaching a letter from Freeland explaining his actions).

34. Complaint at 2, *Nelson* (No. COA97-1120). According to Nelson, he fell "with great force and violence, injuring his left ankle by sustaining an inversion-type fracture with dislocation to the left ankle and a sprain to the right ankle resulting in severe, painful and permanent injuries to himself." *Id.*

35. *See* Complaint at 2, *Nelson* (No. COA97-1120).

36. *See Nelson*, 349 N.C. at 616, 507 S.E.2d at 883.

37. *See Nelson*, No. COA97-1120, slip op. at 5 (N.C. Ct. of App., Apr. 30, 1998).

a licensee when he entered the Freelands' premises.[38] The Freelands, the court noted, owed Nelson a duty to refrain from willfully injuring him and from wantonly and recklessly exposing him to danger.[39] The court concluded that Dean Freeland did not breach this duty by inadvertently leaving a stick on his porch.[40] Judge Walker of the court of appeals filed a written dissent, and Nelson appealed the court's decision as a matter of right.[41]

On appeal, the North Carolina Supreme Court reversed and remanded the case to the superior court for a trial on the merits under the new rules established by its decision.[42] In the majority opinion in which three other justices joined,[43] Justice Wynn noted that despite the supreme court's decisions in past premises-liability cases, the common law system is no more "stable and predictable" than before and has actually "confounded our judiciary."[44] As a result, the court reasoned, landowners are not sufficiently aware of their duties toward entrants.[45] Justice Wynn declared, therefore, that "it befalls us to examine the continuing utility of the common-law trichotomy" in determining landowner liability.[46]

After setting out the traditional common law premises-liability rules in North Carolina, the majority opinion made a case for joining the "modern trend of abolishing the common law trichotomy in favor of a reasonable-person standard."[47] The court noted that many

38. *See id.* at 4.

39. *See id.*

40. *See id.*

41. *See* Notice of Appeal at 1, *Nelson* (No. COA97-1120). Appeal as a matter of right to the North Carolina Supreme Court is allowed when at least one judge on the court of appeals files a written dissent. *See* N.C. GEN. STAT. § 7A-30(2) (1995).

42. *See Nelson*, 349 N.C. at 633, 507 S.E.2d at 893.

43. Justices Frye, Parker, and Whichard joined in the majority opinion. *See Nelson*, 349 N.C. at 615, 633, 507 S.E.2d at 882, 893. Justice Wynn, who was appointed to the court by Governor James Hunt in 1998, lost a bid that same year to be elected to that seat on the court. *See Judges Who Lost in General Election Appointed to Seats on Court of Appeals*, HERALD-SUN (Durham, N.C.), Dec. 24, 1998, at C3. In January 1999, Justice Wynn returned to the North Carolina Court of Appeals where he currently serves as judge. *See id.*

44. *Id.* at 616-17, 507 S.E.2d at 883.

45. *See id.* at 617, 507 S.E.2d at 883.

46. *Id.* The court determined the continuing relevance of the trichotomy sua sponte. In their briefs, neither party argued for a change in existing law. Indeed, Defendant specifically urged against finding for Plaintiff on the grounds that such a ruling would "totally rewrite the case law on premises liability in this state." Defendant-Appellee's New Brief at 9, *Nelson*, 349 N.C. 615, 507 S.E.2d 882 (1998) (No. 216A98). Also, there were no oral arguments on the subject of abolishing parts of the common law. *See Nelson*, 349 N.C. at 634, 507 S.E.2d at 893 (Mitchell, C.J., concurring in the result).

47. *Nelson*, 349 N.C. at 618, 507 S.E.2d at 884.

jurisdictions have attempted to "salvage" the trichotomy by creating exceptions and sub-classifications to the general rules of status and standards of care.[48] The court emphasized that eleven jurisdictions, frustrated with the increasing complexity, have "completely eliminated the common-law distinctions between licensee, invitee, and trespasser" since California first abolished its common-law categories in 1968.[49] In addition, the court reported that fourteen jurisdictions have abolished the distinction between licensees and invitees while keeping the trespasser category.[50] In all, the court concluded, nearly "half of all jurisdictions . . . have . . . abandoned or modified the . . . trichotomy in favor of the modern 'reasonable-person' approach."[51]

The majority opinion turned next to an examination of the advantages and disadvantages of abolishing parts of the trichotomy,[52] concluding that abolition would strike a better balance between protecting "land-ownership rights [and] the rights of entrants."[53] The court first noted that jurisdictions retaining the trichotomy suggest three disadvantages to abolishing the traditional common law in favor of pure negligence: (1) possible jury abuse of the reasonable care standard; (2) unfairly burdening land-ownership rights by forcing landowners to maintain expensive insurance policies; and (3) replacing a stable legal system with an unpredictable one.[54] The court rejected these arguments one by one. None of the feared disadvantages would materialize, the court suggested, since: (1) juries have applied the reasonable care standard for years in other negligence areas; (2) courts have always "explicitly stated" that they did not intend to make landowners "absolute insurer[s] against all injuries" sustained on their premises; and (3) the common law rules are less predictable and stable than the standard of reasonableness required in ordinary negligence cases.[55]

The court then noted several advantages of abolishing the

48. *See id.* at 618-19, 507 S.E.2d at 884.

49. *Id.* at 622, 507 S.E.2d at 886. *But see infra* notes 186-91 and accompanying text (concluding that only eight of the 11 jurisdictions have actually eliminated the common law distinction).

50. *See Nelson*, 349 N.C. at 622, 507 S.E.2d at 886. *But see infra* notes 192-98 and accompanying text (concluding that only 12 of the 14 cases actually repudiated the licensee-invitee distinction).

51. *Nelson*, 349 N.C. at 622-23, 507 S.E.2d at 887.

52. *See id.* at 623-31, 507 S.E.2d at 887-92.

53. *Id.* at 619, 507 S.E.2d at 884.

54. *See id.* at 624-25, 507 S.E.2d at 888-89.

55. *See id.*

common law scheme. First, the basis for the trichotomy is outdated since it was created during a time when it was "desirable to provide a landowner free reign to use and exploit his land."[56] In a "modern," less agrarian society, the trichotomy is no longer viable because it does not reflect our " 'modern social mores and humanitarian values.' "[57] Second, the trichotomy has created a "complex, confusing, and unpredictable state of law."[58] Because the inquiry as to an entrant's status is fact-based and can change on a whim,[59] the trichotomy analysis often leads to illogical results[60] and broad or strained readings of the law.[61] The complexity and confusion is enhanced by the many exceptions and sub-classifications "engrafted" onto the trichotomy.[62] Third, the common law system leads to "unfair and unjust" results,[63] especially because it deflects attention away from the "pertinent issue of whether the landowner acted reasonably under the circumstances."[64] Moreover, the trichotomy interferes with the proper balance of courtroom power in that it gives the judge great discretion to dismiss or decide cases and leaves for the jury only a mechanical application of the rules.[65]

After determining that the advantages of abolishing the common law system outweighed the disadvantages, the court decided to eliminate the licensee-invitee distinction and instead require "a standard of reasonable care toward all lawful visitors."[66] The court emphasized that it did not hold that "[landowners] are now insurers of their premises."[67] The court also stressed that it would retain a separate category for trespassers so as not to place unfair burdens on landowners who have "no reason to expect a trespasser's presence."[68] Finally, despite noting the importance of stare decisis in maintaining stable laws, the court announced it would apply the new reasonable

56. *Id.* at 626, 507 S.E.2d at 889.
57. *Id.* at 622, 507 S.E.2d at 886 (quoting Rowland v. Christian, 443 P.2d 561, 568 (Cal. 1968)). The *Rowland* court explained that "[a] man's life or limb does not become less worthy of protection by the law nor a loss less worthy of compensation . . . because he has come upon the land of another without permission or with permission but without a business purpose." *Rowland*, 443 P.2d at 567.
58. *Nelson*, 349 N.C. at 627, 507 S.E.2d at 889.
59. *See id.*
60. *See id.*
61. *See id.* at 619-20, 507 S.E.2d at 885.
62. *See id.* at 630, 507 S.E.2d at 891.
63. *See id.* at 628, 507 S.E.2d at 890.
64. *Id.* at 631, 507 S.E.2d at 892.
65. *See id.*
66. *Id.*
67. *Id.* at 632, 507 S.E.2d at 892.
68. *Id.*

care standard both prospectively and retrospectively.[69] Therefore, the case was remanded for trial so that a jury could determine whether Freeland satisfied his duty of reasonable care under the circumstances.[70]

The remaining three justices concurred only in the result reached by the majority.[71] In the concurring opinion, Chief Justice Mitchell stated his belief that a jury could find that Nelson was an invitee while on the premises and that Freeland violated the standard of care owed Nelson; therefore, summary judgment for Freeland was premature.[72] Chief Justice Mitchell went on to note that he found it "unnecessary for this Court to consider whether our prior holdings ... have been erroneous and must be modified .... [and] inadvisable to render an opinion of [this] magnitude" in this case.[73] Thus, the concurring justices would have waited for a more appropriate case to consider the question of whether North Carolina should abandon substantial portions of its current premises-liability law.

Pre-*Nelson* premises-liability law in North Carolina was—and to a certain extent still is—a special category of ordinary negligence law.[74] In ordinary negligence cases, a plaintiff must prove, inter alia, that the defendant had a duty to act with reasonable care towards the plaintiff and that the defendant breached that duty.[75] Often, as in the case of governmental immunity, the status of the *defendant* controls the question of what duty, if any, the defendant owes a particular plaintiff.[76] In premises-liability cases, however, the defendant is always the landowner, and it is instead the status of the *plaintiff* that controls the level of care the defendant-landowner owes the plaintiff-entrant.[77] Prior to *Nelson*, the status of a plaintiff-entrant in North Carolina was classified in one of three ways: invitee, licensee, or trespasser.[78]

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69. *See id.* at 633, 507 S.E.2d at 893.

70. *See id.*

71. *See id.* at 634, 507 S.E.2d at 893 (Mitchell, C.J., concurring in the result). Justices Lake and Orr joined the concurring opinion. *See id.*

72. *See id.* (Mitchell, C.J., concurring in the result).

73. *Id.* (Mitchell, C.J., concurring in the result); *see also infra* notes 156-61 and accompanying text (noting that the issue was not raised or briefed by the parties).

74. *See* DAYE & MORRIS, *supra* note 1, § 16.10, at 132 (discussing negligence).

75. *See id.* § 16.30, at 134-35 (discussing the negligence standard of care).

76. *See* Mullis v. Sechrest, 347 N.C. 548, 554-55, 495 S.E.2d 721, 725 (1998) (holding that the defendant was entitled to governmental immunity for acts done in his official capacity as a public school teacher).

77. *See* DAYE & MORRIS, *supra* note 1, § 17.30, at 220 (discussing premises liability cases).

78. *See id.* (discussing entrant categories).

An invitee is a person who enters another's premises by an express or implied invitation in order to confer some direct and substantial benefit on the landowner.[79] In *Mazzacco v. Purcell*,[80] for instance, the plaintiff, at the request of his sister and brother-in-law (the defendants), brought with him on a visit to their home a chainsaw and other tree removal equipment.[81] While there, the plaintiff was injured when helping remove some trees.[82] The court classified the plaintiff as an invitee[83] because he had been expressly invited and because his tree removal service "was of direct and substantial benefit to defendants in maintaining and improving their rental property."[84] Similarly, in *Crane v. Caldwell*,[85] the North Carolina Court of Appeals held that a plaintiff who helped his neighbor move a boat from the neighbor's yard was an invitee.[86]

Licensees enter another's land "with the possessor's permission, express or implied, *solely for [their] own purposes* rather than the [landowner's] benefit."[87] The most common example of a licensee is the social guest—one who enters the premises with permission but

79. *See* Cupita v. Carmel Country Club, Inc., 252 N.C. 346, 348, 113 S.E.2d 712, 714 (1960) ("Plaintiff's presence on the premises ... as a member of a dance orchestra to provide music for a dance in the club building gave him the status of an invitee."). Although the court in *Nelson* suggested that an invitee goes onto the premises for the *mutual* benefit of the invitee and the landowner, *see Nelson*, 349 N.C. at 617, 507 S.E.2d at 883 (citing Newton v. New Hanover County Bd. of Educ., 342 N.C. 554, 560, 467 S.E.2d 58, 63 (1996)), at least one commentary has stated that the real test is mere benefit to the landowner. *See* DAYE & MORRIS, *supra* note 1, § 17.33, at 236 n.132 (discussing duty owed to invitees).

80. 303 N.C. 493, 279 S.E.2d 583 (1981).

81. *See id.* at 494, 279 S.E.2d at 585.

82. *See id.* at 496, 279 S.E.2d at 586.

83. The most common example of an invitee is referred to as the "business invitee"—one who enters a business establishment for any lawful reason during the normal hours of operation. *See* DAYE & MORRIS, *supra* note 1, § 17.33.1, at 240; *see also, e.g.*, Branks v. Kern, 320 N.C. 621, 624, 359 S.E.2d 780, 782 (1987) (classifying a pet owner who took her cat to an animal clinic as a business invitee). "Public invitees," in contrast, are persons who enter a site for the purpose for which the premises are held open to the public. *See* DAYE & MORRIS, *supra* note 1, § 17.33.3 at 241; *see also, e.g.*, Walker v. County of Randolph, 251 N.C. 805, 811, 112 S.E.2d 551, 555 (1960) (holding that an entrant to a county courthouse to read items required by statute to be posted there is an invitee). Examples of persons held to be invitees include a theatre patron, *see* Anderson v. Reidsville Amusement Co., 213 N.C. 130, 133, 195 S.E. 386, 387 (1938), a hotel guest, *see* Lamb v. Wedgewood S. Corp., 55 N.C. App. 686, 691, 286 S.E.2d 876, 880 (1982), and a student at a dance studio, *see* Hedrick v. Tigniere, 267 N.C. 62, 65-66, 147 S.E.2d 550, 553 (1966).

84. *Mazzacco*, 303 N.C. at 498, 279 S.E.2d at 587 (citations omitted).

85. 113 N.C. App. 362, 438 S.E.2d 449 (1994).

86. *See id.* at 366-67, 438 S.E.2d at 452.

87. *Mazzacco*, 303 N.C. at 497, 279 S.E.2d at 586-87.

does not confer a direct or substantial benefit to the landowner.[88] Thus, the landowner has granted the entrant permission to enter his premises, but only as an accommodation to the licensee.[89] In *Martin v. City of Asheville*,[90] for example, the city permitted county ambulance personnel to park county ambulances in the city's fire station.[91] In an action by an ambulance attendant to recover damages for a fall he sustained while in the fire station, the court classified him as a licensee.[92] The court reasoned that the city allowed county personnel to use the fire station only as a matter of accommodation.[93]

Unlike both invitees and licensees, trespassers enter land either without permission, express or implied, or for an illegal purpose.[94] In other words, the trespasser can claim no legal right to be on the land.[95] In *Nelson*, Justice Wynn suggested the example of "[a] real-estate agent [who] trespasses onto another's land to determine the value of property adjoining that which he is trying to sell."[96] North Carolina law provides that children who enter another's premises without permission can also be classified as trespassers.[97]

Unlike ordinary negligence cases, the status of the plaintiff in a premises-liability case determines what level of care must be exercised by the defendant-landowner. In ordinary or pure negligence cases, the duty owed is to act as a reasonable person under all of the circumstances.[98] Thus, all people with whom a defendant comes in contact are ordinarily entitled to expect that she will act

88. *See Nelson*, 349 N.C. at 617, 507 S.E.2d at 884; *see also* Beaver v. Lefler, 8 N.C. App. 574, 575-76, 174 S.E.2d 806, 807 (1970) (classifying the plaintiff as a licensee even though he was injured while helping his neighbor carry meat into the neighbor's home because the plaintiff was a social guest who conferred only a minor benefit on his host).

89. *See* Martin v. City of Asheville, 87 N.C. App. 272, 275, 360 S.E.2d 467, 469 (1987). State employees who enter premises under authority of law have been held to be licensees. *See* Dunn v. Bomberger, 213 N.C. 172, 175, 195 S.E. 364, 366 (1938). *But see* Newton v. New Hanover County Bd. of Educ., 342 N.C. 554, 562, 467 S.E.2d 58, 64 (1996) (holding that police officers who respond to silent burglar alarms and enter premises under authority of law are invitees).

90. 87 N.C. App. 272, 360 S.E.2d 467 (1987).

91. *See id.* at 274, 360 S.E.2d at 468.

92. *See id.* at 274, 360 S.E.2d at 469.

93. *See id.* at 275, 360 S.E.2d at 469.

94. *See* Hood v. Queen City Coach Co., 249 N.C. 534, 540, 107 S.E.2d 154, 158 (1959).

95. *See id.*

96. *Nelson*, 349 N.C. at 627, 507 S.E.2d at 889.

97. *See, e.g.*, Hashtani v. Duke Power Co., 578 F.2d 542, 544, 546 (4th Cir. 1978) (holding that a 14-year-old boy was properly classified as a trespasser); *see also infra* notes 129-31 and accompanying text (explaining that while young children may be classified as trespassers, landowners often owe them a higher duty of care than adult trespassers).

98. *See* DAYE & MORRIS, *supra* note 1, § 16.30, at 134-35 (discussing standard of care for common negligence cases).

reasonably in her actions towards them.[99] In premises-liability cases, however, no such entitlement exists for people injured after entering others' property.[100] Instead, the degree of duty owed an entrant descends based upon the entrant's status: Landowners owe invitees the highest level of care[101] and are required to exercise ordinary care to keep their premises in a reasonably safe condition for such entrants.[102] This duty generally requires that landowners warn invitees of hidden defects or perils discoverable by the landowner upon reasonable inspection of the premises.[103] Compared to invitees, licensees are owed a lesser degree of care.[104] For licensees, the landowner does not have to keep the premises in a reasonably safe condition.[105] Rather, he must merely refrain from willfully or wantonly injuring the licensee and from increasing hazards through active or affirmative[106] negligence.[107] As to trespassers, landowners need only refrain from willful or wanton conduct that results in injury.[108] Willful or wanton describes conduct that is needless and manifests no rightful purpose; mere recklessness or carelessness does not rise to the requisite level.[109]

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99. *See id.*

100. *See* Clarke v. Kerchner, 11 N.C. App. 454, 460, 181 S.E.2d 787, 791 (1971).

101. *See* Hood v. Queen City Coach, 249 N.C. 534, 540, 107 S.E.2d 154, 158 (1959).

102. *See id.*

103. *See* Ross v. Sterling Drug Stores, 225 N.C. 226, 228, 34 S.E.2d 64, 64-65 (1945).

104. *See Clarke*, 11 N.C. App. at 460, 181 S.E.2d at 781; DAYE & MORRIS, *supra* note 1, § 17.32, at 228 (discussing licensees).

105. *See* Pafford v. J.A. Jones Constr. Co., 217 N.C. 730, 736, 9 S.E.2d 408, 412 (1940).

106. Active or affirmative negligence was described by the North Carolina Supreme Court in *Dunn v. Bomberger*:

> The owner is not liable for injuries resulting to a licensee from defects, obstacles or pitfalls upon the premises unless the owner is affirmatively and actively negligent in respect to such defect, obstacle or pitfall while the licensee is upon his premises, resulting in increased hazard and danger to the licensee.

213 N.C. 172, 175, 195 S.E. 364, 367 (1938) (citing Brigman v. Fiske-Carter Constr. Co., 192 N.C. 791, 136 S.E. 125 (1926)).

107. *See Clarke*, 11 N.C. App. at 460, 181 S.E.2d at 791 (quoting *Dunn*, 213 N.C. at 175, 195 S.E. at 367). Professors Daye and Morris have also argued persuasively that North Carolina landowners owe licensees a duty to warn of hidden perils and dangers of which the landowner knows and of which the licensee does not know. *See* DAYE & MORRIS, *supra* note 1, § 17.32, at 228.

108. *See Brigman*, 192 N.C. at 794-95, 136 S.E. at 127. Some cases also speak of holding landowners liable to trespassers injured by the actively (as opposed to passively) negligent conduct of the landowner. *See id.* In *Brigman*, the plaintiff was injured when the defendant backed into the plaintiff's car with a truck. *See id.* at 793, 136 S.E. at 126. The court characterized that conduct as "actual" negligence rather than passive negligence, which would have resulted if the plaintiff had instead been injured by an existing condition of the land. *See id.* at 797, 136 S.E. at 128.

109. *See* Yates v. J.W. Campbell Elec. Corp., 95 N.C. App. 354, 361, 382 S.E.2d 860, 864 (1989).

Despite the well-established nature of the rules governing entrant status and landowners' duty of care, North Carolina courts have created various distinctions within the rules. As noted by the majority in *Nelson*, the common law trichotomy has been plagued by exceptions and sub-classifications. They have generally taken one of two forms: (1) entrant status sub-classifications or (2) exceptions to the landowner's duty of care in certain situations.

Entrant status sub-classifications have often been created because of certain conduct, or a lack thereof, by the entrant. In *Cupita v. Carmel Country Club, Inc.*,[110] for example, the court held that, to the extent that an invitee exceeds the scope of a landowner's invitation, the invitee is downgraded to the status of licensee.[111] *Cupita* involved an orchestra member who was injured when walking towards the building in which the orchestra was to play.[112] As the plaintiff cut across the Club's lawn, he fell into a hole that he could not see because it was dark.[113] The court, in denying the plaintiff's recovery for damages resulting from the fall, noted that the plaintiff entered the premises as an invitee.[114] The landowner thus owed him a duty to exercise ordinary care, but only while the entrant used the premises in a manner consistent with the purpose of the invitation.[115] Since the club owners could not have anticipated that the plaintiff would cut across the lawn, especially in the dark, rather than stay on marked walking paths, the court classified him as a licensee at the time he fell in the hole.[116]

North Carolina courts have further complicated entrant-status classifications with regard to invitees who merely confer a minor or incidental benefit on the landowner. In the 1940 case of *Pafford v. J.A. Jones Construction Co.*,[117] for example, the court indicated that for an entrant to become an invitee as a result of an implied invitation, the entrant's purpose "must be of interest or advantage to the invitor."[118] If so, then it is fair to infer an invitation even if one has not been expressly given.[119] Thus in *Pafford*, a salesman injured after entering a construction site for which he had not been given an

110. 252 N.C. 346, 113 S.E.2d 712 (1960).
111. *See id.* at 350, 113 S.E.2d at 715.
112. *Id.* at 348, 113 S.E.2d at 714.
113. *See id.*
114. *See id.*
115. *See id.* at 349, 113 S.E.2d at 715.
116. *See id.* at 350, 113 S.E.2d at 715.
117. 217 N.C. 730, 9 S.E.2d 408 (1940).
118. *Id.* at 735, 9 S.E.2d at 411.
119. *See id.*

express invitation to visit was held to be a licensee because he failed to show that his visit was of any significant advantage to the owner.[120] In the 1981 case of *Mazzacco v. Purcell*,[121] however, the court also required an entrant with an express invitation to show that his visit conferred more than a minor or incidental benefit on the landowner.[122] Under *Mazzacco*, then, the invitee classification requires that an entrant confer a "direct and substantial" benefit to the landowner.[123] If no such benefit is conferred, the entrant is treated as a licensee irrespective of the express or implied nature of the invitation.[124]

Exceptions to landowners' duty of care, like entrant status subclassifications, have added a layer of fact-based complexity to the analysis of premises-liability cases. In *Branks v. Kern*,[125] for instance, the court suggested that even though a landowner owes an invitee a duty of reasonable care, that duty does not apply when the invitee is injured by an obvious danger—in this case, the plaintiff's own cat, which was angry after receiving a shot in the defendant veterinarian's office.[126] Similarly, in *Little v. Wilson Oil Corp.*,[127] a gas station owner was not required to warn his customer, an invitee, of an obvious protruding concrete structure.[128]

Other exceptions have increased landowners' level of responsibility to certain entrants. Landowners are often required to exercise a higher degree of care towards trespassing children, for example, even where a trespassing adult would not receive the same treatment by the courts.[129] Whereas a landowner must ordinarily refrain only from willfully or wantonly injuring trespassers, children " 'of tender years' "[130] who trespass and are injured by an "attractive

120. *Id.* at 736, 9 S.E.2d at 411-12.

121. 303 N.C. 493, 279 S.E.2d 583 (1981).

122. *See id.* at 498, 279 S.E.2d at 587.

123. *Id.*

124. *See id.*

125. 320 N.C. 621, 359 S.E.2d 780 (1987).

126. *See id.* at 624, 359 S.E.2d at 782 ("[I]t has long been the law in North Carolina that there is no duty to warn an invitee of a hazard obvious to any ordinarily intelligent person.").

127. 249 N.C. 773, 107 S.E.2d 729 (1959).

128. *See id.* at 777, 107 S.E.2d at 731.

129. *See* DAYE & MORRIS, *supra* note 1, § 17.31.2, at 223 (discussing trespassing children).

130. Dean v. Wilson Constr. Co., 251 N.C. 581, 588, 111 S.E.2d 827, 833 (1960) (quoting 65 C.J.S. *Negligence* § 29(11) (1948)). In *Dean*, a 14-year-old boy was held to be too old to benefit from the attractive nuisance doctrine. *See id.* at 589, 111 S.E.2d at 833. The court noted that " 'the great majority of cases in which [the doctrine] has been applied have involved children of less than ten years of age.' " *Id.* at 588, 111 S.E.2d at 833 (quoting 65

nuisance" are entitled to expect that the landowner will "exercise reasonable care to eliminate the danger or otherwise to protect the children."[131] Thus, although such children are still classified as trespassers, an exception is made to the landowner's ordinary duty of care.

Like North Carolina courts, most other jurisdictions have also gradually added exceptions and sub-classifications to their premises-liability common law.[132] Some of these jurisdictions, becoming increasingly frustrated with the growing complexity, began searching for alternatives to the common law system in the late 1950s.[133] England, the jurisdiction where the trichotomy originated, eliminated the distinction between licensees and invitees by statute in 1957.[134] Soon thereafter, the United States Supreme Court refused to extend the common law classifications to admiralty law, concluding that the trichotomy's "classifications and subclassifications . . . have produced confusion and conflict."[135] Furthermore, in the seminal case of *Rowland v. Christian*,[136] the California Supreme Court completely abolished the common law system in favor of a standard of reasonable care towards all visitors, whether lawful or not.[137]

Since *Rowland*, almost two-thirds of United States jurisdictions have addressed the issue of whether to modify the common law classification system, with the outcomes falling into one of four distinct categories. Eight jurisdictions since *Rowland* have followed California's lead and completely abolished all common law classifications in favor of a reasonable care standard towards all entrants.[138] As justification, these jurisdictions cite the outdated

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C.J.S. *Negligence* § 29(11)).

131. Broadway v. Blythe Indus. Inc., 313 N.C. 150, 154, 326 S.E.2d 266, 269 (1985) (quoting RESTATEMENT (SECOND) OF TORTS § 339(e) (1965)). The attractive nuisance doctrine in North Carolina goes back to at least 1908:

> We think that the law is sustained upon the theory that the infant who enters upon premises, having no legal right to do so . . . is as essentially a trespasser as an adult [would be]; but if, to gratify a childish curiosity, or in obedience to a childish propensity . . . he goes thereon and is injured by the failure of the owner to properly guard or cover the dangerous conditions which [the owner] has created, [the owner] is liable for such injuries . . . .

Briscoe v. Henderson Lighting and Power Co., 148 N.C. 396, 411, 62 S.E. 600, 606 (1908).

132. *See* JOHN W. WADE ET AL., PROSSER, WADE AND SCHWARTZ'S CASES AND MATERIALS ON TORTS 494 n.4 (9th ed. 1994).

133. *See Nelson*, 349 N.C. at 621-22, 507 S.E.2d at 886.

134. *See id.* at 620-21, 507 S.E.2d at 885; WADE ET AL., *supra* note 132, at 493 n.2.

135. Kermarec v. Compagnie Generale Transatlantique, 358 U.S. 625, 631 (1959).

136. 443 P.2d 561 (Cal. 1968).

137. *See id.* at 568.

138. *See* Smith v. Arbaugh's Restaurant, Inc., 469 F.2d 97, 105 (D.C. Cir. 1972); Webb

principles upon which the trichotomy rested, the complexity and confusion caused by its application, and the harsh and inequitable results that it produced.[139] Fourteen jurisdictions (including North Carolina in *Nelson*) have completely eliminated the invitee-licensee distinction but have either expressly or implicitly retained the trespasser category.[140] These jurisdictions generally acted based on the same rationales cited by the abolishing jurisdictions, but were not willing to impose a burden on landowners to anticipate the presence of trespassers.[141] Seven jurisdictions since *Rowland* have altered the common law categories without abrogating any of them altogether.[142] These jurisdictions found it either unnecessary to abandon the common law or inappropriate to issue such a sweeping ruling in the context of a particular case.[143] Finally, twenty-one jurisdictions have continued to apply the common law system and either have not

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v. City of Sitka, 561 P.2d 731, 733 (Alaska 1977); Pickard v. City of Honolulu, 452 P.2d 445, 446 (Haw. 1969); Cates v. Beauregard Elec. Coop., Inc., 328 So. 2d 367, 371 (La. 1976); Limberhand v. Big Ditch Co., 706 P.2d 491, 496 (Mont. 1985); Moody v. Manny's Auto Repair, 871 P.2d 935, 942-43 (Nev. 1994); Ouellette v. Blanchard, 364 A.2d 631, 634 (N.H. 1976); Basso v. Miller, 352 N.E.2d 868, 872 (N.Y. 1976).

139. *See, e.g., Rowland*, 443 P.2d at 568 (concluding that "continued adherence to the common law distinctions can only lead to injustice").

140. *See* 740 ILL. COMP. STAT. 130/2 (West 1998); Sheets v. Ritt, Ritt, & Ritt, Inc., 581 N.W.2d 602, 606 (Iowa 1998); Jones v. Hansen, 867 P.2d 303, 310 (Kan. 1994); Poulin v. Colby College, 402 A.2d 846, 851 (Me. 1979); Mounsey v. Ellard, 297 N.E.2d 43, 51-52 (Mass. 1973); Peterson v. Balach, 199 N.W.2d 639, 647 (Minn. 1972); Heins v. Webster County, 552 N.W.2d 51, 57 (Neb. 1996); Ford v. Board of County Comm'rs, 879 P.2d 766, 769 (N.M. 1994); *Nelson*, 349 N.C. at 631-32, 507 S.E.2d at 892; O'Leary v. Coenen, 251 N.W.2d 746, 751 (N.D. 1977); Tantimonico v. Allendale Mut. Ins. Co., 637 A.2d 1056, 1061-62 (R.I. 1994); Hudson v. Gaitan, 675 S.W.2d 699, 703-04 (Tenn. 1984); Antoniewicz v. Reszcynski, 236 N.W.2d 1, 4-5 (Wis. 1975); Clarke v. Beckwith, 858 P.2d 293, 296 (Wyo. 1993).

141. *See, e.g., Nelson*, 346 N.C. at 632, 507 S.E.2d at 892 ("[A]bandoning the status of trespasser may place an unfair burden on a landowner who has no reason to expect a trespasser's presence.").

142. *See* CONN. GEN. STAT. ANN. § 52-557a (West 1991) (raising social guests to the invitee level); Wood v. Camp, 284 So. 2d 691, 695 (Fla. 1973) (treating licensees by invitation as invitees); Burrell v. Meads, 569 N.E.2d 637, 639-43 (Ind. 1991) (treating invited social guests as invitees); Kirschner v. Louisville Gas & Elec. Co., 743 S.W.2d 840, 842-44 (Ky. 1988) (upholding the state constitutionality of a statute defining the standard of care for trespassers in premises liability cases); Baltimore Gas & Elec. Co. v. Flippo, 705 A.2d 1144, 1148-49 (Md. 1998) (distinguishing between licensees by invitation and "bare" licensees); Scheibel v. Hillis, 531 S.W.2d 285, 288 (Mo. 1976) (limiting the significance of categories to entrants whose presence is not known to the landowner); Ragnone v. Portland Sch. Dist. No. 1J, 633 P.2d 1287, 1290-91 (Or. 1980) (rejecting distinction between "active" and "passive" negligence toward licensees).

143. *See, e.g., Wood*, 284 So. 2d at 695 (noting that the reasonable care standard is "too vague and unreasonable a test to apply to a landowner because of the remaining, inherent distinctions in relationships involved between persons who come upon an owner's property").

questioned its continuing validity or have expressly refused to abrogate the trichotomy.[144] For these jurisdictions, the rationales posed by abolishing jurisdictions are insufficient to abandon years of existing law.[145]

By joining the thirteen other jurisdictions that have eliminated

144. *See, e.g.*, Lohrenz v. Lane, 787 P.2d 1274, 1277 (Okla. 1990) ("At this time, we do not find support to depart from the common law principles."); WADE, ET AL., *supra* note 132, at 494 n.5. The twenty-one jurisdictions are: Alabama, Arizona, Arkansas, Colorado, Delaware, Georgia, Idaho, Michigan, Mississippi, New Jersey, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Texas, Utah, Vermont, Virginia, Washington, and West Virginia. *See* Christian v. Kenneth Chandler Constr. Co., 658 So. 2d 408, 410 (Ala. 1995) (expressly refusing to abrogate any of the common law distinctions); Martinez v. Woodmar IV Condominiums Homeowners Ass'n., 941 P.2d 218, 219 n.1 (Ariz. 1997) (en banc) (noting that the common law system has not been abrogated, but not directly addressing that issue); Heigle v. Miller, 965 S.W.2d 116, 119 (Ark. 1998) (applying the common law concepts of invitee and licensee); Bailey v. Pennington, 406 A.2d 44, 47-48 (Del. 1979) (declining to abandon the status and liability distinctions between invitees, licensees, and trespassers); New Madison S. Ltd. Partnership v. Gardner, 499 S.E.2d 133, 137-38 (Ga. App. 1998) (applying common law categories of invitee and licensee), *cert. denied*, No. S981183, 1998 Ga. LEXIS 844 (Ga. Sept. 11, 1998); Keller v. Holiday Inns, Inc., 691 P.2d 1208, 1210-11 (Idaho 1984) (declining to abrogate common law classifications in case where all parties agreed that plaintiff was an invitee); Reetz v. Tipit, Inc., 390 N.W.2d 653, 654 (Mich. App. 1986) (noting that Michigan has not abandoned common law classifications), *aff'd*, 415 N.W.2d 178 (Mich. 1987); Little v. Bell, 719 So. 2d 757, 763 (Miss. 1998) (expressly declining to abandon the common law for a reasonable care standard); Hopkins v. Fox & Lazo Realtors, 625 A.2d 1110, 1119-20 (N.J. 1993) (not abrogating the common law classifications, but holding real estate brokers to a reasonable care standard for the protection of potential clients who take tours of homes for sale); Gladon v. Greater Cleveland Reg'l Transit Auth., 662 N.E.2d 287, 291 (Ohio 1996) (emphasizing Ohio's continued application of common law premises liability); Pickens v. Tulsa Metro. Ministry, 951 P.2d 1079, 1087 (Okla. 1997) (noting that "we see no reason ... to abandon ... the common law classification system and its legal ramifications"); Palange v. City of Philadelphia, 640 A.2d 1305, 1308 n.3 (Pa. Super. 1994) (declining to abolish the common law distinctions); Nesbitt v. Lewis, No. 2978, 1999 S.C. App. LEXIS 63, at *8 (S.C. App. Apr. 26, 1999) (applying the common law classifications); Musch v. H-D Elec. Coop., Inc., 460 N.W.2d 149, 151-52 (S.D. 1990) (continuing to apply the common law categories); Nixon v. Mr. Prop. Management Co., 690 S.W.2d 546, 551 (Tex. 1985) (Kilgarlin, J., concurring in the result) (noting that the majority avoided consideration of abrogating the common law premises-liability classifications); English v. Kienke, 848 P.2d 153, 156 n.1 (Utah 1993) (emphasizing that Utah continues to determine duty of care in premises liability cases through use of the common law categories); Dalury v. S-K-I, Ltd., 670 A.2d 795, 799-800 (Vt. 1995) (noting continued use of the common law categories, particularly that of "business invitee"); Franconia Assocs. v. Clark, 463 S.E.2d 670, 672-74 (Va. 1995) (applying the common law categories); Younce v. Ferguson, 724 P.2d 991, 995 (Wash. 1986) (en banc) (noting that the "[c]ommon law classifications continue to determine the duty owed by an owner or occupier of land in Washington"); Self v. Queen, 487 S.E.2d 295, 296 (W.Va. 1997) ("[T]he Court declines to alter the established law relating to licensees and invitees."); *see also* COLO. REV. STAT. § 13-21-115(3) (1996 Supp.) (reinstating the common law distinctions).

145. *See, e.g., Lohrenz*, 787 P.2d at 1277 ("At this time, we do not find support to depart from the common law principles....").

the licensee-invitee distinction in favor of a reasonable care standard, the North Carolina Supreme Court in *Nelson* significantly changed the landscape of North Carolina premises-liability law.[146] Aside from the fact that the decision modifies or overrules more than a century of established common law,[147] *Nelson* has also had an immediate impact on landowners' liability. Social guests and other related entrants,[148] both invited and uninvited, are now entitled to the same level of care as invitees.[149] Since a large number of premises-liability cases involve social guests,[150] it seems likely that *Nelson*'s impact will soon be felt in litigation. Moreover, landowners are now responsible for the protection of entrants who, prior to *Nelson*, "exceeded the scope of their invitation" at their own risk.[151]

The breadth of the *Nelson* decision is all the more striking given the circumstances of the case. First, because a jury could have found that John Nelson was an invitee under the common law trichotomy, it was not necessary for the court to reverse the summary judgment on such sweeping grounds.[152] In his amended complaint, Nelson alleged that he entered the defendant's premises not only at the defendant's request but also to confer a direct and substantial benefit on Freeland—a ride to a potential job site where Freeland, who was unemployed at the time, could potentially earn nine dollars per

146. *See Ruling May Make It Easier to Sue Homeowners*, NEWS & OBSERVER (Raleigh, N.C.), Jan. 2, 1999, at A3. Michael Dayton, editor of the *North Carolina. Lawyer's Weekly*, was quoted in the article as saying, " 'In legal terms, it's as big as the Beatles.' " *Id.* (quoting Michael Dayton).

147. *See Nelson*, 349 N.C. at 634, 507 S.E.2d at 893 (Mitchell, C.J., concurring in the result). Although the court's decision was certainly groundbreaking, there are at least two reasons why its impact could be substantially curtailed in future decisions. First, the vote was close—4 to 3—to abolish the common law rules, and the opinion's author, Justice Wynn, is no longer on the court. *See supra* note 43. Second, since the jury could have found Nelson to be an invitee under the common law rules and the court could have so held, *see supra* note 72 and accompanying text, the opinion as it applies to licensees might, in the future, be considered dicta. At the very least, the holding in this case could be limited in the future to the proposition that only this plaintiff in this particular fact situation is entitled to the reasonable care standard.

148. *See supra* notes 87-93 and accompanying text (discussing licensees).

149. *See Nelson*, 349 N.C. at 631-32, 507 S.E.2d at 892. *But see infra* note 165 and accompanying text (questioning whether the standard of care previously applied to invitees will satisfy the "reasonable care" standard enunciated by the court).

150. *See Ruling May Make It Easier to Sue Homeowners*, *supra* note 146, at A3 ("Since lawsuits brought by social guests are so common, [Michael Dayton] called the 4-3 ruling one of the half-dozen most significant in civil law in the past decade.").

151. *See supra* notes 110-16 and accompanying text (explaining that under the common law system, invitees are treated as licensees to the extent that they exceed their invitations and are therefore owed a lesser duty of care by landowners).

152. *See Nelson*, 349 N.C. at 634, 507 S.E.2d at 893 (Mitchell, C.J., concurring in the result) (noting that a jury could find that the plaintiff was an invitee).

hour.[153] Since summary judgment requires that all reasonable inferences be drawn in favor of the nonmovant[154] (Nelson in this case), the supreme court could have reversed the court of appeals on the grounds that sufficient evidence existed of the plaintiff's beneficial purpose for entering the premises to allow a jury to decide his status.[155]

Second, the broad ruling issued by the majority was not requested. Neither the defendant nor the plaintiff ever asked for a change in the common law of premises-liability.[156] In their briefs to both the court of appeals and the supreme court, both parties argued the case using common law principles.[157] Neither party's brief contained even a passing suggestion that the court make a change in the law as sweeping as abolition of the licensee-invitee distinction.[158] The court also did not have the benefit of oral arguments on the subject.[159] Moreover, neither the majority nor the dissent in the court of appeals alluded to, and certainly did not argue for, abrogation of the common law.[160] Indeed, it does not appear that any North Carolina court has ever requested such a change.[161]

Despite the majority opinion's seemingly simple solution to the

153. *See* Amended Complaint at 13, *Nelson* (No. COA97-1120); Deposition at 23, *Nelson* (No. COA97-1120).

154. *See* Caldwell v. Deese, 288 N.C. 375, 378, 218 S.E.2d 379, 381 (1975).

155. *See Nelson*, 349 N.C. at 634, 507 S.E.2d at 893 (Mitchell, C.J., concurring in the result).

156. *See id.*

157. *See* Plaintiff-Appellant's Brief at 4, *Nelson* (No. COA97-1120) ("The question arises as to whether, at the time of the accident, plaintiff was on the porch as an invitee or merely a licensee."); Plaintiff-Appellant's New Brief at 4, *Nelson* (No. 216A98) (arguing that a material issue of fact existed as to the plaintiff's status); Defendants-Appellees' Brief at 4, *Nelson* (No. COA97-1120) (describing the issue as whether "a person who picks up a friend on the way to work [is] an invitee on his friend's property"); Defendant-Appellees' Brief at 4, *Nelson* (No. 216A98) (same).

158. *See supra* note 157 (listing briefs).

159. *See Nelson*, 349 N.C. at 634, 507 S.E.2d at 893 (Mitchell, C.J., concurring in the result).

160. *See Nelson*, No. COA97-1120, slip op. at 1-5; *id.* at 1-3 (Walker, J., dissenting).

161. As support for its statement in *Nelson* that "our cases show that the trichotomy is no longer viable because of . . . the numerous exceptions and subclassifications engrafted into it," *Nelson*, 349 N.C. at 630, 507 S.E.2d at 891, the majority opinion pointed out that "[i]ndeed, our Court of Appeals noted that 'the relevant cases tend to illustrate exceptions to the general rule rather than the rule itself.' " *Id.* (quoting Hockaday v. Morse, 57 N.C. App. 109, 111, 290 S.E.2d 763, 765, *disc. rev. denied*, 306 N.C. 384, 294 S.E.2d 209 (1982)). In *Hockaday*, however, the court was addressing only one narrow aspect of premises liability, specifically whether a person visiting a registered hotel guest is an invitee along with the guest. *See Hockaday*, 57 N.C. App. at 111, 290 S.E.2d at 765. Thus, consistent with other North Carolina courts before *Nelson*, the *Hockaday* court was not suggesting that premises-liability cases in general illustrated exceptions rather than the general rules.

"complexity" of the common law system, *Nelson* may be even more significant for the questions that it leaves unanswered. For example, unlike other courts that have abolished the licensee-invitee distinction, the majority opinion in *Nelson* offered no guidelines for instructing juries under the new reasonable care standard.[162] Justice Wynn remanded the case only with instructions that the jury "determine whether defendant Freeland fulfilled his duty of reasonable care under the circumstances."[163] It is not clear, then, what types of factors, if any, the jury may consider when determining if a landowner has exercised reasonable care.[164]

More importantly, the scope of the "reasonable care" standard itself is unclear after *Nelson*. The case leaves open the question of whether the duty includes everything from the former invitee duty of care, or something less, or perhaps more. For example, it is unclear whether "reasonable care" will require a landowner to warn lawful entrants of obvious dangers, a duty not previously required under the former invitee standard of care.[165]

Finally, by retaining the trespasser category, the court may have significantly undermined its goal of creating a less "complex and confusing" premises-liability law.[166] Because the effect of *Nelson* is to improve the position of former licensees, the distinction between licensees and trespassers may now take on even greater

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162. *See Nelson*, 349 N.C. at 631-33, 507 S.E.2d at 892-93. In contrast, in *Sheets v. Ritt, Ritt, & Ritt, Inc.*, the Iowa Supreme Court offered the following guidance for judges when instructing juries as to the adequate exercise of reasonable care:

> Among the factors to be considered ... will be: (1) the foreseeability or possibility of harm; (2) the purpose for which the entrant entered the premises; (3) the time, manner, and circumstances under which the entrant entered the premises; (4) the use to which the premises are put or are expected to be put; (5) the reasonableness of the inspection, repair, or warning; (6) the opportunity and ease of repair or correction or giving of the warning; and (7) the burden on the land occupier and/or community in terms of inconvenience or cost in providing adequate protection.

581 N.W.2d 602, 606 (Iowa 1998) (citing Heins v. Webster County, 552 N.W.2d 51, 57 (Neb. 1996)).

163. *Id.* at 633, 507 S.E.2d at 893.

164. The lack of guidelines in *Nelson* is particularly striking because in ordinary negligence cases—toward which the majority opinion purports to be moving— "the judge must instruct the jury as to what specific acts or omissions under the pleadings and evidence can be found by the jury to constitute negligence." DAYE & MORRIS, *supra* note 1, § 16.30, at 136.

165. *See supra* notes 101-03 and accompanying text (discussing duty of care owed to invitees).

166. *See, e.g.*, Mounsey v. Ellard, 297 N.E.2d 43, 57 (Mass. 1973) (Kaplan, J., concurring) (suggesting that keeping the trespasser category "tends to perpetuate ... the kind of ... mistaken analysis that ... the court was aiming to correct").

significance.[167] Thus, it will still be necessary in many cases for courts to apply the common law trespasser and licensee rules to determine an entrant's status.[168] Moreover, since the duty of care is much less stringent towards trespassers,[169] courts will still have to apply different standards based on the status of the entrant. Consider, for instance, the following scenario cited by the majority opinion in *Nelson* as illustrating the confusion produced by the common law trichotomy: A real estate agent trespasses onto an owner's land to determine the value of adjoining land.[170] The owner sees him and the two begin talking, first about business, then socially.[171] After *Nelson*, at what point, if any, does the landowner's duty of reasonable care begin? Is it when the owner first sees the real estate agent, or is it when they are talking? The majority opinion offers no guidance as to when, if at all, an unlawful entrant, protected only to the extent of the common law, can become a lawful entrant who is protected by the new standard of reasonable care under the circumstances.[172]

Despite the opinion's landmark holding, the court's reasoning is not as compelling as the significance of the decision would seem to require. The court engages in a form of what one commentator has termed "decisional litany,"[173] in which language from other abolishing jurisdictions was "plucked" from those courts' opinions and used without significantly analyzing its relevance or applicability to North Carolina law or conditions. For example, one justification used by the court in abolishing the trichotomy is that it is no longer viable in "modern times."[174] The court recites conclusory language from several other jurisdictions suggesting that the common law system

167. *See, e.g.*, Douglas Payne, *The Occupiers' Liability Act*, 21 MOD. L. REV. 359, 360 (1958) (discussing the effect of England's decision to abolish only the licensee-invitee distinction); *see also supra* notes 87-97 (defining the two common law categories of licensee and trespasser).

168. *See* Payne, *supra* note 167, at 360.

169. *See supra* notes 108-09 and accompanying text (discussing the duty of care owed to trespassers).

170. *See Nelson*, 349 N.C. at 627, 507 S.E.2d at 889-90.

171. *See id.*

172. *See id.* at 632, 507 S.E.2d at 892 (retaining the trespasser category but offering no guidance as to its future application).

173. Daye, *supra* note 1, at 361. Professor Daye defines " 'decisional litany' " as "the practically verbatim repetition of language from prior cases in subsequent judicial opinions without sufficient inquiry into the adequacy and appropriateness of the language as applied to the case at hand." *Id.* at 361. This Note uses the term to describe the court's recitation of language from jurisdictions other than North Carolina without sufficient inquiry as to its appropriateness.

174. *See Nelson*, 349 N.C. at 626, 507 S.E.2d at 889.

was better suited for a rural society.[175] The court does not attempt, however, to explain or elaborate why this justification applies with as much force in North Carolina, a state which is still largely rural with pockets of urban areas, as it does in the jurisdictions from which the court "plucks" the language.[176] Neither does the court attempt to explain where the line should be drawn in order to determine that society is "modern" enough to abolish or substantially modify decades of existing law.[177]

A second justification "plucked" from other jurisdictions is that the common law system has " 'produced confusion and conflict.' "[178] Although the majority opinion discusses three North Carolina premises-liability cases with seemingly conflicting holdings,[179] the opinion offers no further North Carolina case law analysis.[180] Instead, the majority opinion notes several cases that have produced dissents, which "evidence[] that the trichotomy fails to clearly articulate a landowner's standard of care."[181] In six of the seven cases cited by the court, however, the majority and the dissent agreed as to the entrant's status.[182] Rather, most of the disputes centered on application of the

175. *See, e.g., id.* at 621-22, 507 S.E.2d at 886 (" '[I]t is clear that those distinctions are not justified in the light of our modern society.' " (quoting Rowland v. Christian, 443 P.2d 561, 567 (Cal. 1968))). The majority opinion relied on judicial opinions in at least five other jurisdictions (New York, New Hampshire, the District of Columbia, Massachusetts, and Florida), concerning the supposedly outdated, tradition-bound principles undergirding the common law system. *See id.* at 626-27, 507 S.E.2d at 889.

176. *See id.* at 621-27, 507 S.E.2d at 886-89.

177. *See id.*

178. *Id.* at 627, 507 S.E.2d at 889 (quoting Kermarec v. Compagnie Generale Transatlantique, 358 U.S. 625, 631 (1959)).

179. *See id.* at 29-30, 507 S.E.2d at 891 (citing Crane v. Caldwell, 113 N.C. App. 362, 438 S.E.2d 449 (1994); Briles v. Briles, 43 N.C. App. 575, 259 S.E.2d 393 (1979); Beaver v. Lefler, 8 N.C. App. 574, 174 S.E.2d 806 (1970)). As even the court points out, however, any inconsistency produced by these three cases resulted from a narrow issue with respect to invitees—the scope of the "direct and substantial benefit" test. *See id.* It seems inappropriate to characterize the entire common law system as complex and confusing on the basis of cases that address only one narrow, and admittedly confused, issue.

180. *See Nelson*, 349 N.C. at 631-33, 507 S.E.2d at 892-93.

181. *Id.* at 631, 507 S.E.2d at 892.

182. *See id.* (citing Roumillat v. Simplistic Enters., 331 N.C. 57, 69, 414 S.E.2d 339, 345 (1992) (Frye, J., dissenting); Pulley v. Rex Hosp., 326 N.C. 701, 709, 392 S.E.2d 380, 385 (1990) (Meyer, J., dissenting); Goldman v. Kossove, 253 N.C. 370, 374, 117 S.E.2d 35, 38 (1960) (Moore, J., dissenting); Gray v. Small, 104 N.C. App. 222, 224, 408 S.E.2d 538, 539 (1991) (Phillips, J., dissenting), *aff'd per curiam*, 331 N.C. 279, 415 S.E.2d 362 (1992); McIntosh v. Carefree Carolina Communities, Inc., 98 N.C. App. 653, 657, 391 S.E.2d 851, 853 (1990) (Greene, J., dissenting), *rev'd per curiam*, 328 N.C. 87, 399 S.E.2d 114 (1991); Starr v. Clapp, 40 N.C. App. 142, 148, 252 S.E.2d 220, 223 (1979) (Hedrick, J., dissenting); Smith v. VonCannon, 17 N.C. App. 438, 440, 194 S.E.2d 362, 364 (Brock, J., dissenting), *aff'd*, 283 N.C. 656, 197 S.E.2d 524 (1973)). Although *McIntosh* involved a dispute as to whether entrant classification is a matter of law or fact, only *Smith* involved a dispute

standard of care for summary judgment purposes,[183] which will continue to be a source of conflict for as long as summary judgment is available in negligence cases. Moreover, in ninety-two North Carolina premises-liability cases from 1908 until 1998 involving the licensee-invitee distinction, only eleven produced a dissent.[184] Of those eleven dissents, only two involved a dispute as to an entrant's proper classification.[185]

Finally, the majority rested a substantial part of its opinion on its perception of a trend toward abolishing the invitee-licensee distinction and abolishing the trichotomy altogether.[186] Of the eleven jurisdictions cited by the court as having "completely eliminated" all distinctions since *Rowland*,[187] however, only eight have actually done so. Iowa, cited by the court as a complete abrogation state, only abolished the invitee-licensee distinction.[188] The court also cited Illinois, only parenthetically noting in a string of citations that the particular case it cited abolished the distinctions only with respect to children; in effect, the Illinois court merely adopted a form of the attractive nuisance doctrine.[189] Furthermore, in Colorado, the

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about the classification itself.

183. *See Roumillat*, 331 N.C. at 69, 414 S.E.2d at 345 (Frye, J., dissenting); *Pulley*, 326 N.C. at 711, 392 S.E.2d at 387 (Meyer, J., dissenting); *Goldman*, 253 N.C. at 374, 117 S.E.2d at 38 (Moore, J., dissenting); *Gray*, 104 N.C. App. at 224, 408 S.E.2d at 539 (Phillips, J., dissenting); *McIntosh*, 98 N.C. App. at 657, 391 S.E.2d at 853 (Greene, J., dissenting).

184. Search of WESTLAW, NC-CS database (Aug. 25, 1999) (using "Licensee AND Invitee" as the search term). The NC-CS database includes all North Carolina Supreme Court cases from 1887 through slip opinions and all North Carolina Court of Appeals decisions from 1968 (inception) through slip opinions. The search produced 95 total cases. Of these, three cases were decided in 1999 and five cases, although including both of the words "licensee" and "invitee," only indirectly involved premises-liability issues. A case was counted as containing a "dissent" only if an actual dissent appeared in the reported opinion.

185. *See id.* The two cases involving dissents over entrant categories are *Newton v. New Hanover County Board of Education*, 114 N.C. App. 719, 443 S.E.2d 347 (1994) (involving a dispute over the appropriate common law classification of police officers), and *McIntosh v. Carefree Carolina Communities, Inc.*, 98 N.C. App. 653, 391 S.E.2d 851 (1990) (involving a dispute over whether classification decision is matter of law or fact).

186. *See Nelson*, 349 N.C. at 618-23, 507 S.E.2d at 884-87.

187. *See id.* at 622, 507 S.E.2d at 886.

188. *See* Sheets v. Ritt, Ritt & Ritt, Inc., 581 N.W.2d 602, 606 (Iowa 1998) ("We do not decide whether a distinction should persist with regard to trespassers.").

189. *See* Keller v. Mols, 472 N.E.2d 161, 161 (Ill. App. 1984). The North Carolina Supreme Court also did not address the fact that the Illinois legislature abolished the common-law licensee-invitee distinction with respect to children and adults effective September 12, 1984, leaving intact the distinction as to trespassers. *See* 740 ILL. COMP. STAT. 130/2 (West 1998). The legislature amended the act in 1995 to define more clearly the duty of reasonable care owed to former licensees and invitees. *See id.* Specifically, the legislature excluded from the duty of reasonable care any duty to warn of known, open, or

legislature reinstated the distinctions more than nine years ago,[190] at one point citing the "unpredictable and inequitable results"[191] of the reasonable care standard.

Of the fourteen cases the court cited as having "repudiated" the invitee-licensee distinction, an analysis reveals that only eleven of those cases actually abolished the distinction.[192] For example, in a Florida case cited by the majority opinion, the Florida Supreme Court specifically stated that "we continue the category of licensees who are *uninvited*, that is, persons who choose to come upon the premises solely for their own convenience."[193] Thus, Florida continues to have three categories: invitees, uninvited licensees, and trespassers.[194] Additionally, although the court cited an Oregon case as repudiating the distinction, the Oregon Supreme Court emphasized that "there is no need for this court to address the issue whether, or to what extent, the invitee-licensee dichotomy should be abrogated."[195] The North Carolina court also did not note distinctions in the precedential value of some of the cases cited. In Massachusetts and New Mexico, for instance, the cases cited did modify the common law licensee-invitee distinctions but the courts acknowledged that the cases could be decided under the common law.[196] Another jurisdiction cited by the court, Rhode Island, is retreating from its initial complete abrogation of all common law distinctions.[197] In 1994, the Rhode Island Supreme Court reinstated the trespasser distinction and left open whether it would at some point reinstate the invitee and licensee categories as

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obvious dangers, the duty to warn of hidden dangers unknown to the landowner, and the duty to warn of dangers caused by the entrant's own misuse of the premises. *See id.*

190. *See Nelson*, 349 N.C. at 622 n.2, 507 S.E.2d at 886 n.2 (citing COLO. REV. STAT. § 13-21-115(3) (Supp. 1996)).

191. Gallegos v. Phipps, 779 P.2d 856, 861 (Colo. 1989) (discussing the legislative history of statute).

192. *See Nelson*, 349 N.C. at 622, 507 S.E.2d at 886-87. The three cases cited by the court that did not actually abolish the invitee-licensee distinction were *Wood v. Camp*, 284 So. 2d 691, 695 (Fla. 1973), *Baltimore Gas & Electric Co. v. Flippo*, 705 A.2d 1144, 1148-49 (Md. 1998), and *Ragnone v. Portland School District No. 1J*, 633 P.2d 1287, 1291 (Or. 1980). However, with the addition of North Carolina in *Nelson* and of Illinois and Iowa, which were misclassified as having abolished the trichotomy altogether, there are in fact fourteen states that have abolished the invitee-licensee distinction. *See supra* notes 140 (listing all states that have abolished the invitee-licensee distinction), 188-89 (discussing the misclassification of Iowa and Illinois).

193. *Wood*, 284 So. 2d at 695.

194. *See id.*

195. *Ragnone*, 633 P.2d at 1291.

196. *See* Mounsey v. Ellard, 297 N.E.2d 43, 47 (Mass. 1973); Ford v. Board of County Comm'rs, 879 P.2d 766, 768-69 (N.M. 1994).

197. *See* Tantimonico v. Allendale Mut. Ins. Co., 637 A.2d 1056, 1062 (R.I. 1994).

well.[198]

Within the past twelve to fifteen years, the trend actually has been to "uphold the traditional common law categories."[199] Several courts have either refused to abolish the distinctions even when presented with an opportunity to do so,[200] or have continued applying them without questioning their vitality.[201] Twenty-eight jurisdictions now fall into the category of courts that have neither completely abrogated all distinctions nor completely abrogated the licensee-invitee distinction.[202]

In *Nelson*, the North Carolina Supreme Court could have done what a majority of United States jurisdictions have apparently concluded is best: improve the common law premises-liability scheme without abolishing substantial portions of the trichotomy. One method is to reclassify as invitees those entrants whom the landowner by express or implied invitation induces or leads to come onto the property for any lawful purpose; licensees would thus be lawful, but uninvited, entrants.[203] Trespassers would differ from licensees insofar as a trespasser enters premises with no legal right at all.[204] Licensees and invitees would thus be classified based upon the degree to which the landowner could reasonably anticipate any given lawful visitor. The "direct and substantial" benefit test, which the court criticized in *Nelson*, would no longer control an entrant's classification. This would eliminate much of the confusion (to the extent it exists) in the case law regarding entrant status.[205]

In light of the suggested reclassifications above, the court could have kept intact the current duty of care owed by a landowner to each

198. *See id.* at 1062 ("We decline to comment on the other aspects of the holding in *Mariorenzi* as no issues involving invitees or licensees are before us.").

199. *Id.* at 1060.

200. *See, e.g.*, Lohrenz v. Lane, 787 P.2d 1274, 1277 (Okla. 1990) ("It is not reasonable to impose on a landowner the burden of eliminating *all* possible sources of injury which may exist on his property.").

201. *See, e.g.*, New Madison S. Ltd. Partnership v. Gardner, 499 S.E.2d 133, 137-38 (Ga. App. 1998) (applying common law categories of invitee and licensee), *cert. denied*, No. S981183, 1998 Ga. LEXIS 844 (Ga. Sept. 11, 1998).

202. *See supra* note 142 and accompanying text (noting that seven jurisdictions have altered but not abandoned any of the common-law distinctions); *supra* note 144 and accompanying text (noting that 21 jurisdictions have completely retained their common-law framework without alterations).

203. *See, e.g.*, Wood v. Camp, 284 So. 2d 691, 694 (Fla. 1973) (distinguishing licensees by the nature of the invitation).

204. *See supra* notes 87-97 and accompanying text (discussing trespassers and licensees).

205. *See, e.g.*, *Nelson*, 349 N.C. at 629-30, 507 S.E.2d at 891 (criticizing the benefit test).

category of entrant,[206] but with one modification. With respect to all categories, the court could have required landowners to warn entrants of hidden dangers or perils of which the landowner is aware but the entrant is not, as long as the landowner knows or reasonably should know of the entrant's presence.[207] Such a doctrine would merely extend the current duty to warn invitees[208] (and arguably licensees[209]) to all categories of entrants. Thus, once the landowner is or should be aware of the presence of an entrant, he would be required at a minimum to warn the entrant of hidden perils.

By merely modifying the common law categories and standards of care, the court could have achieved a better balance between the privilege historically accorded to landowners to the free use of their land[210] and the responsibility to protect entrants from harm that can be reasonably anticipated.[211] By resting the relevant distinction between invitees and licensees upon the nature of the invitation itself, the privilege of land ownership would be burdened by its attendant responsibility only to the degree that the landowner could anticipate an entrant's presence. Furthermore, by requiring a landowner to warn of hidden dangers to all entrants of whose presence he is or should be aware, the court could have recognized that the privilege of land ownership cannot overcome the landowner's social responsibility to prevent an entrant from proceeding into danger that the landowner can easily prevent.[212]

In conclusion, there is ample evidence that North Carolina's common law premises-liability system needs to be clarified. Indeed, as one court has noted, "[w]ith social change must come change in the

206. *See supra* notes 98-109 and accompanying text (discussing the common law duties of care).

207. *See, e.g.*, Daye, *supra* note 1, at 364 (noting that no North Carolina Supreme Court case has held against such a rule).

208. *See* Ross v. Sterling Drug Stores, 225 N.C. 226, 228, 34 S.E.2d 64, 64-65 (1945).

209. *See* Daye, *supra* note 1, at 364-71 (arguing that such a rule may exist as to licensees).

210. *See, e.g.*, Antoniewicz v. Reszcynski, 236 N.W.2d 1, 14 (Wis. 1975) (Hansen, J., dissenting) ("The concept that 'a man's home is his castle' has deeper roots [than even feudal times], and can hardly be said . . . to have 'long since vanished.' "). Indeed, just because society becomes more "modern" does not mean that the privacy enjoyed by one who owns a home or land becomes any less private. Although it may be correct to note that the ownership of land in itself is not as "deeply rooted" in our culture as it once was, the *privacy* of the land we do own *is* deeply rooted in our present culture. *See id.*

211. *See* Rowland v. Christian, 443 P.2d 561, 568 (Cal. 1968).

212. *See, e.g.*, Daye, *supra* note 1, at 363 ("[I]t is difficult to believe that the law would countenance a landowner's failure to warn [an entrant] whom the landowner saw about to walk onto the covering of a concealed well, when the landowner knew the covering was rotten and would not support the weight of a person.").

law."[213] But change does not necessarily require abrogation. The *Nelson* court abolished over a century of existing law to reach a result that could have been achieved on much narrower grounds. For the North Carolina Supreme Court, *Nelson* is a missed opportunity to improve a venerable area of the common law. For the General Assembly, it is a golden opportunity to strike the best possible balance between both the privilege and the responsibility of land ownership in a modern society.

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213. Wood v. Camp, 284 So. 2d 691, 696 (Fla. 1973).