ILLINOIS BUSINESS LAW JOURNAL

A Publication of the Students of the

University of Illinois College of Law

SPRING 2010 ISSUE, VOLUME 10

Please direct all inquires to:

Illinois Business Law Journal
University of Illinois College of Law
504 E. Pennsylvania Avenue
Champaign, IL 61820
law-iblj@illinois.edu

Table of Contents

THE CAYMAN ISLANDS AND THE JOHN GRISHAM EFFECT: YES, EVERYTHING CHANGED

Introduction

In May 2009 American President Barack Obama spoke of how an address in the Cayman Islands housed 12,000 companies. Alluding to the possibility of illegal activity, he noted that this location was either the biggest building in the world or "*the largest tax scam in the world*." This image of Offshore Financial Centers (OFCs) as havens for wrongdoing is generally held throughout the world. Recent data indicates that the Cayman Islands holds over 670 billion American Dollars in banking assets from international investors.

Because of such statistics, these small islands are considered a global villain, a haven for illegal capital. According to the OECD Harmful Tax Competition: An Emerging Global Issue (1998 Tax Report) jurisdictions that (a) imposes no or only nominal taxes, (b) lacks policy of effective exchange information, (c) lacks transparency and (d) has no requirement of "substantial activity" is identified as a tax haven. A Background Information Brief released by the OECD (Organisation for Economic Co-operation and Development) in March 2010 acknowledged the implementation of the Cayman's actions towards transparency and information exchange. Despite this report's recognition of the Caymans, it touched upon only a few of the measures that have been taken by the Cayman Islands in the last few years. These improvements in the Cayman's internal structure and the regulatory actions taken by the Cayman Islands have enhanced the islands' status within the international community. The Cayman's pejorative title as a "tax haven" is, therefore, incorrect.

First, this article will examine the true atmosphere of the Cayman Islands, and how this British territory and the 5th largest banking center in the world is cooperating with the OECD and other jurisdictions by partaking in several Tax Information Exchange Agreements (TIEAs). Second, this article also aims to defend the valuable and important role of international policy distinctions among nations as a pursuit of effectiveness in the financial system worldwide.

1. The Hurricane Named Organisation for Economic Co-operation and Development and its implications

A taxation system is fundamental to any government's display of authority and the sovereign's capability to govern its territory. The rise in number of cross-border economic activities has created new dilemmas for nations, requiring new fiscally oriented legislation, yet such legislation, in turn causes a questioning of a nation's also, in turn, causing absolute domestic fiscal sovereignty.

As a result, a cooperative approach to addressing internationalization has emerged. Cross-boarder information exchange and general cooperation between nations has become the new benchmark by which offshore financial centers are evaluated and judged. The OECD is current the chief organization in the discussion and implementation of tax cooperation amongst developed nations. The OECD has been highly active on the issues of international transparency and facilitating efficient global exchange of information. The organization believes that these factors are elemental in understan ding how individuals attempt to hide their assets and avoid taxes. To promote this belief the OECD has developed a tax standard that is contained in the article 26 of the OECD Tax Convention and the 2002 Model Agreement on Exchange of Information on Tax Matters. The standard is used as the international norm for tax co-operation and also is a model

for the majority of bilateral tax conventions entered by non-OECD and OECD countries.

Another tool used by the OECD to draw the political attention to tax matters is the the Global Forum, which is a multilateral framework formed by both OECD member and non-OECD member countries. This framework publishes annual assessments of the administrative and legal structure for transparency and exchange of information in over 80 countries.

All members of the Global Forum, including jurisdictions that are not part of the working group, are subjected to the analysis of their systems and the implementation of this policy pertaining to tax related. The TIEAs are model agreements developed jointly by the OECD member countries and delegations of other countries, including offshore centers as the Cayman Islands, to provide for the exchange of information and prevent harmful tax practices.When the Global Forum began, about 22 TIAs were signed in a period of 7 years. Between 2009 and 2010, more than 150 TIEAs were sig ned[9], thereby demonstrating the increased number of jurisdictions willing to exchange tax information with other jurisdictions.

2. A Caribbean Giant: the Cayman Islands

The Cayman Islands, as a prominent offshore financial jurisdiction, is forced to confront many challenges. As an offshore financial jurisdiction, the Cayman organizes its legal system primarily to attract foreign investors, operating its framework for the needs of offshore investment. The subjects of this legal framework combine the traditional areas of the law with attractive innovations, especially tax neutrality and innovative instruments for foreign investors.

The Cayman Islands, as a tax neutral jurisdiction, attract the attention of not only investors worldwide looking for a safe and less costly investment, but also of onshore taxing authorities. Until April 2009, the Cayman Islands were in the "gray list" of the April Progress Report published by the OECD as a jurisdiction that had committed to the internationally agreed upon tax standard but had not substantially implemented it. In light of the OECD listing criteria, the Cayman Islands and other offshore jurisdictions have become the target of stigmatization for the OECD. This lead to the OECD discouraging investors from becoming involved with these jurisdictions, thereby causing severe fiscal and economic damages to these small economies, once the OECD actions can be detrimental to islands that do not have a self sufficient economy.

However, since the introduction of the OECD's 1998 Report on harmful tax competition, these nations have experienced and faced great losses in the financial sector. Antigua and Barbados for instance, when adopting the OECD guidelines lost 54 of the nation's seventy-two banks, concomitantly to a decrease in the number of business incorporation in these territories. Consequently, GDP rates decrease and unemployed in the national increased after such measures. Recently, since the Cayman Islands have consented and complied with the OECD demands, several banks have closed, the government threatened to revoke the charters of companies that had not proved considerable domestic activity, and have compelled the financial industry to not guarantee absolute financial secrecy to its clients.Coupled with the consequences of adhering to the OECD recommendations, in August 2009 the Cayman Islands was promoted to the OECD "white list" after signing its twelfth TIEA with New Zealand. This allowed the Cayman to be considered as a jurisdiction that substantially implements the international tax standards promoted by the OECD. Nonetheless,

it is questionable of to what cost such a title should be given as it jeopardizes the economic stability and continuance of the small offshore jurisdictions.

2.1.Cayman Islands Disclosure Mechanisms

Confidentiality is an essential principle in the offshore legal structures, as its concept differs from the common law countries. At the same time that confidentiality had been responsible for part of the opportunities created in the offshore jurisdictions, the protection of confidentiality also demoralized the offshore jurisdictions. Nonetheless, confidentiality is not a privilege created by such offshore authorities. As a common law principle, the banking sector has long functioned under the value of confidentiality, largely embodied in the famous 1924 United Kingdom decision, *Tournier v. National Provincial Bank*. The United States, for instance, has disputed against disclosure in commercial matters, affirming the existence of a "*strong and vital interest*" in protecting confidentiality in that case.

Despite the fact that confidentiality is not exclusively applied and protected in offshore jurisdiction such as the Cayman Islands, onshore jurisdictions have pressured offshore jurisdictions to make its confidentiality protection laws more flexible. The first half of this sentence doesn't make sense. Consequently, new anti-money laundering laws and treaties have been developed between the Cayman Islands and onshore jurisdictions, largely piercing the confidentiality standard that has historically existed in OFCs.

2.1.1. Banking Confidentiality

With regards to the banking industry, the Cayman Islands Monetary Authority (CIMA) issued in 2008 the Guidance Notes On The Prevention And Detection Of Money Laundering And Terrorist Financing in the Cayman Islands. These standards required the financial institutions to apply a policy of extensive "Know-Your-Customer" (KYC) policies for due diligence investigations of new and existing clients. Financial institutions also have to report suspicious activity and file reports with the Cayman authorities. The KYC rule requires the financial institutions to discover information of potential clients in advance and establish the legitimacy of their investments.

While draconian on their face, such a rule is less intrusive than those being required by the OECD. The Cayman Islands has been able to find a middle ground in order to preserve the legitimate confidentiality standards of the Cayman and in this sense the guidance shows Cayman Island's authorities efforts to frame its regulatory system around international standards of supervision and co-operation with overseas regulatory authorities in the fight against financial crime.

2.1.2. Tax Information Exchange Agreement (TIEA)

The TIEA is not an automatic disclosure of information. Requests may be denied when not in conformity with the TIEA, i.e. when all means available were not pursued to obtain the information in the U.S., and where disclosure would be contrary to public policy. The TIEA agreement signed between Cayman Islands and the United States allows to the IRS to overcome the Cayman confidentiality laws in order to track financial criminals, but not as a method of tax enforcement. When the U.S. submits a letter of request to the Cayman Islands, it must: (a) come from U.S. body having an adjudicative function; (b) establish a need for the evidence in the U.S. proceedings, such as the nature of proceedings for which the

evidence is needed, why evidence is needed, and the precise issue for which evidence will be used; and (c) not attempt to phish for information. Among other requirements, the U.S. must establish the need for the evidence, must know the nature of the information requested, and the identity of the parties; and (d) not attempt to acquire information for tax enforcement purposes.

2.1.3. European Union (E.U.) Savings Tax Directive

The Cayman Islands implemented measures equivalent to the E.U. Savings Tax Directive through bi-lateral agreements with E.U. member states in 2005. The Cayman Islands agreed to exchange information on the accounts of E.U. residents that earn interest. Paying agents in the Cayman Islands must report to the Cayman Islands Competent Authority information about interest payments to a beneficial owner who is a resident in an E.U. member state. The Competent Authority forwards the information to the E.U. member state where the beneficial owner lives

2.1.4. Mutual Legal Assistance Treaty

The Cayman Islands and the United States signed a Mutual Legal Assistance Treaty (MLAT) in 1986. Under the MLAT, proceeds of criminal conduct recovered are either restored to the victims in fraud cases or shared equitably between government agencies.

Also, the MLAT covers exchange of information concerning criminal offenses common to the Cayman Islands and the United States, including insider trading and racketeering.

2.1.5. The United States Reporting Requirements of Offshore Bank Accounts

In 1970, Congress enacted the Bank Secrecy Act ("BSA"), codified in Title 31. The Act specifies that a person who maintains a relationship with a foreign financial agency keep records and file reports.

Specifically, a "U.S. person" with a financial interest or signature authority over a foreign bank account with a balance of more than $10,000 during the calendar must file a Report of Foreign Bank and Financial Accounts (FBAR). A "U.S. person" is a citizen or resident of the United States, a domestic partnership, a domestic corporation, or a domestic estate or trust. The investigation and enforcement of the civil penalties related to FBAR reporting is delegated to the IRS. The Cayman Islands has implemented and changed its regulation in order to comply with the new changes on confidentiality laws, especially by signing TIEAs with various countries. Not only has Cayman been signing agreements with other jurisdictions, but the Cayman Islands also has the necessary resources to support the laws and possible investigations or process that might take place in the Islands.

2.1.6. The Cayman Islands Financial Reporting Authority

The Cayman Islands Financial Reporting Authority (CAYFIN) is responsible for deterring money laundering and preventing terrorist financing from developing in the Cayman. It's a Financial Intelligence Unit (FIU) that receives and analyses financial information concerning the proceeds of money laundering and criminal conduct in the Islands pursuant to the provisions of the Proceeds of Crime Law (2008).

According to the CAYFIN, reports of suspicious financial activity, money laundering and other reports of irregularities related to the finance market increased by about 30% between July 2008 and June 2009. Such reports to CAYFIN come from inside and outside the Cayman Islands, as many transactions turn out to be lecal bank transactions, yet are still examined by the authorities.

3. The Positive Aspects of Jurisdictional Tax Diversity

The determination of tax policy by national governments is likely based upon the needs and the agenda of each national jurisdiction. When different jurisdictions adopt different rules, despite the fact that those rules generate different consequences in each country, they have also a significant impact on the public policy debate. The tax competition is part of this debate. Globalization has contributed to the increase of tax competition in a manner that the OECD seeks to restrain. Because of the mobility of capital and labor over borders, the nations that adopt a better policy attract qualified professionals and investments from other nations.

The presence of a close OFC with an efficient financial sector is likely to have a large competitive implication for the onshore banking sector. In light of this competition, it is not surprising that all the major developed nations have decreased their individual income tax rate in recent years. Among the nations that are members of the OECD, the average top income tax rate used to be nearly 68% in 1980. Due to tax competition among nations to attract capital mainly, the top tax rate today is 42%. Worldwide reductions on corporate tax rate have also been significant over the past three decades. For instance, the United States, following a major corporate tax cut in Britain from 52 per cent to 35 per cent, reduced its federal rate from 46 per cent to 34 per cent in 1986. Another wave of tax

reductions has followed mostly in the European Union and in other countries, and most recently Ireland cut its corporate tax from 50 per cent to 12.5 per cent. Such restructuring in tax policies has resulted in an average corporate tax that ranges in about 27 per cent today, instead of 48 per cent some decades ago.

The OECD economists have already agreed to the fact the tax competition does play an important role in a pro-growth global economy. In this sense, low tax financial centers such as the Cayman Islands have been useful in encouraging politicians in other countries to reduce tax rates, as well as reduce the double taxation of income of investors. Without tax competition, the adequate incentives would not exist to lead governments to reduce its taxation rates. The level of total taxation, without incentives of offshore jurisdictions as the Cayman Islands, would certainly be higher.

Conclusion

The Cayman Islands has been tracing a clear path in the global economy: it is reaffirming it's role as a major financial jurisdiction and concurrently following international disclosure requirements and regulations. The numbers and efforts cited in this article proves the compliance of the Cayman Islands are in lock step with the principles and new requirements of the international community.

Despite the fact that the Cayman Islands face challenges with respect to its financial situation today, it is likely considering the lessons with respect to the history of other OFCs. Curacao, for example, was once considered one of the world's largest offshore financial centers yet around the 1970s, the relationship between the Antilles and the U.S. became difficult. As the tax treaty between the

two countries was abused, and citizens engaged in "*treaty shopping*" There was a decreas in U.S. Revenue. The U.S. authorities therefore terminated the treaty in July 1987, as Antilles' governmental authority would not offer concessions to satisfy the U.S. treasurey on preventing on shore revenue evasion. In contrast to Cuarcao , the Cayman Islands has reformed and modernized its regulation while still preserving their right to maintain their tax policy.

---

[1] Press Release, The White House, Remarks by the President on International Tax Policy Reform (May 4, 2009),*available at*http://www.whitehouse.gov/the_press_office/Remarks-By-The-President-On-International-Tax-Policy-Reform.

[2] [2] Taylor Morgan Hoffman, *The Future of Offshore Tax Havens*, 2 CHI. J. Int'l L. 511, 513 (2001). The author indicates that only the markets of Tokyo, Hong Kong, New York and London have larger capital markets than the Cayman Islands.

[3] Alexander Townsend, Jr., *The Global Schoolyard Bully: the Organisation for Economic Co-operation and Development's Coercive Efforts to Control Tax Competition*, 25 Fordham Int'l L.J. 215 (2001)

[4]*Id.*

[5] OECD Background Information Brief, dated 25 March 2010. *Available at* http://www.oecd.org/document/42/0,3343,en_2649_33767_44392746_1_1_1_37427,00.html

[6] *Id.*

[7] *Id*

[8] Organisation for Economic Cooperation and Development TIEAs, *available at*http://www.oecd.org/document/7/0,3343,en_2649_33767_38312839_1_1_1_1,00.html (last visited April 14, 2010)

[9] *Id.*

[10] Rose-Marie Antoine, *The Legitimacy of the Offshore Financial Sector – A Legal Perspective*, in REGULATORY COMPETITION &OFFSHORE FINANCIAL CENTERS (Andrew P. Morriss, ed. forthcoming)

[11] Natasha Lance Rogoff, *Heaven or Havoc*, FRONTLINE, Feb. 19, 2004,*available at*http://www.pbs.org/wgbh/pages/frontline/shows/tax/schemes/cayman.html

[12]Progress Report on the Jurisdictions Surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard, April 2, 2009. Available at http://www.oecd.org/dataoecd/38/14/42497950.pdf

[13] Richard A. Johnson, *Why Harmful Tax Practices Will Continue After Developing Nations Pay: a Critique of the OECDs Initiatives Against Harmful Tax Competition*, 26 B.C. Third World L.J. 351, 359 (2006). Besides the agricultural dependence in the past, the external factors of distant trading relationship, volatility of the climate, frequent political turmoil have also contributed to the high levels of poverty and debt in these islands

[14] *Id.*

[15] *Id.* The impact of the OECD compliance to the nation of St. Dominica was similar and because of its lost it was forced to change its national budget and increase domestic taxes affecting the population in the island.

[16] WILLIAM BRITTAIN-CATLIN, OFFSHORE: THE DARK SIDE OF THE GLOBAL ECONOMY (2005)

[17] Cayman Islands Government News Release, OECD Recognizes Cayman Islands International Tax Cooperation Regime, 14 August, 2009. Available at http://www.tia.gov.ky/pdf/IM_OECD_Recog_CI_Tax_Regime.pdf

[18] Rose-Marie Antoine, *The Legitimacy of the Offshore Financial Sector – A Legal Perspective,* in REGULATORY COMPETITION &OFFSHORE FINANCIAL CENTERS (Andrew P. Morriss, ed. forthcoming). The author understands confidentiality in offshore jurisdictions as a hybrid concept and it encompasses strict and extremely broad-based statutory duties of confidentiality.
[19] Case: *Tournier v. Nat'l Provincial Bank [1924] 1 K.B. 461 (C.A.) (U.K.).*
[20] Guidance Notes On The Prevention And Detection Of Money Laundering And Terrorist Financing In The Cayman Islands, December 2008. Available at http://www.cimoney.com.ky/regulatory_framework/reg_frame_ra.aspx?id=1738&ekmensel=e2f22c9a_16_92_1738_3
[21] *Supra* note 13
[22] Agreement between the government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland, including the Government of Cayman Islands for the Exchange of Information relating to Taxes (2001), available at http://www.oecd.org/dataoecd/20/17/35514531.pdf?contentId=35514532
[23] Treaty Relating to Mutual Legal Assistance Between the U.S. and the United Kingdom concerning the CaymanIslands (subsequently expanded to cover Anguilla, the British Virgin Islands, Montserrat and the Turks and CaicosIslands), signed 7/3/86; entered into force March 19, 1990, 100th Cong., 1st Sess., Treaty Doc. 100-8, Exec. Rpt.100-26; Exec. Rpt. 101-8; 26 ILM 536, March 1987
[24] Currency and Foreign Transactions Reporting Act, Pub. L. No. 91-508, tits. I-II (1970).
[25] 31 U.S.C. § 5314 (2004)
[26] Regulation of the Financial Reporting Authority of the Cayman Islands . This internal organ in the Cayman is under the guidance of the Anti-Money Laundering Steering Group that consists of the Attorney General, the Financial Secretary, Commissioner of Police, Collector of Customs, Managing

Director of Cayman Islands Monetary Authority (CIMA) and the Solicitor General. Available at http://www.fra.gov.ky/

[27] Brent Fuller, Financial Reporting Authority – Suspicious Activities Reports Up to 30%, Cayman Financial Review, January 5, 2010, *available at* http://www.compasscayman.com/cfr/2010/01/05/Financial-Reporting-Authority-%E2%80%93-suspicious-activity-reports-up-30-per-cent/

[28] *Id*.

[29] *Supra* note 3.

[30]Andrew K. Rose and Mark M. Spiegel, *Offshore financial Centers: Parasites or Symbionts*? *NBER Working Paper No. W12044*, *available at* http://ssrn.com/abstract=885641

[31] Daniel Mitchell, The Positive Global Role of Jurisdictional Competition and International Financial Centres, July 7, 2009

[32] *Id.*

[33] *Id.*

[34] *Id.*

[35] *Id.*

[36] OECD statement about the ability to choose the location of economic activity offsets shortcomings in government budgeting processes, limiting a tendency to spend and tax excessively, *available at*http://www.oecd.org/dataoecd/50/17/2088806.pdf

PROVENA COVENANT MEDICAL CENTER V. DEPARTMENT OF REVENUE: THE DECISION THAT MAY END CHARITABLE EXEMPTIONS FOR NONPROFIT HOSPITALS

I. Introduction

The recent decision by the Illinois Supreme Court regarding tax exemption for hospitals is troubling for the already volatile and uncertain future of many hospitals that are facing increasing difficulties in the current economic market. The Illinois Supreme Court held that Provena Medical Center in Urbana does not provide enough charity care to qualify for the tax exemption provided for hospitals that care for uninsured and poor patients without generating a profit or collecting fees.[1] The decision has generated significant criticism for relying on old precedent, failing to take into account current economic conditions, and for failing to provide clear guidelines for nonprofit hospitals that want to qualify for tax exemption in Illinois.[2] The implications of this decision while not precisely known can have wide ranging consequences for hospital financing and access to healthcare for low income and uninsured individuals. What are hospitals required to do to quality for tax exemption in Illinois? What financial implications does this have on nonprofit hospitals? What implications does this have on patients? Will this decision effectively end charitable exemptions for nonprofit hospitals? This article will attempt to briefly outline the issue and provide the possible policy implications of this decision. Part II considers the law governing tax exemption in Illinois. Part III considers the *Provena* decision and the courts rationale for denying tax exemption. Part IV considers the criticisms of the decision specifically that the court applied an outdated test for charitable care, failed to take into account current market conditions and the constant changes in

medicine and technology, failed to take into account bad debt as part of charitable care, and failed to provide clear guidelines for nonprofit hospitals that tare trying to qualify for tax exemption. Part V concludes with many unanswered questions to this current and controversial decision.

II. Tax Exemption in Illinois

Under Illinois law taxation is the rule and all property must pay taxes unless specifically exempt by Statute.[3] The burden to show tax exemption is heavy and all facts and debatable questions must be construed in favor of taxation.[4] The tax exemption for charitable organizations derives from section 6 of the Illinois Constitution which provides "General Assembly may, by law, exempt from taxation property owned by "the State, units of local government and school districts" and property "used exclusively for agricultural and horticultural societies, and for school, religious, cemetery and charitable purposes."[5] The General Assemble passed a provision that provided what type of property qualifies for the charitable tax exemption. Section 15-65 of the Property Tax Code provides that in order for a property to qualify for the charitable exemption it requires not only that the property be "actually and exclusively used for charitable or beneficent purposes, and not leased or otherwise used with a view to profit," but also that it be owned by an institution of public charity or certain other entities, including "old people's homes," qualifying not-for-profit health maintenance organizations, free public libraries and historical societies."[6] However, the statute does not explicitly mention hospitals or health care facilities. As a result of the vague standards set out in the statute the courts have developed a test to determine whether a nonprofit hospital is entitled to tax exemption.[7]

The test was first articulated in *Methodist Old Peoples Home v. Korzen*, in which the court identified five factors that the organization must fulfill in order to qualify as a charitable institution and hence receive the tax exemption.[8] First, the court defined charity as "a gift to be applied * * * for the benefit of an indefinite number of persons, persuading them to an educational or religious conviction, for their general welfare-or in some way reducing the burdens of government."[9] Then the court provided the following five factors that courts must consider when determining whether an organization qualifies as a charitable institution: (1) it has no capital, capital stock, or shareholders, (2) it earns no profits or dividends but rather derives its funds mainly from private and public charity and holds them in trust for the purposes expressed in the charter, (3) it dispenses charity to all who need it and apply for it, (4) it does not provide gain or profit in a private sense to any person connected with it; and (5) it does not appear to place any obstacles in the way of those who need and would avail themselves of the charitable benefits it dispenses."[10] The court determines whether an institution qualifies for tax exemption on a case by case basis considering all the factors outlined above.[11]

III. *Provena* Decision

The court in *Provena* concluded that Provena Medical center does not qualify for tax exemption because it does not derive enough of its revenue from charitable care. The court analyzed each of the factors outlined in *Korzen* and concluded that Provena only satisfied two of the necessary factors and therefore did not qualify for the tax exemption.[12] Provena satisfies the first factor because it has no capital, capital stock, or shareholders and the fourth factor because it does not provide gain or profit in a private sense to any person connected with it.[13] While Provena does subcontract many of its services to third party, for

profit providers this does not preclude the institutions care from being characterized as charity. However, the court stated that Provena failed to fulfill the other factors outlined in *Korzen*. Specifically, Provena's funds are not generated primarily from private and public charity rather the overwhelming majority of its funds are derived providing medical services for a fee.[14] The court found that only $6,938 out of total revenues of $739,293,000 could be traced to charitable donations and there was no evidence of hospital's charitable expenditures or evidence showing that local government's burden in treating indigents was reduced.[15]

Also, the court noted that the hospital failed to fulfill factors three and five because it did not show with clear and convincing evidencethat it dispensed charity to all who needed it and applied for it and did not appear to place any obstacles in the way of those who needed and would have availed themselves of the charitable benefits it dispenses.[16] Provena did not advertise that it was a charitable organization, patients were billed for services regularly and when they could not pay they were automatically referred to collections agencies.[17] Hospital charges were waived only after it was determined that patients did not have insurance coverage, were not eligible for Medicare or Medicaid, lacked the resources to pay the bill directly, and could document that he or she qualified for participation in the institution's charitable care program.[18]

Provena alleges several important arguments in response to the courts analysis of the *Korzen* factors. First, Provena alleged that the hospital provided care to everyone who requested it regardless of their financial circumstances and that they discounted care for poor individuals.[19] However, the court rejected this argument because patients were regularly billed for their services and when they

could not pay they were automatically referred to collections agencies.[20] Furthermore, the court stated that the discounted care was illusory because uninsured patients were charged "established" rates, which were more than double the actual costs of care and therefore the hospital was still able to generate a profit.[21]

Finally, Provena urged the court to consider its treatment of Medicare and Medicaid patients as charitable care because the payments it receives for treating such patients do not cover the full costs of care.[22] The court rejected this argument stating that accepting Medicare and Medicaid patients is optional and also in the financial interest of the organization since the corporation receives a reliable stream of revenue and is able to generate income from hospital resources that might otherwise be underutilized.[23]

IV. Criticisms of the *Provena* Decision

One of the main criticisms of *Provena* is that the court relied on old precedent to determine whether hospitals should be granted tax exemption without taking into account current market and social conditions. Since the courts decision in *Korzen* in 1968, the hospital industry has endured drastic changes. Medicine and technology has evolved and therefore the cost of providing medical care has increased.[24] Due to the technological advances medical facilities are becoming more competitive and as a result spending more money to keep their facilities state of the art and efficient.[25]

The hospital industry has also changed with respect to the amount of uninsured and underinsured patients that are seeking care. With the current economic crisis the amount of uninsured individuals has grown from 44.8 million in 2005 to 47

million in 2006.[26] In addition, the amount of individuals on Medicare and Medicaid programs has also grown significantly.[27] As a result, the amount of underpayments for Medicare and Medicaid have significantly grown.[28] Underpayments are defined as "the difference between the costs incurred and the reimbursements received for delivering care to patients."[29] The underpayments for Medicaid and Medicare have increased from 3.8 billion in 2000 to 32 billion in 2008.[30] Therefore, as a result of the rising number of uninsured individuals and low reimbursement rates hospitals are enduring more costs associated with bad debt. Bad debt is the charges the hospital expects to collect for the services but for which it does not receive payment and includes losses incurred from low reimbursement rates from Medicare and Medicaid.[31]

The court in *Provena* failed to take into account the constantly changing scientific and economic factors and decided that bad debt cannot be considered when calculating how much charity care a hospital provides. Medicare and Medicaid provide care to elderly and low income individuals that otherwise would have problems accessing health care. Doesn't providing low income individuals and other disadvantaged and vulnerable members of society with care considered charitable? Doesn't Medicare and Medicaid further the goals of charitable institutions? Courts in Illinois have reasoned that bad debt that results from low reimbursements from Medicare and Medicaid could not be considered charity care because the "hospital negotiated preferential rates for these programs and that there was no indication the hospital agreed to accept these patients due to its charitable mission."[32] Furthermore, the court in *Provena* claimed that the hospital receives a steady stream of income from Medicare and Medicaid patients and therefore it's not considered charity care.

Tax exemption provides relief to hospitals that are already facing economic difficulties. Tax exemption also allows hospitals to continue their operations by providing high quality care and helps hospitals further their charitable mission by providing free or discounted care to poor individuals.[33] By making it more difficult for hospitals to qualify for tax exemption the court is threatening the quality and access of health care for Illinois residents.[34] As a result hospitals are cutting services, staff, and closing facilities.[35] The implications for denying tax exemption can be detrimental to the financial health of many nonprofit hospitals and for uninsured individuals who need access to care.[36]

V. Conclusion

What does the future hold for nonprofit hospitals? This question generates many different responses but ultimately the future is uncertain. *Provena* was decided on March 18, 2010 and therefore how this decision will affect other nonprofit hospitals is yet to be seen. Many critics suspect that this decision will hurt hospitals financially because they will not be granted tax exemption under this strict standard.[37] The uncertainty and fear for the future also derives from the fact that the court failed to articulate clear guidelines for hospitals trying to qualifying for tax exemption.[38] Instead the court relied on old precedent and applied it without taking into account how much the health care industry has changed over the decades. Currently the health care industry is experiencing even more changes with the economic crisis and the health care reform. In today's economy hospitals are faced with more obstacles to overcome such as increasing numbers of uninsured individuals, high state deficits, and plummeting reimbursement rates.[39] A recent study of hospitals in 28 states indicates that more than half of them reported negative operating margins.[40] The tax exemption used to be a way for nonprofit hospitals to escape the financial burdens

of providing uncompensated or discounted care. *Provena* has challenged the purpose underlying the tax exemption for nonprofit hospitals and has left the future of health care in Illinois uncertain.[41] What is clear from the decision is that bad debt resulting from uncompensated care cannot be taken into account when calculating charity care. The detrimental affect this will have on nonprofit hospitals is yet to be seen. However, given recent studies indicating that reimbursement rates are lower than ever before and bad debt is increasing will surely have some effect on hospital financing.[42] By creating a difficult standard to meet that does not take into account the current nature of the health care industry the court has made the future of charitable care seem bleak. This decision while attempting to strengthen the need for charity care has in fact undermined it by making it difficult for hospitals to qualify for tax exemption which is essential to providing free care. Now hospitals will have even less money to provide for those individuals that need it the most.

---

[1] *Provena Covenant Medical Center v. Department of Revenue*, 2010 WL 966858, 10 (2010).

[2] Joseph Hylak-Reinholtz, *The Charitable Purpose Exemption and Illinois Hospitals: Its Time to Retire the Methodist Test,* 21 DCBA BRIEF 39, 43-44 (2009).

[3] *Board of Certified Safety Professionals of the Americas, Inc. v. Johnson*, 112 Ill.2d 542 (1986).

[4] *Provena*, *supra* note 1, at 9.

[5] Ill. Const.1970, art. IX, § 6.

[6] 35 ILCS 200/15-65 (West 2002).

[7] Katie Stewart, Property Tax Exemptions for Nonprofit Hospitals: The Implications of Provena Medical Center v. Department of Revenue, 62 TAX LAW 1157, 1163 (2009).

[8] *Methodist Old Peoples Home v. Korzen*, 39 Ill.2d 149, 156-57 (1968).

[9] *Id*.

[10] *Id*.

[11] *Provena*, *supra* note 1, at 10.

[12] *Id*. at 11.

[13] *Id*.

[14] *Id*.

[15] *Id*. at 3-4.

[16] *Id*. at 14.

[17] *Id*.

[18] *Id*.

[19] *Id*. at 15.

[20] *Id*.

[21] *Id*.

[22] *Id*. at 16.

[23] *Id*.

[24] Robert S. McWhorter, *The Industries Most at Risk in Bankruptcy: Legal and Financial Experts on What to Expect, Avoiding Financial Trouble, and Thoughts on the Future*, 2008 WL 5689292, 109 (2008).

[25] *Id*.

[26] *Id*.

[27] *Under Payment for Medicare and Medicaid Fact Sheet*,American Hospital Association. http://www.aha.org/aha/content/2009/pdf/09medicunderpayment.pdf . (last visited March 3, 2010).

[28] *Id*.

[29] *Id*.

[30] *Id*.

[31] Hospital Financial Performance,http://www.oshpd.ca.gov/HID/Products/Hospitals/AnnFinanData/HospFinanPerform/HospitalFinancialPerformance.pdf(last visited March 3, 2010).

[32] Joseph Hylak-Reinholtz, *The Charitable Purpose Exemption and Illinois Hospitals: Its Time to Retire the Methodist Test,* 21 DCBA BRIEF 39, 42 (2009).

[33] Brief of American Hospital Association as Amici Curiae Supporting Plaintiffs, *Provena Covenant Medical Center v. Department of Revenue*, 2010 WL 966858, 10 (2010) (No. 2006-MR-000597).

[34] *Id*. at 20.

[35] *Id*.

[36] *Id*.

[37] *Id*.

[38] Hylak-Reinholtz, *supra* note 32, at 43-44.

[39] McWhorter, *supra* note 24, at 109.

[40] *Hospital Margins Sink with Economy*, AHANEWS.COM,*available at*http://www.ahanews.com/ahanews_app/jsp/display.jsp?dcrpath=AHANEWS/AHANewsArticle/data/AHA_News_090316_Report_hospital&domain=AHANEWS.

[41] Brief of American Hospital Association, *supra* note 33, at 19.

[42] McWhorter, *supra* note 24, at 109.

THE FAILURE OF THE GREEN MOVEMENT

One of the primary problems with land conservation and use aside from the issue of sustainability, is that we as humans have established a culture that is prone to abusing the land we live on. We have tried to heal the environment using the new "Green" movement which is designed to have individuals change their behaviors and then as a result, the collective actions of our society will be environmentally beneficial.[1] However, this method has not produced the effects it was designed for.[2] Individual actions have not changed much and neither has public perception to the problem at hand.[3] This is reflected in the way our economy functions, the way we consume goods and dispose of them, and the expectations placed upon us by the government that we have elected.[4]

In fact in the course of property law, one of the most important aspects is that of exclusion in that when we deem ourselves owners of a certain tract of land or piece of property, we may keep others off and hold that area of the earth as solely our own.[5] As a corollary to this, people have developed the idea that when we own our property, then we have the freedom to do whatever we so choose to it.[6] However, this creates a seemingly butterfly effect in that the adverse use of one parcel of property may create ripples down the chain and end up with a larger effect elsewhere. Our country is losing 6,000 acres of open space every day and 100,000 acres of wetlands every year.[7] We should not place all the blame on our government though. This abuse of property rights stems from the way our economy and market is set up. The focus on profits and free trade inherently has side effects which results in inefficient and environmentally harmful property and individual rights. These habits that contribute to how our economy and market operate are deeply ingrained in our daily lifestyles.

Capitalism and Land Laws

The United States of America is a country that is heavily based on capitalism. Our individual mindsets, our local economics, our government all contribute to trying to make the exercise of our capitalistic beliefs and efforts more efficient. Along with this, we stress the legal system in privatizing goods so as to maximize the incentives for development. However, the drawback to this system is that people are unmonitored when they abuse these rights.

As a society, we have long believed that economically, the free market is capable of resolving all problems because in the end, whoever values certain things the most will end up receiving them.[8] However, this concept or approach cannot be fitted to apply in the realm of environmental conservation. Professor Freyfogle has argued that it is wrong to compensate land and property owners properly act in an environmental sense, because this is inherent in their responsibility as owners of land.[9] We should use the common law and furthermore, the common good system to govern the property ownership system at hand.

Tragedy of the Commons and Enlightenment

We must overcome the tragedy of the commons which is “essentially the situation in which multiple individuals, acting independently, and solely and rationally consulting their own self-interest, will ultimately deplete a shared limited resource even when it is clear that it is not in anyone's long-term interest for this to happen."[10]

One may wonder how we can resolve this problem. First I will explain the situation at hand. In absence of enlightened self-interest, governmental intervention is needed to resolve the collective action problem at hand. It's almost a situation in which children cannot do what is best for them and need an adult to step in and guide them in their actions. Governmental regulations can affect macroeconomics in that they can limit the amount of a common good (in our case, land utility) available for use by any individual. Currently existing government permit systems that limit activities such as fishing, hunting, livestock raising are examples of this approach. Similarly, limits to pollution which may come in the form of pollution/emissions credits are examples of governmental intervention on behalf of the commons. Property rights can effectively ameliorate the problems related to the tragedy of the commons when the rights result in the effective internalization of the cost of over harvesting.[11] However the current state of property law promotes a sense of unbridled freedom in ownership and the property rights are in fact harmful when they reinforce a sense of entitlement to an unlimited harvest. In effect, this causes the owners and resource users to reject any suggest that their usage should be reduced.

Coase theorem, Adam Smith, and Economics

As someone who has an undergraduate degree in Economics, I understand the true impact that the market and economics have on the environment. In economics, there is a very powerful theorem that applies to the world. This theorem describes the economic efficiency of a certain outcome in the presence of externalities. The theorem basically explains that when trade in the presence of an externality is possible and there are no transaction costs, bargaining will lead to an efficient outcome regardless of the initial allocation of property rights.Ultimately, Coase would conclude that if transaction costs were zero, initial allocations of

property rights are irrelevant because they don't affect the final determination of property rights. A Coasean solution would be to have the parties negotiate by themselves a deal in which both would benefit with fewer costs than litigation. However one of the problems with this theorem is that it disregards the environment as a valid externality.[12] Another issue is that economics assumes that trade always takes place between individuals that are both somewhat capable of evaluating and pursuing their own self-interest. However, this is not always a valid assumption. Basic economics premises ignore the fact that in the present day society, there exists an inherently unequal distribution of power.[13] For example, large corporations in the United States are capable of controlling economic and trade conditions with smaller players in the country. If we cannot expect corporations to play fair even in the world of business, then how can we expect them to abide by nature's calling?

Even laws designed for corporations stress the concept of shareholder wealth. The large movers and shakers in our economy focus mainly on profit and ignore any environmental side effects. This is partially in fact due to prevalence of belief in the free market and application of the Coase theorem. Currently, the free market works in a way that promotes self interests and greed.[14] The structure promotes greed in that prices will stay low and quality high when people are more interested in their own bottom dollar and interests. While this may function from a purely economic point of view, this system sacrifices our environmental integrity for the sake of profit.[15] Producers in our economy primarily and only want to maximize their own profits and in turn inevitably causes collateral damage along the way.

Conclusion

We as humans need to realize a few things. First, we are a part of nature and not above it. As a result, we have to understand that we are individuals as a part of a whole. In order to avoid the tragedy of the commons, society has to begin to change in the direction of sacrificing individual rights and enjoyment for the greater good.

Second, we have to change the way our market functions. This can be done through two avenues. Either we can change the market through legislation and politics, or through grassroots movements beginning with individual actions. The fundamental economic concepts that are deeply ingrained in our current market are based on fallible assumptions that do not ring true when the environment is concerned.

[1] What is Going Green?, US Chamber of Commerce, 2010, a*vailable at*http://www.uschambersmallbusinessnation.com/toolkits/guide/P15_1001.

[2] Graves, Richard, *The Climate Crisis: A Case Study of Adaptation, Mitigation, and Transformational Politics,* 2006, *available at*http://www.macalester.edu/~rgraves/citizen%20science/index.htm .

[3] Mike Tidwell, *The Failure of the Green Movement,* The Washington Post, Dec. 2009.

[4] *Id.*

[5] Eric Freyfogle, *The Land We Share,* ISLAND PRESS, 179-181, 2003

[6] *Id.*

[7] Gustave Speth, *Environmental Failure: A Case for a New Green Politics*, Oct. 2008.

[8] Herman E. Daly, *The Perils of Free Trade,* Scientific American, Nov. 1993.

[9] Freyfogle, s*upra* note at 5.

[10] Garrett Hardin, *The Tragedy of the Commons,* 162 Science 3859, at 1243-1248, Dec. 13, 1968.

[11] Patrick Frierson, Applying Adam Smith: A Step towards Smithian Environmental Virtue Ethics, (1999), a*vailable at*http://people.whitman.edu/~frierspr/smith1.htm .

[12] Robin Hahnel, *Economic Justice and Democracy: From Competition to Cooperation* (2005), *available at*http://www.akpress.com/2005/items/economicjusticeanddemocracy .

[13] John Gowdy, *Ecological Economics at a Crossroads,* Science Direct, Mar. 2005.

[14] Daly, s*upra* note at 8.

[15] Gavin Kennedy, *Smith Had Nothing to Say on CSR- for or against!*, 2006, *available at*http://adamsmithslostlegacy.blogspot.com/2006/09/smith-had-nothing-to-say-on-csr-for-or.html .

HAPPINESS AND ITS EFFECT ON ECONOMIC DEVELOPMENT AND BUSINESS PROFITABILITY

Introduction

"Policy decisions at the organizational, corporate, and governmental levels should be more heavily influenced by issues related to well-being—people's evaluations and feelings about their lives."[1] This recent trend in economic development literature, that policy decisions at the government and corporate level should be influenced not by profit maximization but their effect on people's subjective well-being, is gaining acceptance in the real world. Empirical research and analysis shows that policy aimed at improving workplace happiness not only has an impact on employees subjective feelings of well-being, but also improves worker productivity and by extension corporate profitability.

How Do Happiness Studies Work?

Because "happiness" is not a quantifiable variable, there are numerous ways in which researchers control for the subjective aspect of one's reported happiness. A typical happiness survey consists of simply asking respondents, "all things considered, how happy are you with your life?". [2] To control for the fact that a respondent might have gotten into a car accident on the way to work, or that a respondent got a parking ticket that day, which may skew the believability of a response, researchers readminister the survey at random intervals over a period of time. [3] What they find is that respondents generally report the same level of happiness over a long period of time. Another way to control for the problems associated with happiness studies is to ask the friends and family of the

respondents how happy they feel the respondent is with their lives. The idea is that friends and family will have an insight into how happy a respondent is, and researchers find that friends and family tend to report the same level of happiness as did the respondent.[4] Finally, researchers also study things like suicide rates for example, and find that only those respondents reporting a low level of happiness will commit suicide in the future. [5] These findings support the conclusion that respondents give truthful and insightful responses to the question "how happy are you?".

Important Findings of Happiness Studies

People with a higher education report significantly higher levels of happiness than those with less education. [6] People over 60 report being happier than people of middle age.[7] And married couples are happier than singles. [8]
But for the purposes of this paper, one of the most important finding is that although higher levels of income are positively correlated with happiness, this positive relationship has it limits. After an income of approximately $20,000, the statistical relationship between income and happiness is negligible. [9] In other words, marginal increases in income after $20,000 only slightly increases happiness.[10] Also, research in this field has found that although GDP per capita has increased 400% since 1960, the average American does not report high levels of happiness than Americans in the 1960's, even though Americans today are four times as wealthy in real terms. [11] These findings suggest that striving to be the wealthiest nation in the world should not be the basis of our policy decisions if our ultimate goal is happiness and life satisfaction. Other countries are taking note of this phenomenon, and France for example has created The Commission on the Measure of Economic Performance and Social Progress which is engaged in

researching levels of happiness and developing policy initiatives aimed at creating sustainable national well-being.[12]

Happiness and Workplace Productivity

Looking on the bright side, the implication of this literature is not that we must choose between being rich and unhappy versus poor and happy. In fact, implementing workplace policies that foster happiness may increase productivity thereby increasing wealth. Policies aimed at profit maximization may be counterintuitive in that they decrease productivity and limit a business's ability to grow and be profitable. "One academic study found that managers with average salaries of about $65,000 cost their organizations roughly $75 a week per person in lost productivity if they are "psychologically distressed."[13] Providing treatment to depressed workers has been shown to increase productivity, which added up to an estimated annual value of $2,601 per depressed full-time employee. [14] This treatment also resulted in a 28% lower rate of absenteeism.[15] Also, a national survey of 1,792 adults conducted by Peter D. Hart Research found that 63 percent trust employers "just some" or "not much" when it comes to treating employees fairly.[16] The bottom line is that unhappy workers who feel they are not treated fairly have no incentive to be productive and will only do just enough to not get fired.

How Can Happiness and Productivity Be Improved?

Employee morale can be increased in the most obvious ways, yet are sometimes ignored by managers and higher level executives. For example, treating an employee with respect, getting to know employees, creating an employee recognition program, and having regular meetings to address questions or

concerns an employee may have significantly improve morale and happiness, and therefore improve productivity. [17] The problem in the business community is that these methods are not seen as profit maximizing tools, but rather side issues dealt with on a human resources level. If corporations made these sorts of programs as important as their other profit maximization business dealings, they could increase workplace productivity and profitability. "Staff that enjoy good working relationships, receive proactive career development, feel valued by the organization and well treated in times of change, are likely to be contributing the most to a business. Furthermore, they will be ambassadors for the organization, sending out positive messages to the outside community and enhancing the employer brand." [18]

Conclusion

Happiness is more than just an ideal emotion with no place in the business world. Research has shown that happiness at work dramatically effects productivity. Policies centered on strict rules, output, and profit maximization may be counterintuitive in that they displace employee happiness, negating the possible benefits of such programs. In addition, improving employee happiness is inexpensive and can be attained simply by treating employees with respect and recognizing their successes. By implementing policies aimed at promoting workplace happiness, corporations and other businesses will not only improve the workplace environment, but also their bottom line.

[1] Ed Diener & Martin E. P. Seligman, *Beyond Money: Toward an Economy of Well-Being*, 5 PSYCHOL. SCI. PUB. INT. 1 (2004).
[2] *Id.*
[3] *Id.*
[4] *Id.*
[5] Daly, Mary C., Daniel J. Wilson. "Happiness, Unhappiness, and Suicide: An Empirical Assessment."
Federal Reserve Bank of San Francisco Working Paper, 2008-18.
http://www.frbsf.org/publications/economics/papers/2008/wp08-19bk.pdf
[6] "Happiness, Economy, and Insitutions", Institute For Empirical Research in Economics – University of Zurich.
http://www.iew.uzh.ch/wp/iewwp015.pdf

[7] *Id.*
[8] *Id.*
[9] Easterlin, R. A., "Will Raising the Incomes of All Increase the Happiness of All?", *Journal of Economic Behaviour and Organization*, vol. 27(1), pp. 35-48. (1995).
[10] *Id.*
[11] *Id.*
[12] Joseph E. Stiglitz, Amartya Sen, Jean-Paul Fitoussi, "Report of the Commission on the Measurement of Economic Performance and Social Progress". 2009.

[13] Diane Stafford, "Study Finds That Happy Workers Are More Productive Workers". *St. Petersburg Times*. April 10, 2009.

http://bx.businessweek.com/health-and-wellness/view?url=http%3A%2F%2Fc.moreover.com%2Fclick%2Fhere.pl%3Fr1916735415%26f%3D9791

[14] Lloyd deVries, "Happy Workers, Better Workers". 2004. CBSNews.com http://www.cbsnews.com/stories/2004/11/24/health/webmd/main657624.shtml

[15] John Reh, "Which are More Productive, Happy Workers or Sad Workers?". November 27, 2004. http://management.about.com/b/2004/11/27/which-are-more-productive-happy-workers-or-sad-workers.htm

[16] Kent Hoover, "Survey Finds Number of Unhappy Workers on the Rise". *Washington Business Journal*. September 7, 2001. http://washington.bizjournals.com/washington/stories/2001/09/10/newscolumn3.html

[17] Lea Hartog,"15 Ways to Boost Employee Moral". *HRWorld.com.* April 28, 2008. http://www.hrworld.com/features/15-ways-boost-employee-morale/

[18] "Happiness at Work Index – Research Report 2007." *Chiumenta London.* http://www.arboraglobal.com/documents/Happiness%20at%20Work%20Index%202007.pdf

AMERICAN NEEDLE, INC. V. NATIONAL FOOTBALL LEAGUE: WILL THE NFL'S CHALLENGE INTERCEPT A HOCKEY FAN'S ENJOYMENT OF THE NHL?

I. Introduction

The Supreme Court is expected to release its decision in *American Needle, Inc. v. NF*L in the near future after hearing oral arguments on January 13, 2010. [1] In this case, the National Football League (NFL) is arguing that its teams operate as a single-entity and therefore cannot be held in violation of anti-trust laws. Law professor Marc Edelman suggests that, "[i]f the court adopts the NFL's single-entity concept, it would change everything." [2] The view portrayed in Professor Edelman's statement is shared by many as the result of this case is likely to have its impact on other major sports leagues as well. While many of the implications for the NFL have been discussed through coverage of the case, this article suggests specifically how those changes would affect fans of the National Hockey League (NHL).

II. Background

On July 29, 2009, the Supreme Court granted certiorari to hear*American Needle, Inc. v. NFL*. [3] Until 2000 when American Needle ended its relationship with the NFL, American Needle had made knit caps and baseball hats with NFL logos for decades. [4] This relationship ended as a result of a decision by NFL Properties, a separate corporate entity formed by the NFL teams, to "license and market both the league- and team-owned intellectual property and to advertise and promote the sport of professional football." [5] In 2001, NFL Properties did not

renew American Needle's license to manufacture and merchandise NFL headwear. [6] Instead, NFL Properties granted an exclusive headwear license to Reebok International, Ltd. [7] As a result of this decision, American Needle, Inc. filed an anti-trust case against the NFL in claiming that the NFL "was using its monopoly powers illegally to deprive the company of its share of the market for caps and hats bearing logos of NFL teams." [8]

Unfortunately for American Needle and sports fans, courts have not agreed with American Needle. First, the United States District Court for the Northern District of Illinois held against American Needle. [9] The court determined that the licensing agreement between the NFL and Reebok promoted NFL football. Further, by promoting the NFL through this collective licensing agreement, "the NFL teams 'act[] as an economic unit' in such a manner that 'they should be deemed a single entity.'" [10] In its appeal to the United States Court of Appeals for the Seventh Circuit American Needle argued that the district court incorrectly concluded that the NFL teams constitute a single entity when collectively licensing their intellectual property. [11] American Needle's primary argument for why NFL teams do not constitute a single was "that each team 'could' compete against the others in licensing their intellectual property, and that, therefore, NFL Properties functioned to deprive the marketplace of independent sources of economic power." [12]

The Seventh Circuit, in August 2008, disagreed with American Needle's argument and held that the NFL and its teams operate as a single entity. [13] The Seventh Circuit, decided that "NFL teams can function only as one source of economic power when collectively producing NFL football," [14], and as one source of economic power, the NFL constituted a single entity. The court pointed to the fact that a single football team could not produce a football game

by itself and therefore "the NFL teams share a vital economic interest in promoting NFL football." [15] The court further suggests that the marketplace did provide independent sources of economic power because "the league competes with other forms of an audience of finite (if extremely large) size, and the loss of audience members to alternate forms of entertainment necessarily impacts the individual teams' success." [16] The significance of this is that a single entity may not conspire with itself. [17] As a single entity, the NFL would only be open to anti-trust scrutiny if the NFL joined other leagues, such as the NHL, or other providers of entertainment to set prices. [18] As a result, it would be very difficult for the NFL to violate section 1 of the Sherman Act, which prohibits concerted action that unreasonably restrains trade. [19]

In the past, football and basketball unions have used the threat of anti-trust litigation as a way to further the interests of their players. [20] Without this potential threat, unions for athletes would have far less leverage with which to negotiate. [21] Deadlocks will no longer be solved by the courts but instead by player strikes. [22] As seen in Major League Baseball (MLB) and the NHL, strikes can have disastrous effects on the players, owners, and fans. These effects include revenue losses in the absence of games and also many fans are turned off from watching millionaires complaining about enormous salaries.

It appears that this decision has already had some impact on the NHL as well. For example, the Phoenix Coyotes would like to sell their franchise through a bankruptcy proceeding. [23] However, to do so, the Coyotes must have approval of the NHL's Board of Governors, which has refused to approve the sale the franchises preferred buyer. [24]. In the bankruptcy proceeding for the Phoenix Coyotes, the NHL used *American Needle* as persuasive authority to argue that the Coyotes "cannot state an anti-trust claim against the NHL" and cites to the Seventh Circuit's decision. [25]

To prevent the possibility that the NHL will also be held to be a single entity, Paul Kelly, former NHL Players' Association (NHLPA) Executive Director and the NHLPA hired Laurence Gold. [26] Laurence Gold is a Harvard Law School graduate and served as general counsel of the AFL-CIO. Gold joins hires by the MLB and American Needle in assembling an "all star" team of lawyers to argue against the NFL. [27]

III. Analysis – Impact on the NHL

The impact of a court's decision in the Phoenix Coyotes bankruptcy case, seems unlikely to be felt by Phoenix Coyotes fans unless the team moves, however the changes predicted as a result of a Supreme Court decision in favor of the NFL will be felt by fans and players of all major league sports teams. As *American Needle, Inc. v. NFL*, deals directly with allowing one entity to retain a license for league headwear, it is certainly conceivable that a holding in favor of the NFL could allow sports leagues to similarly allow for only one source of all league apparel. Conceivably, the owners of NHL teams could work together to set the price of jerseys at $300. [28] A substantial increase from the current price, but if the NHL was the only source for the license to manufacture these jerseys, they would be the only seller and could determine any price they wanted.

As a single entity the NHL could obtain protection from other anti-trust litigation as well. For example, networks that retain the sole right to broadcast a certain game, such as the NFL network, have been the subject of controversy. [29] The NHL has recently created its own network and has recently begun to broadcast some of its games on Versus Network. This creates controversy because games that were once free to view now require fans to pay, sometimes significantly more, to view the games. [30] With anti-trust protection, the NHL could air more

and more games exclusively on cable networks that require additional fees, thus making it more difficult for fans to watch hockey.

In 2004, the NFL entered into a contract with Electronic Arts giving Electronic Arts the exclusive right to use NFL players, images, teams, logos, trademarks, and statistics. [31] In recent years, Electronic Arts have been able to raise the price of its Madden NFL games in the absence of competition, while also being criticized for lacking innovation. [32] This appears to be a result of limited competition. Similarly, if the NHL exclusively licensed the right to use its players, images, teams, logos, trademarks, and statistics to a single company, it is possible that fans of the NHL will have to accept paying higher prices for lower quality video games as well.

The NHL's Collective Bargaining Agreement ends in 2011. [33] As previously mentioned one of the major bargaining tools of players is the threat of anti-trust litigation. Without this tool on the side of the NHL's players, the players may have to make certain concessions that in the past they had the ability to avoid, or else face the negative consequences of going on strike. For example, players will face the possibility of owners working together to place limits on salaries and restricting free agency rights. Personally, as a Chicago Blackhawks fan, this could be very significant. While the team's core in Patrick Kane, Jonathan Toews, Duncan Keith, Marian Hossa, and Brian Campbell are all signed beyond 2012, the Blackhawks will have ten free agents heading into the summer. [34] For these ten free agents uncertainty could be on the horizon. With salary cap issues looming already for the Blackhawks, a decreased salary cap could result in these free agents looking elsewhere, and settling for a significantly lower contract than those who were lucky to sign long term deals prior to the Supreme Court's decision. Coaches and managers, who cannot form

a union as they are part of management, would face the threat of a salary schedule that could substantially limit their compensation as well. [35] This is not fair for Blackhawks coach Joel Quenneville and team president John McDonough who have helped to turn around a franchise.

IV. Analysis – Legal Impact and Recommendation

In addition to the negative anti-competitive effects classifying a sports league and its teams as a single entity could have on fans of the major sports leagues, there are also arguments against the reasoning that the Seventh Circuit used in making the holding it did. First, the Seventh Circuit's reliance on the fact that a football team could not play a game against themselves, fails to consider that teams "could compete over the sale of apparel and thus could join hands in anticompetitive ways." [36] Therefore, while a parent-subsidiary relationship could be considered a single-entity, as a wholly owned subsidiary lacks the ability to act independently, an individual team with a highly marketable logo may find it desirable to separately compete with the NFL's apparel license. [37] The Seventh Circuit seemed to ignore the fact that the Dallas Cowboys successfully sued the NFL and NFL Properties to keep revenue from its merchandise rather than to share it with other NFL teams. [38] Therefore, without considering more than a single team's reliance on other teams to make games happen, the Seventh Circuit failed to consider other factors to determine whether NFL teams actually do constitute a single economic power, and whether the NFL's exclusive contract with Reebok negatively impacts market competition and the interests of fans. [39]

A second place where the Seventh Circuit may have overlooked how the NFL actually operates is with regards to ownership of intellectual property of the

individual teams. Individual franchises retain ownership in their own intellectual property. [40] If the NFL was a single entity it would seem to follow that the NFL would own these intellectual property rights rather than the individual teams.

Perhaps the strongest argument against the Seventh Circuit's holding is that the court seemed to pay little attention to precedent. [41]. While the circuit court is not required to follow what other courts have done, other federal circuit courts have been unwilling to hold that any other professional sports league and its franchises are a single entity. [42] It is for these reasons, I believe that the Supreme Court should find against the NFL and determine that the NFL is not a single entity.

V. Conclusion

The sports industry is an extremely successful industry. The NFL is one of the most successful sports leagues and even one of the most successful collections of business in America. [43] NFL club revenues expanded from close to $970 million in 1989 to over $6.5 billion in 2008. [44] The NHL has similarly experienced strong growth during the same period. [45] However, the NHL's lockout and cancellation of the 2004-2005 season, resulted in significant losses in revenue and fans. In addition to another lockout being the only action the NHL's players union could take to assert itself, the effect of the Supreme Court finding in favor of the NFL would likely cost the NHL additional fans as many will not be able to afford increases in merchandise prices and the cost to continue to see games.

[1] Lester Munson, *The NFL's Latest Legal Muscle Pose*, ESPN.COMFeb. 4, 2010, *available at*http://sports.espn.go.com/espn/commentary/news/story?page=munson/100204.

[2] Lester Munson, *Anti-trust Case Could be Armageddon*,ESPN.COM Jul. 17, 2009, *available at*http://sports.espn.go.com/espn/columns/story?columnist=munson_lester&id=4336261.

[3] Steven Semeraro, *Is the National Football League a "Single Entity" Incapable of Conspiring Under the Sherman Act?: The Supreme Court Will Decide*, 32 T. JEFFERSON L. REV. 1, 2 (2009).

[4] Munson, *supra* note 2.

[5] James A. Keyte, *American Needle Reinvigorates the Single-Entity Debate*, 23-SUM ANTI-TRUST, 48, 49 (2009).

[6] *Id.*

[7] *Id.*

[8] Munson, *supra* note 2.

[9] American Needle, Inc. v. New Orleans Saints, 496 F.Supp.2d 941 (N.D. Ill. 2007).

[10] American Needle, Inc. v. National Football League, 538 F.3d 736, 740 (7th Cir. 2008).

[11] *Id.* at 741.

[12] Keyte, *supra* note 5.

[13] American Needle, Inc. v. National Football League, 538 F.3d 736 (7th Cir. 2008).

[14] *Id.* at 743.

[15] *Id.*

[16] *Id.*

[17] Michael. A. McCann, *American Needle v. NFL: An Opportunity to Reshape Sports Law*, 119 YALE L.J. 726, 728 (2010).

[18] Munson, *supra* note 2.

[19] Sherman Anti-trust Act § 1, 15 U.S.C. § 1 (2006).

[20] Munson, *supra* note 2.

[21] *Id.*

[22] *Id.*

[23] McCann, *supra* note 17.

[24] *Id.*

[25] Michael. A. McCann, *American Needle v. NFL: An Opportunity to Reshape Sports Law*, 119 YALE L.J. 726, 728 (2010) (citing National Hockey League's Motion to Dismiss or in the Alternative for Summary Judgment at 3, *In re* Dewey Ranch Hockey, 406 B.R. 30, (No. 2:09-bk-09488-RTBP)).

[26] Munson, *supra* note 2.[27] *Id.*

[28] *Id.*

[29] McCann, *supra* note 17 at 763.

[30] *Id.*

[31] McCann, *supra* note 17 at 764.

[32] McCann, *supra* note 17 at 765.

[33] McCann, *supra* note 17 at 766 (citing Steve Zipay, Briefs, Newsday, Sept. 1, at A48).

[34] *2009-10 Player Tracker*, BLACKHAWS.NHL.COM Apr. 3, 2010,*available at* http://blackhawks.nhl.com/club/page.htm?id=47390.

[35] Munson, *supra* note 2.

[36] McCann, *supra* note 17 at 756.

[37] *Id.*

[38] *Id.*

[39] *Id.*

[40] McCann, *supra* note 17 at 756.

[41] *Id.* at 757.

[42] *Id.*

[43] Marc Edelman, *Why the "Single Entity" Defense Can Never Apply to NFL Clubs: A Primer on Property-Rights Theory in Professional Sports*, 18 FORDHAM INTELL. PROP. MEDIA & ENT. L.J.891 (2008).

[44] *Id.*

[45] *Id.*

EXCLUDING THE ENDOWMENT EFFECT?

I. Introduction

The Coase Theorem has no doubt left an indelible mark on Law and Economics. The theorem proposes that, absent transaction costs, property will be allocated efficiently regardless of initial entitlement.[1] Widespread acceptance of this assertion has given rise to much legal analysis aimed at reducing transaction costs in order to lubricate bargaining and achieve efficient allocation of property rights. On the whole this is not a bad thing – transaction costs are a major obstacle to efficient bargaining and should be reduced. However, recent studies which indicate the existence of the endowment effect have lead many scholars to re-examine their initial assumptions regarding the importance initial entitlement.[2]

II. Background

A. The Coase Theorem

The main premise of the Coase Theorem is that, absent transaction costs, property rights will be efficiently allocated regardless of initial entitlement.[3] This conclusion leads to two further assertions named invariance and efficiency. Invariance states that, discounting transaction costs, the same efficient ultimate distribution will prevail. Efficiency states that, discounting transaction costs, the ultimate distribution will be efficient. The theorem is used to support the notion that clearly defined property rights will promote efficient distribution of those rights. One of the primary transaction costs is information – the ability and the cost of obtaining it. The importance of information is

highlighted by the famous prisoners' dilemma.[4] In the prisoners' dilemma each actor would be better off cooperating instead of refusing to cooperate. However, absent such information and confidence, the dominant strategy is to not cooperate. Accordingly, much attention has been given to the reduction of transaction costs.

B. The Endowment Effect

The endowment effect indicates that "[p]eople are reluctant to part with their property, and the amount that they are willing to accept (WTA) to sell it generally far exceeds the amount that others are willing to pay (WTP) for it."[5] The endowment effect is essentially the gap between a person's buy and sell price regarding a specific good. This finding suggests that initial entitlement would play an important role in the efficient allocation of resources because specific valuations will be altered by ownership. In particular, two studies have led to conclusions which could prove influential for a law and economics analysis of the regulation of business transactions.

C. The Endowment Effect and Differing Legal Regimes

The first study conducted by Jeffrey J. Rachlinski and Forest Jourden compared the endowment effects in property and liability regimes.[6] A property regime is one of equity where one's rights are typically protected by injunctive relief or excludability under the law – a court order mandating certain activity or a cessation of activity by the defendant. A liabilities regime is one of law where a plaintiff's rights are protected by damages – the plaintiff receives monetary compensation for her loss. Rachlinski's study was comprised of two similar tests which were further divided into three distinct fact patterns differing only by the remedy to be bought or sold.[7] For each fact pattern there were two groups –

buyers and sellers. Buyers were given the opportunity to purchase a right associated with a piece of property.[8] Sellers were given the opportunity to sell a right associated with a piece of property.[9]Each individual had the opportunity to purchase/sell one of the following rights: a court order prohibiting interference with, a right to a large amount of damages which was coupled with a low probability of occurrence, or a right to a small damages amount coupled with a high probability of occurrence.[10] Each of the individuals only saw the right enumerated in their fact pattern. The Buyers and Sellers in both tests were informed that their purchase, or refusal to sell (obtaining or keeping the right) thereby attaching somewhat diminished utility from not having the money offered/spent.[11] Finally the dependent variable in the test was the willingness to sell/buy. Rachlinski and Jourden's test indicated that rights protected by property rules tended to show a stronger endowment effect than those protected by liabilities.[12] The test which was measured by a "willingness to sell/buy" indicated that a property regime produced more people who were unwilling to sell than a liabilities regime produced.[13] Furthermore the difference between the willingness to buy under a property regime vs. a liabilities regime was almost non-existent.[14]

D. The Endowment Effect and Incentives

The second study by Christopher Sprigman and Christopher Buccafusco measured differing valuations of a non-rivalrous good between "authors", "owners," and "bidders."[15] This test attempted to see if a creator ("author") of a good would experience a larger endowment effect then an "owner."[16] The "author" in this test wrote a poem which would be submitted to a competition to win a prize.[17] The "author" was told that there was an additional group (the "bidders") who would attempt to purchase the chance at winning.[18] Each of the

"authors" was told that the highest bidder would be assigned to their poem, and that they should indicate the minimum amount at which they would be willing to sell.[19] The "owner" was randomly assigned a poem and given the same options as the "author" (keep the chance at winning, or sell the chance). The "bidder" was given no initial entitlement but rather assigned a poem and given the opportunity to purchase that poem's chance at winning.[20] Thus there was one group who was given initial entitlement by virtue of their effort, and another by virtue of simply being there, and the third group had no entitlement.[21]The three groups were subjected to three different tests involving the aforementioned options.[22] In the first test they were told that the winner would be selected subjectively (that the "best" poem would win). [23]The groups were only allowed to view the poem assigned to them, and asked their willing to sell/buy price.[24] In the second test the selection of the winning poem was the same as the first.[25] However, in this test they were allowed to see all of the poems, but still only given the opportunity to buy/sell the poem assigned to them.[26] In the third test, the subjects were informed that the winner of the contest would be random (that it would be drawn from a hat). In this third test they were allowed to read the poems, but were reminded that the chance of winning was not contingent on the quality of the poems.[27] The results of the experiment indicated that "authors" and "owners" did not show any significant difference in the endowment effect.[28] The experiment also showed a rather significant endowment effect goods which would be covered by IP law, even when the profitability of the rights were clearly objective (luck of the draw) as opposed to subjective (quality of the poem).[29] The findings of the two tests, combined with the larger implication of the endowment effect (that initial entitlement does matter, creates variables, which thought seemingly at odds with, are not wholly incompatible with Coasin Bargaining, but would have to be accounted for.

III. Discussion

According to classical economics, it is assumed that, when one purchases property both the property and the cash are being transferred to those who value it most – a major tenet of Rational Choice Theory.[30] For example, if person A sells a bicycle to person B for $10 then person A would typically be held to value the ten dollars more than the bicycle and person B would be held to values the bicycle more than $10. In such a transaction $10 would indicate A's minimum sell price and B's maximum buy price. It can be inferred that the minimum sell price indicates the point at which any less money received would have less value than the bicycle, and that the maximum buy price indicates the point at which any more money paid would outweigh the value of the bicycle.

Alternatively, if A's minimum sell price is $12 but B's maximum is $10 then the transaction will not occur because neither party would accept the other's price – having the bicycle is more valuable to A then $10 and having $12 is more valuable to B then having the bicycle. Therefore in this second scenario the rights would already be efficiently allocated. If the initial bicycle entitlement were granted to B instead of A, but they still retained the same aforementioned valuations, then according to the Coase theorem the right to the bicycle should transfer to A. This conclusion is only made possible if one makes several assumptions. First, one would have to assume that their valuations impute a preference – that because A is unwilling to accept anything less the $12 in exchange for his bicycle he would be willing to pay anything less than $12 to obtain it, and that because B is unwilling to pay more than $10 for a bicycle he would be willing to accept any amount higher to sell it. This first assumption derives A's maximum buy price from his minimum sell price should he lack initial entitlement, and derives B's minimum sell price from his maximum buy

price should he enjoy initial entitlement. This assumes that the previously stated (and presumably "measured" values) can reliably indicate a predicted value should the situation change. This first assumption is founded on a larger assumption – valuations and/or preferences do not change according to initial entitlement. It is posited here that these assumptions are only possible if one discounts the endowment effect and that if either of these assumptions is incorrect they would threaten to undermine the conclusion of the Coase theorem. I would like to note that there are other assumptions that must be made in order for the Coase theorem to work (e.g. absence of transaction costs etc.); however these assumptions will not be addressed as they are beyond the scope of the paper.

The bicycle example assumed that the valuation of the bicycle would remain the same whether or not the person was buying or selling. However, this may not always be the case. Numerous experiments and studies point to the existence of an endowment effect.[31] As mentioned above the endowment effect can best be described as the phenomenon that people are often willing to sell an item they own for a much higher price than they would be willing to pay for it.[32] The most famous experiment regarding the existence of the endowment effect was conducted by Robert Thaler and his colleagues.[33] In this test, Thaler gave mugs out to half of his students, and according to classical economic theory both the owners and potential buyers of the mugs should have valued them at the same price and about half of the mugs should have been exchanged.[34] However, the owners consistently over valued the mugs and only about a quarter of them were exchanged.[35] Jeffrey J. Rachlinski and Forest Jourden in their 1998 law review article provide an excellent example which analyzes the effects of initial entitlement on ultimate distribution and valuation.[36] In the example there is a homeowner who would be willing to purchase a pollution easement for $2,000 or less, but would only be willing to sell

it for $6,000 or more.[37] In the same example, there is a factory owner who would be willing to pay $2,500 or less for this same right, and would be willing to part with it for $5,500 or more.[38] In this scenario, regardless of who receives initial entitlement, no transaction will occur, which in turn might lead some to conclude that the rights are in possession of those who value them most.[39] However, this conclusion is without merit because arbitrarily switching the initial entitlement would still yield no transactions – either person, if she/he is the owner, will refuse to sell because both willing to sell prices are higher than the other's willing to buy price. Thus, in this scenario the rights are not necessarily in the hands of those who value them most, but rather merely who received them first.

The stagnation illustrated in Rachlinski's problem does not necessitate regulating the distribution of initial entitlement to avoid the endowment effect.[40] Such an undertaking would face very serious moral criticisms in addition to complications associated with cost and proof. Such a regulation would have to take into account that initial entitlement colors valuation of a specific right. In order to mitigate this effect the regulation would have to ensure that the initial entitlement did not interfere with the allocation of this right to the person who valued it most. In the aforementioned scenario, and lacking such regulations, the only way to do this would be to assign it to the party who valued it most. Determining which party valued it the most would be quite difficult as using or deriving the buy/sell prices of either party would be influenced by whether or not they owned it in the first place. In light of the difficulties it is apparent that regulation should not focus on forcing efficient distribution of initial entitlements in an effort to avoid the endowment effect, but rather encourage legislation that attempts to minimize the endowment effect itself. Thus, in a sense, Coasian

bargaining may still take place but only if the initial entitlement does color the valuations such that it impedes Coasian bargaining.

IV. Analysis

If one is to focus not on the efficient distribution of initial entitlement, but rather the original goal of allowing property rights to be efficiently distributed then one must first turn examine the nature of property. Property is often broken down in terms of rivalry and excludability. Rivalrous goods are whose consumption affects the consumption of that good by another person. A milk dud I eat cannot be eaten (at least in the same way) by another person. Excludability is the ability to bar someone from consuming the good in question. Public Goods are goods which cannot be excluded, and whose consumption does not affect the consumption by another. Knowledge and ideas are two things which could conceivably fall into this category. When a person has a new and original idea it could technically be called a club good. In order to get access to this club you have to be the originator. However, if the originator of the idea lets people know and it becomes common knowledge it is no longer a club good but a public good. The rights granted by Intellectual property law essentially turn what would be a public good into a club good, or rather temporarily maintains its prior status. In the United States, the purpose of Intellectual Property Law is to "to promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."[41] The presumption is that originators of ideas will lack incentives to share those ideas because they will often not be allowed to monetize the benefits of those ideas and thus may be less likely to spend the time to create new thing, or in the event that they do they will be more likely to internalize the benefit as opposed to sharing it in order to gain a marginal competitive advantage.

Thus temporary excludability is often granted to Intellectual Property in order to promote its creation and dissemination.

The experiment from Rachlinski's paper suggests that the endowment effect is increased when the right is protected by a property regime and that the endowment effect is mitigated (or even eliminated) when that same right is protected under a liabilities regime.[42] The experiment showed that as the right being exchanged between parties moved from a property regime to a damages regime those willing to sell the right increased, whereas those willing to buy remained relatively constant.[43] Rachlinski suggests that the data retrieved from his experiments the notion that "the inability of other people to appropriate my things lies at the core of the notions of 'ownership' and 'property'"[44] Thus by granting one the right to exclude it increases his unwillingness to sell it but leaves his willingness to purchase unaffected. This difference can be seen as a skewed attachment stemming from initial entitlement, and is indicative of the endowment effect because the willingness to buy is not reciprocally diminished. When combined with the findings from Sprigman's paper – that the endowment effect does exist in intellectual property, and that it exists whether or not the profitability of that good is determined by chance or quality – it may hold that the endowment effect created in goods made excludable by IP law may be reduced if the coverage extends to protections involving liability without decreasing the willingness to purchase.[45]

V. Conclusion

Many studies have indicated the presence of an endowment effect. This presence of this effect given the right conditions could lead to inefficient bargaining, and/or an inefficient allocation of property rights due to initial

entitlement. If the Endowment Effect is determined to be a common barrier to efficient bargaining such that it warrants legislative regulation, then that regulation should forgo any possibility of forcing initial entitlement from one party to another. Alternatively, the regulation should first work on identifying the possible sources of the effect, and work to create laws which would allow the market to take care of the allocation of property rights. If the right to exclude does not incentivize the buyer to buy, and disincentivizes the owner to sell then it may prove to be an impediment to bargaining. Perhaps the court's reluctance to apply equitable remedies is not merely following protocol rooted in the old rivalry between law and equity. Modern Courts have done away with the plaintiff's matter-of-course right to an injunction.[46] Perhaps this is evidence that excludability is not necessarily required to maintain incentives and profitability of a Club Good which would otherwise be a Public Good.

---

[1] *See* Robert Cooter and Thomas Ulen, LAW & ECONOMICS, 85-1, 225, 268 (Pearson Addison Wesley 2008)

[2] See Daniel Kahneman, Jack L. Knetsch & Richard H. Thaler, *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. POL. ECON. 1325 (1990); *See* Richard Thaler, *Toward a Positive Theory of Consumer Choice*, 1 J. ECON. BEHAV. & ORG. 39 (1980); "); Amos Tversky & Daniel Kahneman, The Framing of Decisions and the Psychology of Choice, 211 SCI. 453 (1981); Russell B. Korobkin, *The Endowment Effect and Legal Analysis*, 97 NW. L. REV. 1227, 1229 (2003); Jason F. Shogren; Seung Y. Shin; Dermot J. Hayes; James B. Kliebenstein 'Resolving Differences in Willingness to Pay and Willingness to Accept' *The American Economic Review*, Vol. 84, No. 1. (Mar., 1994), pp. 255–270; W. Michael Hanemann 'Willingness to Pay and Willingness to Accept: How

Much Can They Differ?' *The American Economic Review*, Vol. 81, No. 3. (Jun., 1991), pp. 635–647; Jeffrey J. Rachlinski & Forest Jourden, *Remedies and the Psychology of Ownership*, 51 VAND. L. REV. 1541 (1998); Christopher Sprigman & Christopher Buccafusco, *Valuing Intellectual Property: An Experiment* (2010).

[3] Milton Friedman, *Essays in Positive Economics*, 15, 22, 31 (1953).

[4] Cooter, *supra* note 1, at 38-41.

[5] Sprigman, *supra* note 2, at 3.

[6] Rachlinski, *supra* note 2, at all.

[7] Id.

[8] Id.

[9] Id

[10] Id.

[11] Id.

[12] Id.

[13] Id.

[14] Id.

[15] Sprigman, *supra* note 2, at all

[16] Id.

[17] Id.

[18] Id.

[19] Id.

[20] Id.

[21] Id.

[22] Id.

[23] Id.

[24] Id.

[25] Id.

[26] Id.

[27] Id.

[28] Id.

[29]Id., at 30

[30] Friedman, *supra* note 3.

[31] *Supra*, note 2.

[32] *See* note 1 supra

[33] Thaler, *Supra* note 2

[34] *See* Thaler, s*upra* note 2; *see* Sprigman *supra* note 2

[35] See Thaler *supra* note 2.

[36] Rachlinski, *supra* note 2, at 1555.

[37] *See* Id. at all.

[38] Id.

[39] Id.

[40] Id.

[41] U.S. CONST. art. 1, § 8

[42] Id.

[43] Id.

[44] Id.

[45] *See* Sprigman, *supra* note 2.

[46] *See* eBay v. MercExchange, LLC, 126 S. Ct. 1837 (2006)

I'LL STICK WITH THE COUCH: HOW PERSONAL SEAT LICENSES ARE PRICING THE AVERAGE NFL FAN OUT OF THE LIVE GAME MARKET

Personal Seat Licenses (PSLs) have pit owners and stadium operators against the fans since their inception. The idea of paying for a right to buy tickets in a specific seat, is repugnant to some, and good business sense to others. This issue has come to the forefront recently as one of the most successful franchises in professional sports, the New York "Football" Giants, have started selling personal seat licenses to fund their new billion dollar stadium. This new stadium will be home to the Giants and neighbor New York Jets.[1] This article outlines why owners would use such a system, arguments against the practice, and a quick look at potential alternatives.

Background:

PSLs are essentially the right to purchase a ticket to a game or an event.[2] PSLs are usually one time fees that allow you right of first refusal to purchase tickets to all games or events at the venue. However, PSLs are usually several hundreds to thousands of dollars, and the fees for PSLs do not include tickets to sporting or other events at the venue; the tickets must be paid for separately.[3] They are usually seat specific, but some venues have non-seat specific PSLs such at Soldier Field, home of the Chicago Bears.[4] PSLs have not always been thought of in a negative light. Rick Ohanian proposed a "ticket bond" in the 1980s to pay for a professional sports complex in Columbus, Ohio.[5] The idea of ticket bound grew out of genuine belief that it was progressing the financing of sports and taking the burden off the taxpayers' shoulders.[6] The "ticket bond" has

transformed into the Personal Seat License, and the debate has raged on since its inception. Today, almost half the teams in the NFL have PSL programs in place, and the practice is gaining momentum in other sports.[7] The price for a PSL varies greatly by team and by location of the seat one is buying the rights to. PSLs in the NFL can range anywhere from several hundred dollars to $150,000 in Jerry Jones' "cathedral to football," the new Dallas Cowboys' stadium.[8]

The Issue

At its face, PSLs, as envisioned by Rick Ohanian create a way to fund new sports venues without putting the burden solely on the taxpayers. PSLs provide owners with a funding source beyond their personal means making them more amicable to constructing new facilities. Because public funding of private sports venues has been so controversial in the past, PSLs put the financial burden on the shoulders of only those who wish to consume the product, the sports/music fan. These cost allocation alternatives are positive aspects of the PSL system, and their utility cannot readily be questioned. Major sports franchises have been successful in raising money for the projects without public funding. The St. Louis Cardinals built the new Busch Stadium in St. Louis without public grant money in part because of the help of $40 million in revenue for the sale of 10,300 PSLs.[9] Some fans even use these programs to make a profit, buying PSLs when they are first offered and selling them when their resale value is at its highest (i.e. after a championship or excitement around a new coach/player).[10] Although PSLs provide an alternative stream of revenue apart from public tax grants or completely private funding, there are several issues that fans and sports writers have criticized. First, the cost to attend an NFL game is rising, preventing NFL fans from being able to afford to go to the games. This is especially true for

families. The average cost of one NFL game ticket hovers around $75, which does not take into account parking, concessions or souvenirs.[11] An NFL marketing group has compiled a Fan Cost Index which takes into account a family of four attending a game and purchasing average tickets, concessions, and a couple souvenirs.[12] The NFL average is already well above $400, and the fans of the Dallas Cowboys can look forward to an average price of around $750 to take a family of four to the game. This is largely due to the Cowboys' steep $159.65 average ticket price.[13]This alarming cost of attending an NFL game is only accentuated by the rising use of the PSL. Even fans using StubHub or other third party ticket brokers will see the cost of a single game rise because of fans trying to recoup some of the cost of their PSL. Individuals who have had the same seats for decades, must now pay an additional "one time" fee for the right to buy the tickets they have purchased year after year.[14] A Giants fan with season tickets since 1962 recently stated that he does not plan to buy the PSL and renew his tickets because he would have to spend an extra $30,000 on top of the steadily increasing ticket prices for his seats in the lower deck.[15] Major franchises across all sports have been ripe with horror stories such as this. Season tickets being passed down generation to generation now have to be turned over because a family cannot afford the tens of thousands of dollars it would cost to retain those seats through a PSL. Mike Florio writes pointedly that, ". . .a real problem will arise if and when the blue-collar fans who form the heart and soul of so many NFL franchises must yield to the polo and caviar crowd. This is especially true in towns like Pittsburgh, Cleveland, Buffalo and Philly, where the local football team forms such an important part of the city's identity and spirit. Whether it happens through PSLs, increased ticket prices or both, the same tax bracket that now ends up with all the Super Bowl tickets might eventually take over the regular season games, as well."[16]

To put simply, the franchises that are utilizing PSLs are pricing the real fans out of the market and making it more of a social networking event and client breeding ground for wealthy business executives. These franchises are forgetting the fans who have continued to pour what little money they have into the sport even through strike and controversy after controversy. The average businessmen looking to entertain clients will not bring a franchise out from the brink of bankruptcy if they start to struggle or a strike hits, the average fan will; and team owners should do well to remember that.

Possible Alternatives to the PSL System

Owners of professional sports franchises need more revenue streams, especially when they are looking to build a new facility. Largely gone are the days of private financing by the owner himself. Hoping for a return to that system is somewhat unrealistic. The economy and current well-grounded frugality of the American public may also bleed over and make it improper to place a several hundred million or billion dollar burden on the taxpayers. Instead of placing the burden solely on the fans through PSLs and thus cutting the average fan out, a combination of programs should be put in place to maintain the status quo. When a single approach is taken, it usually has an extremely adverse affect on one group of people; in this case, the average sports fan. These alternatives to PSLs are not ideal, and should be utilized only after other revenue streams have been exhausted.Although frowned upon as against the true nature of the game, in-game advertising could help create a substantial revenue stream for owners, while making games more affordable for the middle-class fan. Although repugnant to some, commercials on the big screens during timeouts or between quarters would provide businesses an opportunity for a local and captive audience as well as provide owners with a consistent game-by-game revenue stream. Other less direct

means of advertising could be initiated, and the creative marketing teams of NFL franchises could create a program more tailored to the needs and values of each NFL team. Increased advertising is especially attractive because it puts the costs on a third party and does not directly affect the pocketbook of the average fan. While the Stadium itself is usually branded with a company's namesake, there is a world of potential sponsorships that could be utilized to defray the costs for constructing and updating athletic facilities. Soccer has utilized advertising on jerseys, which may be a little too much for the sports purist. However, increased branding on the field and throughout the stadium could bring in substantial revenue. While not ideal, raising ticket prices for a few years after building an athletic facility may also be a possibility. Once the cost is realized, owners can drop ticket prices down to previous levels. If owners are up front with fans and tell them about the reasons for the ticket hike, to prevent the use of PSLs and agree to drop prices after a few years, fans would be more receptive. For example, if the New York Giants (who share the new Meadowlands Stadium with the New York Jets) were to raise each ticket to each game by $5, an individual with four season tickets would only see an increase of $320 for a few years instead of several thousands of dollars to buy a PSL. For the franchise, an increase of $5 per ticket per game would equate to $6.6 million dollars per year for Meadowlands Stadium 82,500 fan capacity.[17] A franchise may be well suited to do a survey to gauge fans tolerance of ticket price increase in lieu of a PSL system. The owner may find that even a higher increase is tolerable to avoid shifting to PSLs.

Conclusion

Obviously, some alternatives by themselves cannot rise to the level of funding PSLs would provide. However, a combination of in-game advertising and

increased ticket prices for only a few years provides a start of new revenue streams for franchise owners, and at least starts the dialogue for alternatives to PSLs. New technology and digital mediums may also provide a new revenue stream to help pay for new sports complexes. The opportunity for revenue is there, but franchises may need to be open and receptive to unconventional means of raising capital. Fans need to believe that owners are not abandoning them for the almighty dollar. Owners will undoubtedly have their PSL sacrifice repaid when their franchise or the league struggles, as it will be the average fan that brings them back to prominence.

---

[1] Associated Press, *Giants to sell personal seat licenses to help build $1.6 billion stadium*, (2008), http://www.nfl.com/news/story?id=09000d5d809066fb&template=without-video&confirm=true

[2] Tom Barlow, *Personal seat licenses are a license to print money*, DailyFinance, May 17, 2009, http://www.dailyfinance.com/story/investing/sports-biz-personal-seat-licenses-are-a-license-to-print-money/1547028/

[3] *Id*.

[4] ChicagoBears.com Seat Specific PSL questions and answers, http://www.chicagobears.com/tickets/psl.asp (last visited March 9, 2010).

[5] Jemele Hill, *Bleeding the Fans!*, ESPN Page 2, Aug. 4, 2008, http://sports.espn.go.com/espn/page2/story?page=hill/080801&sportCat=nfl

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] Danielle Sessa, *Yankees, Mets Won't Sell Seat Licenses; Stadium Funds in Place*, Bloomberg.com, May 11, 2007, http://www.bloomberg.com/apps/news?pid=20601103&sid=akeCVF7vEDlU&refer=us

[10] Jeff Barker, *Owning a Ravens Seat Can Pay off Big Time*, The Baltimore Sun, June 25, 2009, http://articles.baltimoresun.com/2009-06-25/news/0906240127_1_ravens-psls-seat-licenses

[11] Larry Weisman, *NFL Blitz: Ticket Prices and the Fan Cost Index*, Redskins.com, Sept. 18, 2009, http://www.redskins.com/gen/articles/NFL_Blitz__Holding_the_Line_On_Ticket_Prices_51755.jsp

[12] *Id.*

[13] *Id.*

[14] Cat Contiguglia and Tracy Connor, *Seat hits the fan over prices for Giants Personal Seat Licenses*, NYDailyNews.com, Sept. 6, 2008, http://www.nydailynews.com/sports/football/giants/2008/09/05/2008-09-05_seat_hits_the_fan_over_prices_for_giants.html

[15] *Id.*

[16] Mike Florio, *Expensive seats squeezing out NFL fans?*, Sporting News, June 27, 2008, http://nbcsports.msnbc.com/id/25417558/

[17] Joe Lapointe, *New Meadowlands Stadium has Bells and Whistles*, NYTimes.com, Oct. 30, 2008, http://www.nytimes.com/2008/10/31/sports/football/31stadium.html?_r=1

The Modern Role of the General Counsel as Corporate Lawyer & Business Executive

I. INTRODUCTION

The role of the General Counsel (GC) expands beyond the traditional chief legal officer of the company. [1] Scandals involving insider trading, white-collar crime, and the recent economic crisis have lead to the expansion of corporate governance regulations. [2] The GC serves as an overseer of corporate governance and compliance, therefore, it is important to analyze the board of directors' methods for monitoring the expanding role of the GC. Furthermore, the many hats the GC wears in today's modern corporation potentially includes holding dual roles as the corporation's chief legal officer and a member of the executive management team. [3] This dual role will be analyzed to determine if the GC having a seat at the strategic management table benefits the corporation or hinders the GC's role as the corporate police officer. [4] Given the complexity of the GC role and the important connection of the role to maximizing shareholder wealth, the board of directors need to implement methods to ensure the GC upholds their primary duty as the corporation's chief legal officer. These efforts may be complimented by regulations and/or guidelines outside the realm of the board of directors, which further limits the GC's actions.

II. BACKGROUND

GCs advise a company's board of directors on their oversight responsibilities in an effort to keep the best interests of the company and shareholders at the forefront. [5] Additionally, GCs handle a vast array of tasks including, in-house day-to-day activities, complex corporate transactions, legal cost management, oversight of the

corporation's compliance with federal and state regulations, and outsourcing of legal matters to outside counsel. [6] Furthermore, a GC's potential dual role as the corporation's chief legal officer and a member of the executive management team raises issues as to whether the GC will give the board of directors advice as the corporation's lawyer or as a business executive interested in passing through the management initiatives proposed by colleague executives. [7] On the other hand, conflicts may arise when acting as the corporations' lawyer a GC disapproves of the CEO's plans and decisions on how to implement the board of directors' agenda for the company. Therefore, the GC may have its duties impeded by the possibility of getting fired if the GC delivers disappointing news to the board and/or executives as to which corporate actions are appropriate. [8] For example, a snapshot of current headlines demonstrates the legal wrangling faced by the GC of Bank of America, particularly as to whether or not the GC of Bank of America was fired for advising executives to disclose information on bonuses to Merrill Lynch executives. [9] Therefore, in order to promote compliance with corporate governance and fulfill their fiduciary duties, the board of directors must implement appropriate authority and chain of command for the GC, balancing both the many roles of the GC and potential conflicts of interest.

III. ANALYSIS

From the perspective of the board of directors, overseeing the principal-agent relationship with the GC may take different forms, including: utilizing an outside counsel to monitor the state of the corporation's compliance program and providing the board with monthly or quarterly corporate compliance reports [10]; requiring the GC to provide the board annual reports on "the day-to-day operations of the compliance program"; and/or setting forth a board structure that includes a number

of independent directors that would sit, among others on a Legal Compliance Committee. [11]

As more corporate scandals emerge and government regulations increase, boards have started to separate any tasks involving compliance (e.g. through the role of a corporate compliance officer) from the role of the GC. [12] The corporate compliance officer should monitor the company's internal policies and procedures to ensure that federal and state laws and regulations are met. [13] The internal compliance program best meets the corporations' objectives if itis developed with "a more integrated approach also focuses on legal as well as internal compliance to mitigate the risks of fraud, as well as to reach strategic, operational, and financial reporting objectives." [14] Maintaining a separate corporate compliance officer role from the GC obviously adds additional higher company overhead, but the benefits of having a program that either catches issues early or displays to governmental agencies that proper procedures were in place for monitoring violations may aid in retaining future corporate profits. [15] The corporate compliance officer may be set up to report directly to the GC, or directly to the board of directors, with increased involvement from the GC in compliance and risk assessment reviews. [16] If the corporation's monetary limitations disallow the separation of the roles, issues may arise when the GC holds the dual roles mentioned previously of chief legal officer and a member of the executive management team. This is especially true if the GC's compensation package is partially set-up in the form of company stock options that are tied to the profitability of the company. [17] The board could face potential actions for breach of fiduciary duties if they have a GC that is resistant in reporting crucial plans of the executive team. Therefore, separating the roles of the corporate compliance officer and GC may create more benefits in maintaining the best long-run interests of the shareholders, although it increases operational costs.

Furthermore, the board may oversee the role of the GC through the implementation of decision-making restrictions within an employment contract. [18] As one of the main ways to define the boundaries of the agency relationship between the corporation and the GC is through a contractual agreement. [19] Restrictions as to the GC's authority maybe set up within the GC's employment contract (in addition to the company bylaws) and any violation of restrictions could mean withholding year-end bonuses. The GC may require additional compensation or benefits to offset the scrutiny of its day-to-day responsibilities. [20] Furthermore, the board ofdirector's may restrict the GC's authority in other ways. For example, within large corporations the purchasing department may have restrictions on the amount of contracts they can execute without the review and approval of the GC, although even the smaller size contracts are most likely tailored within the legal department's pre-approved purchaser order terms and conditions. The board of directors may utilize this type of requirement to restrict the monetary level of contracts a GC can approve without first notifying the board and seeking its approval.

The interrelation between the GC as the company lawyer and the GC's executive colleagues further complicates the evolving role of the GC. [21] In order to best counsel and advise the corporation the GC requires an understanding of the company's business model and industries, with the possession of business acumen being preferable. [22] Many business executives see the legal department as just an impediment to their plans and may attempt to leave the GC out of the loop. [23] But, if the GC demonstrates that they have a balanced perspective on both the legal and business aspects of decisions to be made, they are more likely to be kept in the loop and the corporation'soverall risk exposure will benefit. [24] Therefore, benefits may arise from providing the GC the dual role of the chief legal officer and a member of the executive management team. [25]

Although the dual role may provide GC's with compensation packages similar to other executives, including a portion of their compensation in the form of company stock options. This provides the GC with further incentives to uphold its roleas the chief legal officer, but implementing stock options as a pay-out mechanism may bring into question the GC's compliance impartiality, because of the possible personal incentive in allowing other company officers to "manipulate financial results and to maximize their option payouts." [26] Furthermore, questions of impartiality come into play with any transaction involving conflicting interests, such as strategic plans regarding joint ventures or mergers & acquisitions, which may also result in the GC acquiring a higher amount of company shares. Therefore, the board of directors need to design a plan for the GC, possibly based on market trends or the advise of outside expertise, which gives the GC incentives to uphold the role of corporate police officer and mitigates the risks of the GC in a dual role capacity. At the same time the plan should not put the GC into a corner, in which the GC is at the whim of the board or CEO/Executives and faces the risk of getting fired if the GC does not follow the lead of either group. While from the perspective of the GC stock options allow the GC to be more in line with the pay of the other company executives, since the GC's role and actions as compliance officer ideally maximizes profits and shareholder wealth.

Studies demonstrate that restricting other employee's abilities through the use of GC approval of their actions limits employees' ability to confiscate shareholder wealth. [27] The findings in a study by the Stanford University Graduate School of Business regarding the insider trading policy of various corporations found that the ability of the executives to use insider information to "extract rents from shareholders" correlates to the extent of the corporation's governance program. [28] The corporations' level of restrictiveness on their insider trade policy correlates to how much power the GC has to approve trades, "we find that the level of

restrictiveness is lower when the chair of the board is also an officer of the firm and when there are fewer institutional blockholders." [29] The study further found that trades within a restricted period that required GC approval were found to be less profitable and a less prediction of future performance than trades without GC approval, indicating that restrictive corporate governance programs assist in maximizing shareholder wealth. [30]

Finally, regulations and/or guidelines outside the realm of the board of directors may benefit the corporation, because they set limits on what the GC can do and may force the GC to be more cautious and conservative in its compliance approach. [31] These may include the GC's interest in complying with state licensing requirements, following ABA recommendations on the ethical behavior of lawyers, reputation considerations for the GC, civil liability from the corporation or the SEC, and/or the Sarbanes-Oxley Act of 2002. [32] For example, the Federal Sentencing Guidelines for Organizations indicates corporations will be held responsible for the criminal acts of their employees acting within the scope of the employer-employee agency, but that demonstrating the corporation has an "effective compliance program" may mitigate fines. [33] Furthermore, the Sarbanes-Oxley Act specifically sets forth the responsibilities of a public corporation's chief legal counsel when allegations of "a material violation of securities laws or breach of fiduciary duty of similar violation by the company or any agent thereof" are brought to their attention. [34] SEC Rules require the chief legal counsel to conduct an inquiry into the material violation and make a determination as to whether such violation occurred, and if so, "take reasonable steps to ensure that the issuer adopts appropriate remedial measures and/or sanctions – including appropriate disclosures," and report such remedial measures "up the ladder." [35]

IV. RECOMMENDATION

Two important ways the board of directors may oversee the GC's role include, the use of outside counsel and the use of a separate and distinct corporate compliance officer reporting directly to the board of directors. [36] First, the use of outside counsel by the GC to resolve complicated matters and/or advise on market and regulatory trends on issues, will demonstrate credibility to the board that the GC exercised duty of care in his capacity. [37] Furthermore, the outside counsel providing copies of compliance assessments to the board or providing directors with independent advice regarding intricate issues may demonstrate to a court or shareholders that the board as well has met their fiduciary duties and their business judgment will be protected. [38] Secondly, the use of a separate and distinct corporate compliance officer that reports directly to the board appears as a strong option. [39] Utilizing this chain of command assists in ensuring the GC does not have conflict of interest issues if the GC has the dual role of chief legal officer and is a member of the executive management team.

V. CONCLUSION

With the ever-changing, complex role of the GC, the board of directors implementing efficient mechanisms to oversee the principal-agent relationship with the GC assists the board and the GC to fulfill their fiduciary duties as overseers of the corporation's compliance program. While the costs of these mechanisms may extract shareholder profits in the short-term, they will certainly maximize shareholder wealth in the long run when the board and the GC work together to limit corporate exposure.

End Notes:

[1] *See, e.g.*, Alan D. Jagolinzer, David F.Larcker, & Daniel J. Taylor, *Corporate Governance and the Information Content on Insider Trades* (Stanford Univ. Rock Ctr. for Corporate Governance, Working Paper Series No. 3, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1138723

[2] *See* Ron Kral, *Effective Corporate Compliance Programs*, CORPORATE COMPLIANCE INSIGHTS, Nov. 30, 2009, http://www.corporatecomplianceinsights.com/2009/effective-corporate-compliance-programs-ron-kral-candela; *see also* OFFICE OF INSPECTOR GEN., U.S. DEPT. OF HEALTH AND HUMAN SERVICES & AM. HEALTH LAWYERS ASS'N, AN INTEGRATED APPROACH TO CORPORATE COMPLIANCE (2004) [hereinafter *OFFICE OF INSPECTOR GEN.*], *available at* http://oig.hhs.gov/fraud/docs/complianceguidance/Tab%204E%20Appendx-Final.pdf.

[3] *See The Evolving Role of the Chief Legal Officer*, FOLEY & LARDNER'S NAT'L DIRECTORS INST. (2010) [hereinafter *The Evolving Role of the Chief Legal Officer*], *available at* http://www.foley.com/files/tbl_s88EventMaterials/FileUpload587/2564/NDICLOEvolvingIssues.pdf

[4] *Id.*

[5] *See General Counsel Board Effectiveness*, FOLEY & LARDNER'S NAT'L DIRECTORS INST. (2005) [hereinafter *General Counsel Board Effectiveness*], *available at* http://www.foley.com/files/tbl_s31Publications/FileUpload137/2683/NDI_GCBoard_FINAL.pdf

[6] Jagolinzer ET AL., *supra* note 1, at 2.

[7] The Evolving Role of the Chief Legal Officer, *supra* note 3.

[8] Ashby Jones, *So Why Was BofA's General Counsel Fired? Here's BofA's Answer*, WALL ST. J., Feb. 17, 2010, http://blogs.wsj.com/law/2010/02/17/so-why-was-bofas-general-counsel-fired-heres-bofas-answer/tab/article/.

[9] *Id.*

[10] OFFICE OF INSPECTOR GEN., *supra* note 2.

[11] *Id.*

[12] *Id.*

[13] Kral, *supra* note 2.

[14] *Id.*

[15] U.S. SENTENCING COMM'N, AN OVERVIEW OF THE ORGANIZATIONAL GUIDELINES [hereinafter *U.S. SENTENCING COMM'N*], *available at* http://www.ussc.gov/corp/ORGOVERVIEW.pdf.

[16] *OIG Issues Corporate Compliance Guide for Boards*, (Crowell & Moring, Wash., D.C.), Jul. 2, 2004, *available at* http://www.crowell.com/NewsEvents/Newsletter.aspx?id=534

[17] *See generally Market Mechanisms for Public and Private Decision Making, Reduction in Agency Costs*, PREDICTOCRACY.ORG, Jan 22, 2008 [hereinafter *PREDICTOCRACY.ORG*], http://predictocracy.org/blog/?p=50.

[18] *See generally* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. OF FIN. ECON. 305 (1976), *available at* http://ssrn.com/abstract=94043

[19] *Id.*

[20] *Id.*

[21] The Evolving Role of the Chief Legal Officer, *supra* note 3.

[22] *Id.*

[23] F. Douglas Raymond III, *Where to Turn for Legal Advice? Both Inside and Outside Corporate Counsel Play an Important Role in Advising the Board of Directors*, DIRECTORS & BOARDS, Aug. 2003.

[24] *Id.*

[25] The Evolving Role of the Chief Legal Officer, *supra* note 3.

[26] PREDICTOCRACY.ORG, *supra* note 17.

[27] Jagolinzer ET AL., *supra* note 1, at 4.

[28] *Id.*

[29] *Id.*

[30] *Id.* at 25.

[31] OFFICE OF INSPECTOR GEN., *supra* note 2.

[32] *Id.*; Press Release, U.S. Sec. & Exch. Comm'n, SEC Proposes Rules to Implement Sarbanes-Oxley Act Provisions Concerning Standards of Professional Conduct for Attorneys (Nov. 6, 2002) (onfile with author) [hereinafter *U.S. Sec.& Exch. Comm'n*], *available at* http://www.sec.gov/news/press/2002-158.htm

[33] U.S. SENTENCING COMM'N, *supra* note 15.

[34] U.S. Sec. & Exch. Comm'n, *supra* note 31.

[35] *Id.*

[36] OFFICE OF INSPECTOR GEN., *supra* note 2.

[37] *General Counsel Board Effectiveness*, *supra* note 5.

[38] OFFICE OF INSPECTOR GEN., *supra* note 2.

[39] *Id.*

READING BETWEEN THE LAW: A CASE STUDY OF THE HOME REPAIR AND REMODELING ACT OF ILLINOIS

I. Introduction

When thinking about judicial activism, the first thing that comes to mind often is the Supreme Court of the United States making decisions regarding civil rights. However, judges expand the law and create exceptions thereto in many fields and at many levels. The purpose of this article is not to question whether judicial activism exists, or even whether or not it is proper to practice it. Instead, this article considers one instance of activism in an everyday legal situation and then analyzes a series of judicial approaches and considers the ramifications of each.

A trial judge in Illinois once ordered an unnecessary evidentiary hearing, noting that he would "err on the side of caution… and allow [the case] to go forward" hoping that "some day, [he would] be enlightened by the Appellate Court… [as to] whether there can ever be an exception to the application of this Act."[1] The act in question was the Home Repair and Remodeling Act[2](hereafter the "HRRA") and the act has been the cause of several judicial squabbles within the state of Illinois in the last few years. The act enumerates certain requirements that must be met by contractors hoping to recover their fees after performing home repair or remodeling worth in excess of $1000 and acts as an extension of theMechanic's Lien Act.[3] The problem, many judges would argue, is with the language of the act, which serves to create situations that appear contrary to the act's stated purpose.[4] Other judges, however, would counter that the problem actually lies with the judicial creation of exceptions to the act rather

than with the act itself.[5] This article will examine the act as well as the case law surrounding it and examine the approaches taken by Illinois state judges as they attempt to expand the law to deal with the situations that have arisen since its inception.

II. The Mechanic's Lien and Home Repair and Remodeling Acts

The question of contractors hired for home repairs has loomed large in Illinois for some time.[6] Contractors and homeowners both have little coercive power on the other. Like other states, Illinois presents contractors with the option of filing mechanic's liens as a means of insuring payment. Mechanic's liens are strictly a statutory construction and do not exist at common law, and this has typically led the courts to interpret the requirements spelled out in mechanics' lien statutes very strictly. [7]Generally, statutory rights cannot be exercised without full compliance withthe statute creating that right.[8] As remedial acts, these statutes protecting consumers and contractors are typically held to be applicable liberally once the requirements have been clearly met. [9]

In Illinois, the Mechanic's Lien Act[10] provides contractors with the statutory right to liens on the property they improved should their work go unpaid. The act also conversely sets forth requirements for contractors to follow in order to have the right to a lien, in part because of the great coercive power afforded to them through the ability to create liens. [11]

The Mechanics'Lien Act gives great power to the contractors, who can now enforce the collection due to them. As a result, the HRRA serves to protect homeowners and other unsuspecting consumers with unequal bargaining power by providing further requirements for the validity and enforceability of their

contracts. Without proof of a valid contract, contractors are unable to obtain a mechanics' lien, thereby reducing the potential for abuse by limiting their ability to contract. Particularly, the statute requires that homeowners be provided with a brochure outlining their rights and responsibilities towards the contractor, and it also requires all work orders and changes thereto to be signed by the homeowner.[12] However, the statute only declares the failure to do so illegal, rather than state exactly what this means for contract recovery.

III. The Cases

Several cases have considered the issue in the last few years, and many of the judges have had their own unique approach to the issues. Amongst others, *K. Miller Const. Co., Inc. v. McGinnis*[13], *Behl v. Gingerich*[14], and *Fandel v. Allen*[15] present three very different views of the act in question and of its interpretation. Though all generally concur on the necessary outcomes in terms of fairness and justice, the three courts have very different procedural and interpretive approaches.

A. *K. Miller Cons. Co., Inc. v. McGinnis*

In *K. Miller*, a contractor and homeowner orally agreed to a renovation project. [16] In the midst of the project, the scope of the work greatly expanded, as did the costs. [17] The two parties came to disagree on what the owners actually owed. [18] While the homeowners made some payments, they failed to pay the amount the contractor claimed was due in full. [19] The contractor sued for foreclosure of a mechanic's lien, for recovery under the contract, and, inter alia, for quantum meruit recovery. [20] Quantum meruit recovery would allow the contractor to recover for the fair market valueof their services to prevent

homeowners from being unjustly enriched by not having to pay for the contractor's work.[21] The homeowners successfully filed a motion to dismiss, and the contractor appealed. [22] The Illinois Appellate Court for the First District concluded that while foreclosure of the mechanics' lien and contract-based recovery were barred bythe unlawful violation of the HRAA, quantum meruit recovery was still available because the act did not specifically forbid it. [23]

B. *Behl v. Gingerich*

In *Behl*, a plumber hired a contractor to do work on his personal residence.[24] Thecontractor performed significant amounts of work on the home before vacating the work site because of deteriorating relations with the homeowners.[25] The contractor was only paid $39,895 of the $55,395 total.[26] The contractor sued the homeowner on the basis that he was owed the remaining amount for his services. [27] The homeowners alleged wrongdoing on the part of the contractor, but the court concluded that the contractor had indeed completed work in accordance with the initial work order. [28]The lower court initially awarded the contractor a monetary award. [29] Thehomeowner appealed on the basis that the HRRA should bar the contractor from recovering at all. [30] The Appellate Court for the Fourth District of Illinois concluded that the HRRA only barred recovery if the contract did not substantial perform his duties in the act. [31] In the end, the court concluded that though the exact requirements were not met, the contractor had performed sufficiently under the act to meet its intents and therefore was not barred recovery. [32]

C. *Fandelv. Allen*

In *Fandel*, a homeowner contacted acontractor for roofing work. [33] Though the contractor did itemize a work order, it was never signed, and the contractor never provided the homeowner with the required brochure. [34] The contractor completed the work and was thereby owed $9,681.00 for the work.[35] The homeowner tendered a check, and then subsequently cancelled payment on said check. [36] The contractor filed a claim for a mechanic's lien, and later tried to foreclose on said lien. [37] The lower court dismissed the foreclosure action because the contractor had failed to follow the requirements of the HRRA. [38] On appeal, the Third District Court of Illinois determined that a HRRA violation did not bar recovery under a contract suit or the foreclosure of a mechanics' lien and that the HRRA's only effect was to give the attorney general the ability to fine the offending contractor. [39]

IV. Analysis

All four of the approaches outlined above are clearly contradictory. Each attempts to realize afair outcome in line with the intents of the legislature and with regard to the facts before each tribunal.

All four courts realized the basic problem that lies at the heart of the issue: it is possible for a contractor to fail to meet the act's requirements but still deserve someform of payment. The court in *K. Miller* decided that a strict interpretation of the statute was warranted. [40] As a result, that court concluded that its contractor was not entitled to any recovery under the contract because an illegal act, a violation of the HRRA, had taken place. [41] However, it also concluded that allowing quantum meruit recovery to the contractor for his work would not run

afoul of the legislature's intent in creating the act. [42] Specifically, the *K Miller* court found that there was no reason to conclude that the legislature had intended to harshly punish offending contractors by removing all potential for recovery. [43] Rather, the court concluded, it was the legislature's intent to bar recovery on suspecton contracts and instead allow recovery based on the value of the services rendered. [44]

The *Fandel* court, however, strongly disagreed with the *K Miller* approach. [45] The court in *Fandel* simply refused to recognize that the HRRA could bar recovery on the underlying agreement between a contractor and a homeowner and therefore concluded that quantum recovery, as was prescribed in *K Miller*, was unnecessary. [46] It even went so far as to accuse the *KMiller* court of totally misreading the section that voids contracts and contends that it is clearly not intended to apply in these situations.[47] The *Fandel* court instead concluded that the HRRA enabled the attorney general to have the contractor fined for his failure to follow the brochure and work order requirements but that it did not negate the underlying agreement between the parties. [48] As such, *Fandel* similarly concluded that there was no legitimate reason to block the contractor's recovery given that it appeared legitimate, but instead concluded that the HRRA itself did not bar recovery in any way. [49]

Generally, it appears as though the *K Miller* court preferred to read the HRRA to be a block upon recovery whereas the *Fandel* court refused to do so. The court in *Behl* took a tempered approach, falling between the *Fandel* and *K Miller* courts. It concluded that the HRRA *could* be a bar on recovery, but that the contractor only needed to have had "substantial compliance"with the act and generally focused its analysis on whether the actions taken by the contractor

in *Behl* generally met with the purpose of the statute. [50] The purpose in question, according to the court, was to improve communication between homeowners and contractors, reduce the amount of disputes, and promote good business practices. [51] An interesting consideration when studying *Behl* is that the homeowner in that case was a plumber himself and therefore was not an unsuspecting homeowner at all. [52]This therefore raised the question as to whether a lower standard could be applied, or maybe an exception even exist, when the homeowner is a fully informed party. Ultimately, the court concluded that because the homeowner had approached the contractor, had specifically requested the work, and because the two had negotiated every aspect of the work with proper expertise, the court further decided that the homeowner would not be especially prejudiced if the contractor were allowed recover. [53] As such, the court concluded that the statutory requirements were substantially met and allowed recovery. [54]

Each of the three approaches is based in the idea that the contractor in that case was not the problem the legislature had intended. None of the three contractors at issue appeared to have padded their bills, and none attempted to coerce the homeowner into paying more than was truly owed. As a result, each of the three courts had to come up with a legal mechanism that could allow the contractors to recover what they were owed. *Fandel* took the most straightforward approach and decided that the HRRA did not bar recovery at all, despite any indication to the contrary. *K. Miller* went the opposite direction, and found that quantum meruit was the only way to recover. Finally, *Behl* went with a softer more subjective standard of questioning whether the intent of the statute has been met before allowing recovery. So which is the right answer? Each expands on the law as written for the purpose of allowing a just recovery for contractors, but each does so based on its set of facts and therefore, its own limited perspective.

The approach of *Fandel* is dangerous. By not barring recovery at all, the door is open for unscrupulous characters to take advantage of homeowners. In such a case, a fine hardly seems like the proper enforcement mechanism. The *Fandel* reading of the statute is dangerous because it offers little protection to homeowners in theevent that they are taken advantage of. *Behl* is equally troublesome because it doesn't recognize an illegal act the way *Fandel* and *K. Miller* do. As a result, *Behl*allows contractors that have substantially performed their duties under the HRRA to file for mechanics' liens, which would not be possible under the *Fandel* or *K. Miller* approaches. This is largely contrary to the typical wisdom of mechanics' liens, which require full and complete compliance with the law.[55]

The *K. Miller* view again approaches the problem knowing that the contractor should likely have some resort for recovery so as to disallow homeowners from attempting to get free services from forgetful contractors. However, *K Miller* choose to retain the protection for homeowners from reading a bar on recovery into the HRRA and instead chose to allow for another well guarded means of recovery: quantum meruit. This may be the wisest approach from an outcome-based perspective because quantum meruit allows any contractor to recover, but only for the *worth* of the services rendered, rather than what he had intended to charge for them. As such, homeowners do not get free home repair services, but they also cannot be overcharged. As such, they are more protected than under the *Fandel* or *Behl* approaches. For the homeowner, this is the best decision. Given the legislature's stated intent in the act to protect the homeowner, this further seems like it might be the best outcome.[56] However, as noted earlier, it is questionable whether this reading of the act is actually supported by the language of the statute.

V. Recommendation

The obvious recommendation in this case is for someone to figure this out. The *K. Miller* decision has been vetted for an appeal and so a final decision on the interpretation might be forthcoming. Of course, the need for creating clear statutes is a second obvious take away from this analysis. This is a constant goal of the legal system, but the exact formula continues to elude our legislatures. Perhaps unfortunately, statutes require constant interpretation and often lead to unwanted results.

As a result, another question is raised about the way the courts choose to extend statutory law. In this case, each court had a similar outcome in mind that was arguably not the one prescribed by a close reading of the statutory language. Each of the courts interpreted the law differently and extended it in a different direction in order to secure the fair outcome. Yet, the question remains, which is the better approach? Should courts follow in the footsteps of *K. Miller* and sidestep the offending statute and rely on already existing common law? Should they take the *Behl* approach of liberally applying the intent of the statute instead of its text? Or is the straightforward method of *Fandel*, to simply change the then-accepted interpretation of the text, the best way to about it? In this case, opinions can vary, but the *K. Miller* approach seemed to cause the least damage and to be the one most in line with legislative intent. This story serves as an additional reminder of the importance of questioning the methods the courts use to force just results on the unintended consequences of statutory law. The need for stable and predictable application of the law further seems to call for a steadier judicial hand in applying these methods, for the efficient functioning of our systems.

VI. Conclusion

Even a relatively simple law like the HRRA can lead to unintended results. When the courts attempted to stray from statute and apply judicial principles in hopes of attaining an outcome that is more just in the court's eyes, there can be more than one approach. Each of these approaches can come with its own consequences because each changes the law beyond just merely solving the initial problem presented to the court. In this case, trying to protect contractors who made unintentional mistakes in their paperwork from receiving no payment could have more significant effects on the protections that homeowners have against unscrupulous contractors who would take advantage of them. Such extension of the principles of law is a natural result of having a common law system. It is therefore incumbent upon both judges and the lawyers requesting relief before them to consider not only whether it is right to judicially change and extend the law, but also consider the method in which they do so, so as to avoid unnecessary damage.

---

[1]Behl v. Gingerich 920 N.E.2d 665, 667-68 (2009).

[2]815 ILCS 513/1 et sec

[3]770 ILCS 60/1 et sec

[4] *See e.g.* Behl, 920 N.E.2d 665

[5] *See e.g.* Fandel v. Allen, 2010 WL 184076(2010)

[6] *See e.g.* CHARLES EMMETT DAVIDSON, THE MECHANIC'SLIEN LAW OF ILLINOIS: A LAWYER'S BRIEF UPON THE TOPIC (1922) (noting the importance of mechanic's liens in the property of Illinois as early as 1922)

[7] *See e.g.* Westcon/DillinghamMicrotunneling v. Walsh Construction Co., 319 Ill. App. 3d 870, 877 (2001).

[8] *Id.*

[9] *Id.*

[10]770 ILCS 60/1 et sec

[11] *Id.*

[12] *Id.*

[13] K.Miller Constr. Co. v. McGinnis, 394 Ill. App. 3d 248 (Ill. App. Ct. 1st Dist. 2009)

[14] Behl, 920 N.E.2d 665 (2009).

[15] Fandel, 2010 WL 184076 (2010).

[16] K.Miller Constr. Co., 394 Ill. App. 3d 248, 251.

[17] *Id.*at 251.

[18] *Id.*

[19] *Id.*

[20] *Id.*at 252.

[21] *Id.*

[22] *Id.*

[23] *Id.* at 265.

[24] Behl, 920 N.E.2d 665.

[25] *Id.* at 667.

[26] *Id.*

[27] *Id.*

[28] *Id.* at 668.

[29] *Id.*

[30] *Id.*

[31] *Id.* at 677-78.

[32] *Id.*

[33] Fandel, 2010 WL 184076.

[34] *Id.* at *2.

[35] *Id.*

[36] *Id.*

[37] *Id.*

[38] *Id.*at *3.

[39] *Id.*at *24-25.

[40] K.Miller Constr. Co., 394 Ill. App. 3d 248, 253-54.

[41] *Id.*

[42] *Id.*at 257-58.

[43] *Id.*at 268.

[44] *Id.*

[45] Fandel, 2010 WL 184076.

[46] *Id.* at *14.

[47] *Id.* at *22-23.

[48] *Id.* at *14-15.

[49] *Id.* at *24-25.

[50] Behl,920 N.E.2d 665, 671.

[51] *Id.* at 672.

[52] *Id.* at 668.

[53] *Id.* at 675.

[54] *Id.* at 677-78.

[55] Westcon/DillinghamMicrotunneling v. Walsh Construction Co., 319 Ill. App. 3d 870, 877 (2001).

[56]815 ILCS 513/5 (2008)

SHOULD THE UNITED STATES EXEMPT FOREIGN-SOURCE INCOME SIMILAR TO FOREIGN BUSINESS PARTNERS?

I. Introduction

In 1918, the United States enacted a foreign tax credit (FTC) system for taxing foreign-source business income earned by multinational corporations (MNCs). (1) This system, known as "worldwide" taxation is said to implement "capital export neutrality" by neutralizing a citizen's decision between investing domestically or abroad. (2) About half of the Organization for Economic Co-operation (OECD) countries have adopted a similar approach. (3) However, as foreign trade agreements and the complexity of U.S. tax treatment continue to increase, a "territorial" taxation system, as implemented by the other half of OECD countries, might be worth considering in the United States.(4)

This article will 1) define some of the underlying principles behind international tax policies, 2) suggest a proposal for a tax-exemption system, 3) explain how the proposal solves problems under the current system, and finally 4) attempt to rationalize potential criticisms surrounding an exemption system.

II. Background

The existing U.S. foreign tax credit rules are extraordinary complex and require American companies doing business abroad to spend large and disproportionate amounts in compliance. (5) One study estimated that "nearly 40 percent of the income tax compliance costs of U.S. multinationals is attributable to the taxation of foreign-source income, even though foreign operations account

for only about 20 percent of these companies' economic activity." (6) In addition, "recent economic research suggests that moving to an exemption system might increase revenue to the U.S. Treasury by over $9 billion annually." (7) For these reasons, economists have suggested that the United States adopt a territorial system similar to trading partners like Germany, Canada, and the Netherlands. (8) Territorial systems allow for a tax-exemption instead of a tax credit, and are said to implement "capital import neutrality" by subjecting all business activity in a specific country to the same overall level of taxation despite citizenship. (9) Regardless of the tax regime, the primary goal is to avoid double taxation without encouraging U.S. taxpayers to shift operations, assets, or earnings abroad. (10) However, to understand these concepts better, one must be familiar with the underlying principles behind international tax policy.

III. International Tax Policy Principles

Under tax rules, the "s**ource" country** refers to the location where income is earned typically by an investor, who resides in the "resident" country. (11) Therefore, "foreign-source business income" for this discussion refers to the income derived in foreign-source countries by American companies. While nations recognize that both the country of residence and the country of source are entitled to tax income, the country of source is said to have the primary right to tax active business income. (12) However, complications occur when both the source and the resident country simultaneously exercise their rights to tax, resulting in an injustice to taxpayers who end up being taxed twice on the same income. (13) The current U.S. worldwide system mitigates the effects of double taxation by allowing American firms to claim tax credits on foreign-source income only in the case that it is taxed in excess of U.S. domestic taxes. (14)

IV. Proposal

This article proposes that the United States replace the current worldwide system with a territorial system by exempting active foreign-source business income along with dividends from active business income from taxation. Although the Internal Revenue Code and Treasury Regulations do not provide a comprehensive definition for "active business income," it generally refers to income derived in the normal course of trade or business. (15) Alternatively, income that does not fall under this definition is usually referred to as "passive income." Under the new system, passive income and U.S. source business income will not receive tax-exemptions, unless provided for under de minimus rules. (16) Passive income cannot receive exemption because unlike active business income, it is highly mobile, lacks any nexus to business activity, and is likely to escape taxation by any country. (17) Finally, to ensure the success of such a system, current anti-abuse tax rules and some forms of tax credits must remain in effect as they exist today.

V. How it Solves Problems Under the U.S. System

The current U.S. worldwide system can be costly, complicated, and inefficient. As mentioned earlier, companies are spending disproportionate amounts to comply with the current tax regime. (18) Part of the reason is because the current U.S. system disadvantages a U.S. MNC's ability to raise capital and causes inefficiency. The worldwide tax burden decreases the after-tax returns of foreign investing firms, resulting in higher costs of capital. (19) In turn, these costs cause U.S. MNCs in foreign jurisdictions to become less productive and undercapitalized. (20) This places U.S. MNCs at a disadvantage in competition with foreign MNC counterparts (most of which exempt taxation from foreign-

source income) when competing in the same jurisdictions. (21) This may also discourage potentially profitable business or immature U.S. businesses from capitalizing fully in new foreign ventures or acquiring other foreign MNCs. (22) The current system therefore creates inefficiency by distorting allocation of capital between foreign MNCs in relation to US MNCs with higher tax burdens. (23) Under an exemption system, however, financial constraints on investment will be relaxed, allowing U.S. MNCs to free up capital, pay higher wages through greater productivity, and essentially increase the productivity of domestic firms through positive spillovers. (24) It is estimated that U.S. MNCs will be able to positively contribute to economic welfare by increasing the U.S. Treasury by billions annually. (25)

Additionally, foreign tax credit systems are very complicated and costly because they require extensive research and increased regulation to prevent tax abuses and evasions. One of the abuses that the current system tries to prevent is "cross-crediting. (26) Cross-crediting occurs when an activity generates excess foreign tax credits, which are then used to offset or minimize U.S. taxes on other items of income. (27) To alleviate this trend, the U.S. government has implemented a complicated basket system to reduce cross-crediting by placing different incomes in separate "baskets." (28) If the United States were to switch to an exemption system, the basket system could essentially be eliminated. (29) This is not to say that all anti-abuse rules could be eliminated, however, under an exemption system.

Finally the current system is inefficient in that it creates ownership distortions by encouraging U.S. MNCs to place assets abroad. The current tax system is based on residence which places emphasis on seemingly fictional differences. (30) For example, income earned by French residents in France is not

subjected to a U.S. tax, alternatively, if the income is earned by a U.S. MNC, the United States will tax French source income allocable to French shareholders of the U.S. corporation. (31) Consequently, there is a large incentive to move parent corporations by locating headquarters out of the United States. Not only are American firms spending significant amounts of resources to engage in tax planning, but also the U.S. Treasury in an attempt to curb such efforts. (32) Under the proposed exemption system, however, residence would no longer be a controlling factor, and costs associated with these problems would largely disappear. (33)

VI. Potential Criticisms

A country engaging in an exemption system accepts the fact that investors will experience different taxes depending on the tax rates of the countries in which they invest or do business. (34) A potential criticism is that this leads to locational distortions by creating an incentive for owners to invest in the lowest tax jurisdictions abroad to maximize after-tax returns. This arguably results in investment leaving the United States. (35) However, opponents overlook the fact that the current system creates similar incentives. For example, the U.S. tax treatment does not tax active foreign income until it is repatriated back to the United States, generally in the form of dividends. (36) (As mentioned earlier, dividends would be exempt and therefore, no deferral regimes would exist under the new proposal.) For this reason, U.S. held foreign subsidiaries will likely retain this income abroad until the amount reaches equilibrium. (37) In other words, the amount will be retained and most likely be reinvested as foreign capital or assets, thereby avoiding taxation. Consequently, the result has the same effect as if the income from the capital investment were exempt from tax. (38)

Furthermore, others might argue that replacing the current U.S. system with an exemption system would be more complicated. A National Foreign Trade Council (NFTC) report concluded that "on balance, legislative efforts to improve current international tax rules are better spent on reform of our current deferral and foreign tax credit system." (39) One study predicted that it would cost the United States an additional $5.2 billion a year to implement such a change. (40) However, many economics contest this statistic and believe that the United States will ultimately see an increase in revenue inflows in the long run. (41) Although there would seemingly be additional complication involved with moving to an exemption system, "such a move does provide an opportunity to reconsider a variety of issues that might simplify taxation of international business incomes." (42)

VII. Conclusion

This article proposes that the United States replace the current worldwide system with a territorial system by exempting active foreign-source business income along with dividends from active business income from taxation. Under the new system, passive income and U.S. source business income will not receive tax-exemptions, unless provided for under de minimus rules. (43) Finally, many of the current anti-abuse tax rules and some forms of tax credits will exist as they do today.

One must understand that there are still potential abuses and criticisms with the proposed system however, no system is without fault. Furthermore, changing to an exemption system would allow American companies to be more in line with foreign business partners, and clearly solve the more complicated, costly, and inefficient problems that exist under the current system.

(1) Michael J. Graetz & Paul W. Oosterhuis, *Structuring an Exemption System for Foreign Income of U.S. Corporations*, 54 NAT'L TAX J. 771, 772 (2001). The Organization for Economic Co-operation and Development (OECD) is an organization consisting of thirty member countries, which attempts to "seek answers to common problems and work to co-ordinate domestic and international policies to help members and non-members deal with an increasingly globalized world." OECD Homepage, *available at* http:www.oecd.org.

(2) *Id.* at 771.

(3) *Id.* at 772.

(4) *Id.*

(5) *Id.*

(6) Marsha Blumenthal & Joel B. Slemrod, *The Compliance Cost of Taxing Foreign-Source Income: Its Magnitude, Determinants, and Policy Implications*, 2 INT'L. TAX & PUB. FIN. 37.

(7) Harry Grubert, *Enacting Dividend Exemption and Tax Revenue*, 54 NAT'L TAX J. 811, 816-817 (2001).

(8) Rosanne Altshuler & Harry Grubert, *Where Will They Go if We Go Territorial? Dividend Exemption and the Location Decisions of U.S. Multinational Corporations*, 54 NAT'L TAX J. 787, 787 (2001).

(9) Michael J. Graetz, *The David R. Tillinghast Lecture Taxing International Income; Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 54 TAX L. REV. 261, 271 (2000).

(10) Graetz & Oosterhuis, *supra* note 1, at 772.

(11) MICHAEL J. GRAETZ, FOUNDATIONS OF INTERNATIONAL INCOME TAXATION 5 (2003).

(12) Graetz & Oosterhuis, *supra* note 1, at 772.

(13) GRAETZ *supra* note 11, at 5.

(14) MIHIR A. DESAI, JAMES R. HINES, JR. & MARK F. VEBLEN CORPORATE INVERSIONS: STANLEY WORKS AND THE LURE OF TAX HAVENS (Harvard Business School, 2002).

(15) GRAETZ *supra* note 11, at 267. "'Trade or business' is any considerable, continuous, and regular activity engaged in for profit."

(16) Graetz & Oosterhuis, *supra* note 1, at 775. For simplification, a de minimus rule may be necessary to ignore small amounts of passive income by companies that might lead to an unacceptable level of tax planning.

(17) *Id.*

(18) *Id.* at 772.

(19) Terrence R. Chorvat, *Ending the Taxation of Foreign Business Income,* 42 ARIZ. L. REV. 835, 846 (2000). Assume that an American firm earning $100 of foreign income faces a U.S. tax rate of 35%, and is therefore subject to a foreign tax credit limit of $35. If the firm pays more than $35 in taxes, for example, $70 in foreign taxes, then it would be permitted to claim a tax credit upon repatriation to the U.S., but no more than the $35 foreign tax credit limit. Alternatively, if the firm pays foreign income taxes of less than $35, then the firm would have to pay additional taxes to reach the $35 tax limit imposed upon repatriation to the United States. Therefore, if an American firm is located in a foreign jurisdiction with a tax rate of 20%, it will still be effectively paying $35 after it is taxed under the worldwide system, instead of $20 if the foreign-source income had been exempt in the U.S.

(20) *Id.*

(21) *Id.*

(22) *Id.* at 847.

(23) *Id.* at 846.

(24) MICHAL P. DEVERUEX, THE IMPACT OF TAXATION ON THE LOCATION OF CAPITAL, FIRMS AND PROFIT; A SURVEY OF EMPIRICAL EVIDENCE (2006).

(25) Grubert, *supra* note 7, at 816-817.

(26) Chorvat, *supra* note 19, at 851.

(27) *Id.*

(28) *Id.*

(29) *Id.*

(30) *Id.* at 852.

(31) *Id.*

(32) *Id.*

(33) *Id. at* 853.

(34) Paul R. McDaniel, *The U.S. Tax Treatment of Income Earned in Developing Countries*, 35 GEORGE WASH. INT'L L. REV. 265, 272 (2003).

(35) Chorvat, *supra* note 19, at 842.

(36) *Id.* at 843.

(37) *Id.*

(38) McDaniel, *supra* note 34, at 270.

(39) Nat'l Foreign Trade Council, Inc., *The NFTC's Report on Territorial Taxation*, 27 Tax Notes Int'l 687, 689 (2002).

(40) *Id.*

(41) Grubert, *supra* note 7, at 816-817.

(42) Graetz & Oosterhuis, *supra* note 1, at 784.

(43) *Id.* at 775. For simplification, a de minimus rule may be necessary to ignore small amounts of passive income by companies that might lead to an unacceptable level of tax planning.

HOSPITALS IN DISTRESS: HOW THE ECONOMY HAS AFFECTED FINANCING OF HEALTH CARE

I. Introduction

In the current financial crisis borrowers are finding it increasingly more difficult to access capital for their investments. This is affecting one of the most important industries in our society, heath care. Hospitals are a vital part of the health care industry and they are facing especially hard times in today's economy. It is not a surprise to many people that hospitals are facing financial difficulties. Hospitals have consistently faced financial difficulties even in a good economy. However, the current credit crisis is affecting hospitals more than any other organization because of the high levels of uninsured seeking health care services, low reimbursement rates from Medicaid and Medicare, and staff shortages.[1] Now more than ever before hospitals are facing increasing debt and are unable to gain more capital or refinancing their existing loans because it is more difficult to obtain credit.[2] As a result, hospitals all over the country are filing bankruptcy and some even closing down.[3] Why are hospitals more vulnerable in the current economic crisis than other organizations? Why are some hospitals successful in the current economy and others unable to stay open? What can be done about this? What implications does this have on the health care system? This article will identify some of the reasons why hospitals are facing financial difficulties and propose possible solutions to help hospitals become financially stronger. Specifically, Part II generally outlines how hospitals are financed. Part III considers a myriad of issues that are causing hospitals to suffer financially in the current economy. Part IV presents solutions to the problems faced by hospitals, specifically drawing upon examples of hospitals that are able

to generate a healthy operating margin. Part V concludes by urging hospitals and the government to start taking serious steps to fix this problem because hospital closures may have a devastating effect on the ability of Americans to access health care.

II. Hospital financing

In order to measure a hospitals financial viability there are several factors to consider. First, it is necessary to identify how a hospital generates its revenue. There are several sources of revenue for hospitals which include but are not limited to revenue for providing medical services, revenue for providing nonmedical services, investments, and donations and grants from individuals, foundations, and the government.[4] Operating revenue, or income earned by delivering patient services, is the primary way that hospitals generate revenue.[5] Hospitals rely directly on the patient or third party payers for reimbursement for their services.[6] Often times third party payers are responsible for reimbursement and therefore the payment collection process can be complicated, time consuming, and expensive process.[7] Furthermore, the reimbursement for health care services will vary greatly depending on the third party payer.[8] Third party payers may include private insurance companies, health maintenance organizations, and government entities such Medicaid and Medicare. The reimbursement rate and the how long it may take to get the reimbursement will depend on the third party payer.

Second, it is necessary to identify hospital expenses. The majority of hospital expenses result from wages and salaries paid to employees.[9] Other expenses include supplies, depreciation, interest payments, and bad debt.[10] Bad debt is

the charges the hospital expects to collect for the services but for which it does not receive payment.

Hospital revenue and expenses are used to calculate the operating margin. The operating margin measures the "hospitals profitability, before taxes, and reflects a hospitals ability to sustain and grow its business in the future."[11] This is measured generally by comparing the hospitals total operating revenue against its total operating expense.[12] A healthy operating margin for a hospital is 3 to 5 percent.[13] A negative operating margin means that the hospitals operating revenue is less than the operating expenses.[14] A recent study of hospitals in 28 states indicates that more than half of them reported negative operating margins.[15] This indicates that the declining economy is having a drastic effect on hospitals.[16]

III. Why hospitals are facing financial difficulties and how that has increased in today's poor economy

There are many reasons why hospitals are facing financial difficulties and considering closing down. The large organizational structure in hospitals often makes it difficult to isolate just a few factors responsible for hospitals poor financial health. This paper will attempt to isolate the factors that have had the most impact recently and that are the most vulnerable to changes.

A. Low reimbursement rates

Reimbursement rates from Medicaid and Medicare have fallen which has put a significant financial burden on hospitals. A recent study done by the American Hospital Association indicates a steady rise in the amount of underpayments for both Medicare and Medicaid.[17] Underpayments are defined as "the difference

between the costs incurred and the reimbursements received for delivering care to patients."[18] The underpayments for Medicaid and Medicare have increased from 3.8 billion in 2000 to 32 billion in 2008. As a result of low reimbursements hospitals are having to cost-shift which results in an increase in the price of supplies and services.

Reimbursement rates for Medicaid are dependant on state budgets and often take a long time to obtain and are fairly low.[19] The American Hospital Association reported that hospitals received payment of 88 cents for every dollar spent treating Medicaid patients.[20] In addition, as the economy is declining the amount of people eligible for Medicaid is increasing.[21] An American Hospital Association report indicated that hospitals have reported a "forty- six percent increase in the proportion of patients covered by Medicaid or other public programs."[22] This will results in higher state deficits and lower reimbursement rates.

Alexian Brothers Medical Center in Illinois like many hospitals is affected by Medicaid's low reimbursement rates. Less than 12% of hospital's patients are covered by Medicaid.[23] While this may not be as high as other hospitals it still requires the hospital to cost-shift in order to make up for the amount that is not reimbursed.[24] In addition, in Illinois there has not been a Medicaid inpatient rate increase since 1995.[25] The high deficit in Illinois as well as in other states is having an impact on hospitals financially.

Medicare reimbursement rates are higher but still present a financial obstacle for many hospitals. The Medicare Hospital Trust Fund has reported that it will cover only 78% of hospital services.[26] In addition, many hospitals see a higher percentage of Medicare patients. For instance, about 44% of Alexian Brothers

patients are covered by Medicare.[27] While the reimbursement rates for Medicare are higher the amount of patients on the program are growing.[28] As a result of the growing aging population, Medicare may become a greater financial burden on hospitals in the future.[29]

B. Type of patient: uninsured and older

The number of uninsured individuals is increasing causing many hospital services to go unpaid. For instance, the number of uninsured has increased from 44.8 million in 2005 to 47 million in 2006.[30] As the amount of uninsured increase more are going to hospital emergency rooms for their basic health care needs not emergency services.[31] This is increasing the amount of debt hospitals are facing because state and federal law often require hospitals to provide care for people going to the emergency room regardless of their ability to pay.[32] The Emergency Medical Treatment and Active Labor Act ("EMTALA"), a federal statute enacted in 1986, requires hospitals with an emergency room department and that participate in Medicare to take uninsured individuals and provide them with emergency treatment.[33] Under EMTALA hospitals must screen an individual who requests care and if that person is found to have an emergency medical condition the hospital must stabilize that individual before transferring him to another facility.[34] Critics of EMTALA allege that uninsured individuals are using the emergency room department more frequently for non-urgent care.[35] Since the enactment of EMTALA in 1986, visits to the emergency room have increased from "85 million visits per year to almost 110 million visits per year, while more than 550 hospitals and 1,100 emergency departments closed, as did many trauma centers, maternity wards, and tertiary referral centers."[36] This suggests that EMTALA is a significant drain on the hospitals resources and capital.

In addition to a higher number of uninsured, people are living longer and therefore requiring more care and longer hospital stays.[37] It is estimated that by 2030 the population of people that are 65 and older will increase from 27 million in 2006 to 71.5 million.[38] Also, between 1992 and 2004 the average estimated health care costs of older Americans increased from $8,644 to $13,052.[39] As a result, hospitals will be treating sicker and older patients who will be staying longer in hospitals.[40]

C. High cost of hospital resources: updated equipment, training and labor

Technological advances in the field of medicine can cause a hospital to become outdated if it does not keep up with the changing technology.[41] Keeping up to date with current technology can cause a hospital to incur significant costs for purchasing the equipment and training the staff to use the equipment.[42] However, if the hospital does not keep with the technological changes it may lose patients because they will be more likely to go to a hospital that has state of the art equipment.[43] In addition, technological advances in the field of medicine have reduced the need for medical care and the length of inpatient hospital stays.[44] As a result hospitals will be losing revenue because patients no longer need extensive and long medical treatment.[45]

Also, there are increased labor costs due to an acute shortage of registered nurses. According to a report released by the American Hospital Association in 2007, U.S. hospitals need approximately 116,000 nurses to fill vacant positions nationwide, meaning that a national registered nurse vacancy rate of 8.1 percent.[46] Furthermore, the demand for registered nurses is expected to grow by 2 percent to 3 percent each year.[47]

IV. Recommendations for hospitals in financial distress

What can be done to prevent hospitals from closing their doors? Hospitals around the country are approaching their financial distress with various cost saving approaches. The approaches outlined below are only a few of the many considerations that a hospital can make when determining how to stay financially viable during the economic crisis.

A. Uninsured patients

One of the largest financial burdens that hospitals face is uncompensated care that is provided to uninsured individuals, especially in the emergency room department. Hospitals around the country have started charging uninsured patients for non-emergency treatment.[48] For instancee, in Atlanta the Grady Health System began charging fees for non-emergency visits based on a sliding scale to residents that live outside of Fulton and DeKalb counties.[49] In Cleveland, the MetroHealth Medical Center "implemented a $150 charge for uninsured patients living outside of the county."[50] This was designed to make an effort to divert patients from the emergency room to its primary-care physician offices.[51] Charging fees for non-emergency room services may divert patients from using the emergency room department but the uninsured patients are still not going to be able to pay their bills. Research shows that uncompensated care costs the hospital industry up to 41 billion annually.[52] This includes both uninsured and underinsured patients who are unable to pay their hospital bills.[53] Marty Callahan, vice president for Health Care Solutions for Transunion, recommends that when hospitals are dealing with underinsured or uninsured patients they should focus on identifying the patient and matching them with charity care or other financial assistance programs or setting equitable payments plans.[54] By

verifying patient information thoroughly hospitals are able to lower the amount of uncollectable debts from patients that cannot be located.[55] Also, providing patients with financial assistance and manageable payment plans will increase their likelihood of payment.[56]

B. Monitoring productivity and resource consumption

One of the largest expenses for hospitals is labor and supplies.[57] Therefore, one of the best ways for a hospital to save money is to monitor and control expenses on labor and supplies.

Alexian Brothers Medical Center has a healthy operating margin of 3.8 percent and serves as a good example of what can be done to save costs. In order to control labor costs Alexian Brothers monitors the productivity of each department daily.[58] First, the hospital considers what the patient will need to ensure that patients are receiving the highest quality care.[59] Second, the hospital looks at the productivity of each department and compares it with the expectations or bench marks set in each department. Productivity measures are specific to each department.[60] For instance, for central transportation productivity is measured by productive hours per patient transports, surgery is measured by productive hours per surgical minute, and laboratory is measured by productive hours per test performed.[61] This allows the hospital to determine daily how each department should be staffed and ensures that the hospital is making the most cost effective decisions.[62]

Supplies are also significant expenses for many hospitals and therefore effective resource utilization is an important part of saving costs. Alexian Brothers puts teams together that focus on monitoring resource consumption and look for ways

to save money but still retain a high quality of care.[63] The hospital focuses on making sure that the patient is receiving the appropriate level of care for the appropriate amount of time[64]. First, the patient needs to be timely screened and the results need to be obtained quickly.[65] Second, the patient needs to be treated timely.[66] This ensures that the hospital is decreasing bottlenecks, or the time between the physician ordering the test and it being performed and the results received.[67] Also, the hospitals monitors whether physicians are conducting the appropriate amount of tests and that they are not over testing.[68] By eliminating delays and unnecessary tests the hospital can provide better and quicker care to the patient and save time and costs.[69] In addition to monitoring resource consumption, Alexian Brothers looks to make sure that the hospital is not overpaying for supplies by standardizing with a particular vendor.[70]

C. Better financial oversight and management

Requiring hospitals to have better financial oversight and management can also help hospitals regulate their finances and prevent bankruptcy. Many times the executives find themselves concerned for preserving their jobs rather than focusing on the financial well-being of the hospital.[71] In states, like New Jersey, the legislature has decided to take action in order to monitor hospital finances and make sure that hospitals are not closing down. For instance, the New Jersey legislature passed a law which requires hospitals to file financial statements monthly rather than quarterly.[72] The law "also allows state officials to impose monitors at struggling hospitals and in extreme cases state officials could veto power over a hospital's actions."[73] Other measures designed to increase transparency "require hospitals to hold annual public hearings to give communities a glance at their inner workings."[74] Also, the law requires

“mandated training and financial oversight for hospital boards of trustees.”[75] In addition, a $44 million "hospital stabilization" fund was created, which will be used to prop up struggling safety-net hospitals.”[76]

Improving management and increasing transparency in a hospital is one of the primary ways to ensure that hospital finances are being utilized in an effective way to prevent low or negative operating margins.[77] First, monitoring the behavior of financial managers and holding them accountable for their mistakes is a good way to ensure that hospital resources and capital are being utilized properly.[78] Second, setting goals for the organization in terms of how much money is spent in each department as well as for overhead costs.[79] Finally, it is important for a CFO to implement flexible budgeting techniques that can be changed with the current market fluctuations.[80]

D. Increasing or changing the quality of services provided

Hospitals can also change or increase the quality of services they offer in order to be able to compete in the market. For instance, a hospital can invest money to develop their cardiac or cancer treatment centers which will attract more patients from different areas.[81] It can also attract more fee-for-service of PPO patients which can help the hospital make a higher profit in the long run.[82] New programs and treatment centers will also influence more doctors and nurses to join their hospitals.[83] This may cost money to develop but it has the potential to bring in higher profits because specialized care cost more money and attracts more patients who are unable to receive this care in other hospitals or from their physicians.

E. Cutting staff, benefits, and services

Reducing benefits is also another way to save costs. For instance, the Goshen Health System deferred merit increases, reduced paid vacation time and suspended its retirement matching program in order to save costs.[84]

Hospitals all round the country are finding ways to save money and sometimes this involves cutting services or staff**.** A recent American Hospital Association survey has reported that many hospitals around the nation are forced to cut staff as a result of financial difficulties.[85] Furthermore, hospitals are also cutting services, such as behavioral health programs, post-acute care, clinics and patient education to save money.[86] Unfortunately, these solutions can affect the quality of care that people are receiving in hospitals. Therefore, hospitals should try to balance quality of care concerns with financial management in order to ensure that patients are receiving the best care possible.

F. Consolidations and acquisitions

Another way for weaker hospitals to improve efficiency and save costs is by merging with stronger facilities.[87] Mergers occur when separate hospitals come together under a shared license and "have common ownership, do business under a single license, report unified financial records, and possibly consolidate some physical facilities."[88] On the other hand acquisitions are "when joining hospitals retain their licenses but are owned by a common governing body."[89] Mergers provide a good solution for weaker hospitals who are considering closing down. Mergers can provide hospitals with cost savings, greater access to capital, improved utilization of resources, and more efficiency in the delivery of health care.[90] By saving costs the hospital decreases its operating expenses and as a result consumers can enjoy lower health care costs.[91]

However, there are also many disadvantages to mergers. Critics allege that mergers have been responsible for price increases in services and lower quality care.[92] Mergers can result in large multi-hospital systems which obtain considerable market power in local communities.[93] As a result multi-hospital systems decrease the amount of competition which can result in increased prices.[94] Mergers can also cause complications with the hospital management and organizational structure which can lead to hospitals closing down or becoming less efficient.[95] Mergers are a possible solution for hospitals facing financial difficulties but given the disadvantages hospitals should consider other alternatives before heading in that direction.

V. Conclusion

If hospitals are unable to keep open and provide services this can have a devastating affect on access and quality of health care in the United States. Studies have indicated that hospital closures in rural parts of the country are having devastating effect on the health of the citizens.[96] Several studies have indicated that hospital closures in rural areas have caused "perception of a loss of quality of life and health status, an increase in the waiting time for routine medical care, and a decrease in medication compliance."[97] In addition, residents reported that they have problems in securing transportation to travel to other facilities and that their travel time has increased.[98] These barriers become even more problematic for vulnerable populations such as pregnant women, children, and elderly.[99] In addition, low income individuals are suffering even greater barriers to accessing health care since hospitals often times are the only providers in the area that take Medicaid.[100] What can be done to fix the financial problems of hospitals and provide American's with access to health care?

The solutions discussed above are a good place to start for hospitals facing financial difficulties. However, the solutions are limited in scope and can only fix some problems. Inevitably some hospitals will have to close their doors. This is a concern that should be addressed at a higher level than the hospital managing boards. Its time for legislatures to start taking actions and subsidizing the costs of hospitals. The current health reform will change the financial conditions of many hospitals but the future is still uncertain. The current health care bills indicate stronger support for government programs such as Medicaid and Medicare and increasing access of health care to more individuals. This may hurt hospitals that are already experiencing financial problems as a result of low reimbursement. However, if reimbursement levels are improved this may provide hospitals with the necessary capital to continue their operations. Unfortunately, this is beyond the scope of this paper and should be considered in greater detail as the health care reform bills pass and their plans are put into action.

---

[1] Samuel R. Maizel, Shane Passarelli, and George D. Pillari,*The Financial Crisis Facing America's Hospital Industry: Part I*,27-JAN AM. BANKR. INST. J. 16, 55, 56 (2009).

[2] *Id*.

[3] *Id*.

[4] A Community Leaders Guide to Hospital Finance,http://www.accessproject.org/downloads/Hospital_Finance.pdf(last visited March 7, 2009).

[5] *Id*. at 16.

[6] *Id*.

[7] Robert S. McWhorter, *The Industries Most at Risk in Bankruptcy: Legal and Financial Experts on What to Expect, Avoiding Financial Trouble, and Thoughts on the Future*, 2008 WL 5689292, 109 (2008).

[8] *Id*.

[9] *Id*. at 25.

[10] *Id*.

[11] Whorter, *supra* note 7, at 107.

[12] Hospital Financial Performance,http://www.oshpd.ca.gov/HID/Products/Hospitals/AnnFinanData/HospFinanPerform/HospitalFinancialPerformance.pdf(last visited March 3, 2010).

[13] Whorter, *supra* note 7, at 107.

[14] *Id*.

[15] *Hospital Margins Sink with Economy*, AHANEWS.COM,*available at*http://www.ahanews.com/ahanews_app/jsp/display.jsp?dcrpath=AHANEWS/AHANewsArticle/data/AHA_News_090316_Report_hospital&domain=AHANEWS.

[16] *Id*.

[17] *Under Payment for Medicare and Medicaid Fact Sheet,*American Hospital Association. http://www.aha.org/aha/content/2009/pdf/09medicunderpayment.pdf . (last visited March 3, 2010).

[18] *Id.*

[19] *Id*.

[20] Whorter, *supra* note 7, at 110.

[21] *Economy forces hospitals to cut staff, services*, AHA NEWS, April 27, 2009.

[22] *Id*.

[23] Interview with Sherri Vincent, Chief Financial Officer of Alexian Brothers Medical Center, in Elk Grove Village, IL. (March 11, 2009).

[24] *Id*.

[25] *Id*.

[26] Heidi B. Malhotra, *Financial Crisis Looms Over Healthcare Industry*, THE EPOCH TIMES, May 3, 2008.

[27] Vincent, *supra* note 24.

[28] McWhorter, *supra* note *7*, at 110.

[29] *Id*.

[30] *Id*. at 109.

[31] Laura D. Hermer, *The Scapegoat: EMTALA and Emergency Department Overcrowding*, JOURNAL OF LAW AND POLICY, 695 (2006).

[32] *Id*.

[33] *Id*.

[34] *Id*. at 699-700.

[35] *Id*. at 703.

[36] *Id*. 703-704.

[37] McWhorter, *supra* note *7*, at 110.

[38] Vicky Cahan, *Americans Living Longer, Enjoying Greater Health and Prosperity, but Important Disparities Remain, Says Federal Report*, NATIONAL INSTITUTE ON AGING, *available at*http://www.nia.nih.gov/NewsAndEvents/PressReleases/PR20080327OlderAmericans.htm.

[39] *Id*.

[40] *Id*.

[41] McWhorter, *supra* note 7, at 109.

[42] *Id*.

[43] *Id*.

[44] Maizel, *supra* note 1, at 58.

[45] *Id*.

[46] *Id*. at 55-56.

[47] *Id*.

[48] Diana Manos, *Hospitals Find Ways to Cope with Increase in Uninsured Visits*, HEALTHCARE FINANCE NEWS, May 26, 2009.

[49] *Id*.

[50] *Id*.

[51] *Id*.

[52] Marty Callahan, What Every Hospital Should Know,FINANCIAL MANAGEMENT WHITEPAPER, *available at*http://www.futurehealthcareus.com/?mc=uncompensated-care&page=fin-viewmarketplace.

[53] *Id*.

[54] *Id*.

[55] *Id*.

[56] *Id*.

[57] Lindsey Dunne, 10 Best Practices of Increasing Hospital Profitability, BECKER'S HOSPITAL REVIEW, *available at*http://www.hospitalreviewmagazine.com/news-and-analysis/business-and-financial/10-best-practices-for-increasing-hospital-profitability.html.

[58] Vincent, *supra* note 23.

[59] *Id*.

[60] *Id*.

[61] *Id*.

[62] *Id*.

[63] *Id*.

[64] *Id*.

[65] *Id*.

[66] *Id*.

[67] *Id*.

[68] *Id*.

[69] *Id*.

[70] *Id*.

[71] Maizel, *supra* note 1, at 57.

[72] Jonathan Tamari, *Doing more to keep Hospitals Alive*,PHILADELPHIA INQUIRER TRENTON BUREAU, Aug. 24, 2008.

[73] *Id*.

[74] *Id*.

[75] *Id*.

[76] *Id*.

[77] Steven H. Berger, *10 Ways to Improve Heath Care Cost Management*, HEATHCARE FINANCIAL MANAGEMENT, Aug. 2004, 2.

[78] *Id*.

[79] *Id*.

[80] *Id*. at 3.

[81] Whorter, *supra* note 7, at 118.

[82] *Id*.

[83] *Id*.

[84] Dunne, *supra* note 57.

[85] *Id*.

[86] Whorter, *supra* note 7, at 111.

[87] Renee Tomcanin, *4 Trends in Hospital Financing: Discussion With Claudia Gourdon of Healthcare Finance Group*, BECKER'S HOSPITAL REVIEW MAGAZINE, August 19, 2009, *available at* http://www.hospitalreviewmagazine.com/news-and-analysis/business-and-financial/4-trends-in-hospital-financing-discussion-with-claudia-gourdon-of-healthcare-finance-group.html.

[88] David Dranove and Richard Lindrooth, *Hospital Consolidation and Costs: Another Look at the Evidence*,NORTHWESTERN UNIVERSITY, 3, March 1,

2002, *available at*http://www.kellogg.northwestern.edu/research/chime/papers/Hospital_Consolidation.pdf.

[89] *Id*.

[90] Jennifer R. Conners, *A Critical Misdiagnosis: How Courts Underestimate The Anticompetitive Implication of Hospital Mergers*, 91 CALIFORNIA LAW REVIEW 543, 548 (March 2003).

[91] *Id*.

[92] *Id*.

[93] *Id*. at 545.

[94] *Id*.

[95] *Id*.

[96] Susan Reif, Susan DesHarnais, Shulamit Bernard, *Effects of Rural Hospital Closure on Access to Care* (North Carolina Rural Health Research Program, Working Paper No. 58, 1998)*available at*http://www.shepscenter.unc.edu/rural/pubs/report/wor58.pdf.

[97] *Id*.

[98] *Id*.

[99] *Id*.

[100] *Id.*

ANTITRUST ACTIVISM

I. Introduction

Recent antitrust activity showed relevant cases moving forward in a reminder that antitrust can be one of the most effective legal measures to put some limit to an era of globalization that has raised many criticisms.The current economic crisis that –under a formal view- began in 2008 with the falling of Lehman Brothers, ringed many bells in connection with the so called Too Big To Fail Companies.[1] Several claims and some proposals to limit the size of those companies were raised but no new regulation was enacted yet. In these circumstances, antitrust activism could be seen as the only effective way to restrict the size or somehow limit the growing potential of companies.

II. Europe and Microsoft: an old claim comes to an end

In 1997 Antitrust proceedings were initiated against Microsoft in regard to Internet Explorer, its web browser. The argument was that, since the Internet Explorer was built-in every Windows system, Microsoft was abusing of its position. At the time, a direct victim of this situation was Netscape, a company which developed a browser that was threatening Internet Explorer gaining users day by day.After a long and detailed analysis, a settlement was reached requiring Microsoft to share its application programming interfaces with third-party companies.[2]Some years later, Netscape disappeared from the market and the antitrust complaint against Microsoft's Internet Explorer reached Europe. [3]In December 2009, the European Commission announced that Microsoft acceded to settle the case.[4]Under the settlement agreement, Microsoft committed to

distribute its Windows operating system in Europe including a “choice screen” giving users the capacity to choose the web browser they prefer to use rather than imposing the already-installed Internet Explorer. Thus, Windows users in Europe will have 12 web browsers to choose from, including Internet Explorer and other web browsers provided by Microsoft’s competitors. [5]Microsoft’s committed to offer this “choice screen” for 5 years. [6]In March 2, 2010, the European Commission issued a Press Release celebrating Microsoft’s implementation of the settlement. The heading of such Press Release stated the following:

> The European Commission welcomes the implementation by Microsoft of its commitment to give consumers in the European Union the opportunity to choose from a variety of browsers to access and surf the Internet. From the beginning of March, users of Windows PCs who have Internet Explorer as default web browser are being provided with a browser Choice Screen, designed to give them an effective and unbiased choice between their default and competing web browsers. This should ensure competition on the merits and allow consumers to benefit from technical developments and innovation both on the web browser market and on related markets, such as web-based applications.[7]

According to the Press Release, since March 2010 European Windows users who receive automatic updates for their operating systems and have Microsoft's browser set as default will be offered the possibility to choose their browser through the “choice screen”. It is expected that the browser “choice screen” will be displayed on over 100 million computers in Europe by mid-May 2010. The central page of the choice screen is also available to any internet user at http://www.browserchoice.eu .The effectiveness of the EU’s measures will be

seen soon. Yet, it is clear that Microsoft will not have an easy time "spontaneously" offering its users to replace Internet Explorer with other competitors' browsers.The Economist evaluated the case as follows: "This settlement goes much further than an inconsequential deal that Microsoft struck in America in the early part of this decade. But it still invites questions over whether Europe's case was worth the trouble." [8]There is no doubt that the Microsoft Internet Explorer case, in its American and European version, became a major antitrust case in history.

III. **Europe and Google: an upcoming fight**

In February 2010 it was made public that the EU Competition Commission was investigating Google on antitrust-related matters. While the investigation is yet to become formal, there have been initial approaches between European officers and Google with regard to three complaints filed with the Commission. [9]Foundem, a price comparison site, is deemed to be one of the complainants. [10] Ejustice.fr, a legal information French site is to be another one. [11]But perhaps most interesting is the fact that the third complaint was raised by Ciao, an online shopping site that was acquired by Microsoft to become part of Bing, its search engine. [12]Among the main allegations set forth by plaintiffs is the fact that Google penalizes certain websites by excluding them from Google's search results. [13] In overall, the complaints addressed Google's search and advertising system. Google has denied the accusations and explained that searches are conducted by algorithms without any "penalty" or similar measure adopted. [14]Google's dominant position in the search engine market seems not to be in question. It is said to have about a 65% share of the US market and about 90% in Europe [15] or even more. [16] But the relevant issue is how the company behaves while being in that position –if it abuses of that advantage-.This might be

the beginning of a major antitrust investigation. Indeed, if Google's search engine and advertising system –the core business of the company—are put under investigation, it will not be difficult to find similarities between such case and the Internet Explorer investigation run over Microsoft until December 2009. The matter is yet to be resolved, but it certainly promises an interesting outcome.

IV. **Argentina and Telecom: a Complex Ongoing Case**

During the 1990s Argentina decided to turn private many of the public utilities companies and the phone service company (ENTEL) was among them. After a bidding process, and with the idea of avoiding a monopoly to occur in that market, the Argentinean Government decided to assign half of ENTEL to Telecom Italia and the other half to Telefonica from Spain.In January 2009, the Argentinean Competition Commission initiated an investigation to determine if Telefonica's acquisition of certain stock on Telecom parent companies –incorporated abroad— had the effect of creating a dominant position in the Argentinean telecommunications market. [17]Some months later, the Argentinean Secretary of Internal Commerce enacted Resolution 483 which ordered Telecom Italy to disinvest in Telecom Argentina given that the entering of Telefonica in Telecom Italy's capital affected the competition in the Argentinean market. [18]In February 2010, the Argentinean Courts overruled Resolution 483. Telecom had brought the case with the Courts claiming that the Argentinean Competition Commission violated Telecom's right of defense during the administrative proceedings that generated the grounds for Resolution 483. [19]The Courts ordered a new investigation to be conducted under the direction of a Government officer different that the one in charge before –evidencing the political issues that were present behind this case. [20]Complying with the Court's order, in February 24, 2010, the Government appointed a new officer to conduct the investigation.

[21] The Government instructed the new officer to assure Telecom the exercise of its right of defense.Surprisingly, in March 11, 2010, Telecom announced immense profits for its last fiscal period and that it would make important investments in the near future in Argentina. [22]At the same time that the Competition Commission is conducting this investigation, Telecom is suffering internal disputes among its shareholders.[23]With more than 15.000 employees, Telecom is one of the most important companies in Argentina.The case is expected to be decided soon since the Argentinean Government and Telecom have important interests at stake.

V. **Antitrust Activism**

These are three of many antitrust cases currently going on in the world, which serve as a signal of how active and relevant this area of law remains for international business.Antitrust regulation has existed for more than 100 years. Yet, there is no doubt that globalization process –both in the economic and the technological sense-, put things to extremes not seen decades before.The economic and financial crisis that formally began with the fall of Lehman Brothers in 2008 is still extending its effects to current times with no clear dead line. That crisis pointed out that some companies are too interconnected in this modern world and, under certain circumstances, can be a threat to national economies –and even to the global one-. [24]Nevertheless, no new regulation was enacted to address that point and antitrust rules seem to remain the only ones to set forth some limits to the size of companies in modern times.

---

[1] Bill Saporito, *How AIG Became Too Big to Fail*, Time Magazine, Mar. 19, 2009, *available*

at http://www.time.com/time/business/article/0,8599,1886275,00.html. *See also* Jamie Dimon, *No more 'too big to fail'*, Washington Post, Nov. 13, 2009, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2009/11/12/AR2009111209924.html. U.S. Treasury Secretary, Timothy Geithner, said: "No financial system can operate efficiently if financial institutions and investors assume that government will protect them from the consequences of failure." The term "too big to fail" must be excised from our vocabulary." *Id. See also* Michael McKee and Scott Lanman, *Greenspan Says U.S. Should Consider Breaking Up Large Banks*, Bloomberg, Oct. 15, 2009, *available at* http://www.bloomberg.com/apps/news?pid=20601087&sid=aJ8HPmNUfchg. According to Former Federal Reserve Chairman Alan Greenspan, "U.S. regulators should consider breaking up large financial institutions considered too big to fail." *Id.*

[2]Microsoft Case, FindLaw special coverage,http://news.findlaw.com/legalnews/lit/microsoft/ (last visited March 14, 2010). *See also* Microsoft Legal News,http://www.microsoft.com/presspass/legal/default.mspx (last visited March 14, 210); Open Law: The Microsoft Case, Harvard Law School,http://cyber.law.harvard.edu/msdoj/ (last visited March 14, 2010).

[3] Editorial, *Microsoft and antitrust – The end, sort of*, The Economist, Dec. 16, 2009,*available at* http://www.economist.com/business-finance/displaystory.cfm?story_id=15108468.

[4] Kevin J. O'Brien, *Europe Drops Microsoft Antitrust Case*, The New York Times, Dec. 16, 2009, *available at*http://www.nytimes.com/2009/12/17/business/global/17msft.html?_r=2. See also Lance Whitney, *EU resolves Microsoft IE antitrust case*, Cnet News, Dec. 16, 2009, *available at* http://news.cnet.com/8301-10805_3-10416402-75.html.

[5] Editorial, *supra* note 3.

[6] Press Release, European Commission, March 2, 2010, *available at*http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/216&format=HTML&aged=0&language=EN&guiLanguage=en.

[7] *Id*.

[8] Editorial, *supra* note 3.

[9] Richard Waters and Nikki Tait, *Google faces Brussels antitrust scrutiny*, Financial Times, Feb. 24, 2010, *available at* http://www.ft.com/cms/s/2/46018520-20da-11df-b920-00144feab49a.html.

[10] Kamal Ahmed, *Google under investigation for alleged breach of EU competition rules*, The Telegraph, Feb. 24, 2010, *available at*http://www.telegraph.co.uk/technology/google/7301299/Google-under-investigation-for-alleged-breach-of-EU-competition-rules.html.

[11] *Id*.

[12] *Id*.

[13] *Id*.

[14] Waters and Tait, *supra* note 9.

[15] Editorial, *Google faces European competition inquiry*, BBC News, Feb. 24, 2010, *available at* http://news.bbc.co.uk/2/hi/8533551.stm.

[16] Waters and Tait, *supra* note 9.

[17] Editorial, *Defensa de la Competencia en contra de Telecom Italia*, Revista Mercado, April 22, 2009, *available at* http://www.mercado.com.ar/nota.php?id=360906.

[18] Editorial, *Feletti, a cargo del caso Telecom*, La Nación, Feb. 24, 2010, *available at* http://www.lanacion.com.ar/nota.asp?nota_id=1236973.

[19] *Id*.

[20] *Id*.

[21] Editorial, *Telecom Italia podrá defenderse ante la CNDC*, La Nacion, Feb. 25, 2010, *available at* .

[22] Editorial, *Telecom invertirá $ 2000 millones,* La Nación, March 11, 2010,*available at* http://www.lanacion.com.ar/nota.asp?nota_id=1242024.
[23] Editorial, *Suspendieron a los Directores Nombrados por Telecom Italia*, Abogados.com.ar, March 12, 2010, *available at*http://www.abogados.com.ar/suspendieron-a-los-directores-nombrados-por-telecom-italia/5158. See also Editorial, *Solicitan reincorporar directores de Telecom,* La Nacion, March 13, 2010, *available at*http://www.lanacion.com.ar/nota.asp?nota_id=1242939&origen=NLEco.
[24] See *supra* note 1. See also G. Morales Oliver, *2008/9 Financial Crisis: A Lot to Learn On Bailouts and Too Big To Fail Companies In Order To Draft New Regulation,* Illinois Business Law Journal, December 3, 2009, *available at*http://www.law.uiuc.edu/bljournal/post/2009/12/03/20089-Financial-Crisis-A-Lot-to-Learn-On-Bailouts-and-Too-Big-To-Fail-Companies-In-Order-To-Draft-New-Regulation.aspx.

CONFIDENTIAL SECURITIES TRADING V. DISCLOSURE REQUIREMENTS OF BANKRUPTCY RULE 2019

I. Introduction

Bankruptcy reorganizations do not come without their fair share of issues. As large companies teeter on the verge of bankruptcy, affected parties begin to configure their positions. Some creditors, before a bankruptcy, will sell their claims in the debtor's estate to interested third parties. Of course, these third party investors wouldn't buy these claims unless they thought they could receive a return on their investment. However, sometimes these third party investors have incentives to receive less back on their claims in the bankruptcy reorganization

process. This not only creates a stall in the reorganization process, but it can also force other creditors to receive less back on their claims.

This paper focuses on these abusive third party investors and the rule that is used to combat these types of abusers, Rule 2019 of the Bankruptcy Code. Rule 2019 requires disclosure of these third party investor's economic interests so the court can evaluate whether or not they are an abuser. However, some of these third party investors engage in secretive securities trading, which is largely unregulated by the Securities Laws, therefore one can see the opposition they would have against disclosure. They have maintained the position that Rule 2019 was not meant to cover them because they are not the type of person Rule 2019 was meant to cover; a committee. In the traditional sense, they are not an official committee. They are ad hoc committees. An examination on the history of Rule 2019 might shed more light on whether or not these ad hoc committees were meant to be covered. It will then be useful to examine the Rule 2019 in today's bankruptcy proceedings and the effects the proposed amendments might have. Finally two solutions will be presented that might bring equilibrium between disclosure and non-disclosure.

II. History of rule 2019

Rule 2019 has not come without its issues. "The disclosure requirements of Rule 2019 has a lengthy history in corporate reorganization cases." [1] The predecessor to Rule 2019 was 10-211 under the former Chapter X of the Bankruptcy Act, which was adopted following a report by Justice William O. Douglas ("The report"). [2] The report identified several problems that were present in the bankruptcy code. [3] More specifically, problems that was associated with committees during the bankruptcy reorganization process. [4]

The unofficial committees, the report addressed, were called “protective committees.” [5] These committees, usually sponsored by the debtor, would solicit proxies to individual creditors who would then grant control over their claims to these “protective committees.” [6] Essentially Douglas was concerned that these “protective committees” were controlling the reorganization process, hanging outside investors up to dry. [7] He attacked these abuses by finding an owed fiduciary duty by these “protective committees.”

In Douglas’ report, he stated that these committees owed a fiduciary duty to the investors they represented, based on the claims they would purchase from these individual creditors. [8] He then came to the conclusion that these “protective committees” were violating their fiduciary duties, and that the existing laws were inadequate to protect the public investor from these violations. [9] Douglas’ recommendation was to have any committee representing more than twelve creditors or stockholders to disclose their economic interests during the reorganization proceeding, so that theBankruptcy Court can adequately evaluate if there will be abuse. [10]

The reports recommendation was adopted in Chapter X of the former Bankruptcy Code and later as rule 10-211 in the 1978 Bankruptcy Code, which would later become Rule 2019. [11]

III. Current Rule 2019 and its disclosure affects on security holders

These “protective committees” are no longer present in today’s restructuring cases. [12] The committees that are created today are by creditors who seek to

collectively share their costs and increase their leverage within the bankruptcy case. [13] However, recently we have seen otherkinds of creditors that have become involved in bankruptcy reorganizations; creditors who have a credit default swap agreement ("CDS") for their claim in the bankruptcy case. [14]

A CDS is a type of insurance contract for a security holder. [15] An investor will purchase a CDS contract against a certain security. In the event that the security defaults on its payments, the CDS contract will make payments to the investor just like an insurance policy. [16]

These CDS agreements have now made their way to bankruptcy reorganization cases. Funds will invest in the securities of failing companies, at a discount, in hopes that the securities are undervalued. [17] They will then get these securities insured by these CDS agreements. [18] This in turn creates an incentive for these security holders to receive less on their claims in a bankruptcy proceeding because they will then be made whole by these CDS contracts. [19] Some bankers and lawyers involved in these restructuring efforts have said that many companies stand to default because of the existence of these CDS contracts, that the creditors holding these CDS' hold out to efforts towards restructuring. [20]

During a bankruptcy proceeding, these creditors would form ad hoc committees, unlike the traditional committees that are created under the bankruptcy regime. [21] Subsequently, the debtor or other creditors will usually attack the economic interests of these ad hoc committees. However, the members of these ad hoc committees do not want to disclose their economic interests because it will require disclosure of their security trading secrets. [22] The issue then becomes whether or not these ad hoc committees are the types of committees Rule2019 were meant to cover?

Standing in the forefront of this particular issue is the Delaware Bankruptcy Court. Judges in this Court seem to be split on whether or not Rule 2019 covers ad hoc committees. Judge Sontchi in *in re Premier International Holdings* disagreed sharply that Rule 2019 extends to ad hoc committees. [23] He then went on to explain that any amendments to Rule 2019 to increase the required disclosures would have no affect to those not already covered by the rule. [24]

Judge Sontchi's decision was in complete opposition to that of his counterpart, Judge Walwrath's in *in re Washington Mutual Inc*. [25] Judge Walwrath used the currently proposed amendments to Rule 2019, which will force disclosure by ad hoc committees, as evidence of Rule 2019's coverage of ad hoc committees. [26]

IV. Proposed amendments

Currently Rule 2019 states that "every entity or committee representing more than one creditor or equity security holder. . .shall file a verified statement setting forth" their economic interests. [27] The proposed amendments are simple. They will require "disclosure by all committees or groups that consist of more than one creditor or equity security holder, as well as entities or that represent more than one creditor or equity security holder. [28] It also authorizes the court to require disclosure by an individual party in interest when knowledge of that party's economic stake in the debtor would assist the court in evaluating the party's arguments." [29] In essence, not only represented traditional committees would be subject to the disclosure rules, but also ad hoc committees. [30]

V. Solution

Striking equilibrium between disclosure and non-disclosure presents a problem. If we don't allow disclosure, then we might be teetering with the survival of large companies when they can be a going concern after reorganization. On the other hand, if we allow too much disclosure then we might be putting a cap on liquidity to distressed securities. As mentioned earlier, sometimes investors buy securities in distressed companies if they view those companies as undervalued. Not only does the company that's sitting on the line of bankruptcy need more liquidity in their security, but also the creditor selling the security would sometimes rather sell their security to an interested third party than risk getting less back on their claims through bankruptcy. If we require too much disclosure, then this could potentially decrease the demand on these securities by interested third parties.

Any attempt to reach equilibrium between these two schools of thought would require concessions on both sides of aisle. A sensible solution would be to have confidentiality agreements in place before an ad hoc committee gives in to disclosure. These confidentiality agreements would not be displayed to the public and would preserve the confidential nature of these investors trading secrets. Another solution could be to require a closed-door disclosure before disclosures are made to all the parties in a bankruptcy proceeding. More specifically, the presiding judge could hold a private hearing in which he will determine if the economic interests of one party need to be disclosed. Subsequently, we could pass discretionary standards bankruptcy judges would need to adhere to when deciding whether or not disclosure is needed. This would prevent discretionary abuse by the presiding judge.

VI. Conclusion

Rule 2019 presents a valid problem in business reorganization cases. There are many interested parties to the process that have competing claims. Striking an equitable balance between these two parties would unquestionably require them to meet in the middle. The parties fighting for non-disclosure must be open to some form of disclosure, confidential disclosures at the bare minimum. The parties fighting for disclosure must be open to disclosures with confidentiality strings attached.

[1] In re Washington Mut., Inc., 419 B.R. 271, 277 (Bankr.D.Del. 2009).

[2] *Id.*

[3] Alexander L. Sparkle, *The Rule 2019 Battle: When Hedge Funds Collide With The Bankruptcy Code*,73 BROOK. L. REV. 1411, 1418(2008).

[4] *Id.*

[5] *Id.*

[6] *Id.*

[7] Daniel J. Bussel, *Coalition-Building Through Bankruptcy Creditors' Committees*, 43 UCLA L. REV. 1547, 1556 (1996).

[8] Sparkle, *supra* note 3.

[9] Sparkle, *supra* note 3, at 1419

[10] *Id.*

[11] *Id.*

[12] Sparkle, *supra* note 3, at 1460

[13] *Id.*

[14] Megan McArdle, *Do We Hare Credit Default Swaps ForThe Wrong Reasons?*, THE ATLANTIC, Apr. 17th 2009, *available at*http://www.theatlantic.com/business/archive/2009/04/do-we-hate-credit-default-swaps-for-the-wrong-reasons/16296/

[15] Matthew Phillips, *The Monster That Ate Wall Street*, NEWSWEEK, Sept. 27th 2008, *available at*http://www.newsweek.com/id/161199

[16] *Id.*

[17] Ilan D. Scharf, *Show And Tell: Ad Hoc Committees' Rule 2019 Disclosures Under Examination*, 28AM. BANKR. INST. J. 58, 58 (2009).

[18] McArdle, *supra* note 14.

[19] *Id.*

[20] Henny Sender, *CDS derivatives are blamed for role inbankruptcy filings*, FINANCIAL TIMES, Apr. 17th 2009, *available at*http://www.ft.com/cms/s/0/12f16208-2ae6-11de-8415-00144feabdc0.html?nclick_check=1

[21] Scharf, *supra* note 17.

[22] *Id.*

[23] In re Premier International Holdings, Inc., et al., No.09-12019 (Bankr. D. Del. 01/20/10).

[24] *Id.*

[25] *supra* note 1.

[26] *Id.*

[27] 11 U.S.C. § 2019(a)

[28] *Pending Rules Amendments*, US Courts (Effective Dec. 1, 2011) *available at* http://www.uscourts.gov/rules/newrules6.htm

[29] *Id.*

[30] Bob Eisenbach, *With Revisions To Bankruptcy Rule 2019 Under Review, A Second Delaware Bankruptcy Decision Goes The Other Way On Whether The Rule Requires Informal Committees To Disclosure Their Trades*, INTHE (RED), JAN. 27TH 2010, A*VAILABLE AT* HTTP://BANKRUPTCY.COOLEY.COM/2010/01/ARTICLES/BUSINESS-BANKRUPTCY-ISSUES/WITH-REVISIONS-TO-BANKRUPTCY-RULE-2019-UNDER-REVIEW-A-SECOND-DELAWARE-BANKRUPTCY-DECISION-GOES-THE-OTHER-WAY-ON-WHETHER-THE-RULE-REQUIRES-INFORMAL-COMMITTEES-TO-DISCLOSE-THEIR-TRADES/

KEEPING THE CHICAGO CUBS SPRING TRAINING FACILITY IN ARIZONA

I. Introduction

The Chicago Cubs are the highest drawing baseball team in the Arizona Cactus League [1] and earn nearly $52 million for the state of Arizona annually. [2] The team's current deal with Mesa, Arizona allows the Cubs to buy out of its agreement to play in Mesa after 2012. [3] As a result, the Cubs have received pitches from groups in both Arizona and Florida trying to persuade them to choose their state for the site of their new spring training facility. In January, the Cubs and the city of Mesa, Arizona signed a memorandum of understanding which gave the city the exclusive right to negotiate an agreement for a new Spring Training facility for the Cubs. [4] Initially, an Arizona House committee proposed legislation that would approve a $1 surcharge on auto rentals in the Phoenix area and an 8 percent surcharge on the tickets to all Cactus League games in order to fund the new facility. [5] In the current economic times, the idea of taxing citizens to build a baseball stadium may strike out in the minds of citizens in Arizona. However, proponents for the project will likely argue that as other tax incentives that attract businesses help to fuel local economies and create jobs, keeping the Cubs in Mesa, could do the same thing. [6] This raises two significant issues. First, do stadiums actually have these positive results for local economies or do they benefit another party? And second, in light of recent case law, is a tax incentive for the Cubs to stay in Arizona a constitutional option?

II. Background

The Chicago Cubs have had their spring training facilities in Arizona since the 1950s and at the current location since 1979. [7] With their current deal ending in 2012, and new ownership in place, the Cubs are looking for 120 contiguous acres, a stadium with seating capacity for at least 15,000, six practice fields, sufficient parking, and a training complex that could be used eleven months out of the year. [8] Major League Baseball has two spring training leagues, one in Arizona and another in Florida. Arizona has proposed a publicly funded plan and Florida has proposed a privately funded plan. As mentioned, the Cubs are the highest drawing team in Arizona, raising an estimated $52 million per year, compared with the Boston Red Sox, one of Florida's most popular teams, that draws only $24 million a year for Florida. [9]

A website dedicated to bringing the Cubs to Florida, floridacubs.com suggests that brining the Cubs to Collier County, Florida would increase tourism, add revenue to local businesses, improve property values, and be a "priceless community asset." [10] The privately funded training facilities would be located in "Wrigley Village," which would have beach access and room for hotels and restaurants as well. [11] Craig Bouchard, who is part of the private group trying to persuade the Cubs to call Collier County their new spring training home, originally thought the idea was a long shot and that it was not possible. [12] Now however, it seems like it could be very possible, or at least now Arizona has legitimate competition.

The idea of a private group and a local government competing to finance a stadium is a new phenomenon as public financing for professional sports stadiums have not always been the norm. [13] However, since roughly the 1950's many

stadiums have received funding from taxpayers. [14] As previously mentioned, politicians have justified public funding for stadiums because of the economic benefits a new stadium are commonly thought to create. [15] Two studies of the public benefits of stadium projects seemed to show mixed results based on where the facility is located. [16] However, generally the studies concluded that constructing sports facilities do not produce the expected economic benefits to the cities. [17] The benefits, however, can clearly be felt by the owners. The owners of the team increase the value in their team when they can generate net revenues. [18] It is not hard then to see that a new stadium would increase the revenues for the owners. However, without proof that new stadiums benefit the public, it may be hard to argue that private owners should be the sole party reaping the benefit from the public's financing for their stadium. Although sports fans may appreciate the nicer stadiums, people who are not sports fans may find no benefit.

In addition to changes in the way stadiums have been funded, a recent court decision has given a new perspective on the way state and local governments may encourage companies to increase investment in their jurisdiction. The Sixth Circuit in *Cuno v. Daimlerchrysler, Inc.*, held that the State of Ohio's investment tax credit was unconstitutional because it attempted to interfere with interstate commerce. [19] The investment tax credit in *Cuno*, provided a credit of 13.5 percent against the state corporate franchise tax for certain investments. [20] The tax credit unfairly discriminated against interstate commerce because it pressured companies to investing in Ohio. [21] Specifically it held this way because it provided for differential treatment of in-state and out-of-state economic interests that benefits in-state interests over out-of-state interests. [22] Prior to this decision, an economic-development benefit granted to a business or industry, in the form of a tax credit, granted to a business was not

questioned on federal constitutional grounds. [23] A practice that once seemed completely acceptable has been called into question. Nearly every state has enacted tax incentives to attract business to their state. [24] However, the Sixth Circuit's decision seems to have put a "cloud over billions of dollars of tax incentives." [25]

III. Analysis

In considering whether to finalize a deal with the Chicago Cubs, Arizona should consider if the project will be beneficial to its citizens and then if the proposed tax is a feasible option to fund the project. First, the Arizona legislature is in a better position than other state and local governments to determine whether building a new spring training facility would be beneficial to its citizens, because the Cubs have played in Arizona in the past. The current proposed memorandum of understanding, requires the Cubs to acquire the land to build the stadium and to maintain and operate the stadium, parking, and public access roads surrounding the stadium. [26] Also, if the construction costs exceed $84 million, the Cubs would cover the excess. [27] Arizona, therefore need only to secure legislation to finance the project, and compare these costs to expected yearly revenue. If it is anything close to the estimated $52 million a year proposed, it would not take long to earn back the money spent. As previously mentioned Arizona could determine how much revenue the Cubs would generate and then make its decision on how much to invest in keeping the Cubs in Arizona. This decision may also be influenced by how much the private group from Florida, is willing to invest in pulling the Cubs out of Arizona. Currently, the exact details of what the private group would offer the Cubs are not as clear as Arizona's proposal. If the current memorandum of understanding does not result in a deal, Florida may be able to

provide an even better deal. In Florida, however, the deal would not be at the expense of public taxpayers.

While Arizona may be able to determine if their proposal would be profitable, as a result of the Floridian proposal, it may not be the most profitable. When multiple jurisdictions are making bids for a business, industry, or in this case a team, the value received by the chosen jurisdiction may be the victim of a "race to the bottom." This situation provides limited opportunities for state and local governments to encourage baseball teams to locate their spring training facilities in Arizona or Florida, because teams may only choose between two states. Also, as previously mentioned, the private group from Florida thought that the Cubs may not have even thought to leave and intriguing Florida to enter the picture could have been intended to just get the Cubs a better deal from Arizona. However, when fifty states are competing for a company to carry on business in their state, there may be far more bidders. This bidding could greatly reduce the benefits citizens reap as states compete to give companies better and better deals. This situation is likely to appear in areas where teams can choose between a greater numbers of locations. States may want to work together to prevent the possible abuse by sports teams or businesses that may occur as a result of state and local governments encouraging teams or businesses to relocate. While this suggestion may have less applicability in the sports world, it could have a greater impact in preventing businesses from taking advantage of state and local governments to provide them an unreasonable deal for its citizens. With regards to the question of whether or not funding a new stadium through tax dollars would violate the Constitution, it appears as though, like Ohio, Arizona is pressuring a company to do business in its state by giving them a deal they may not be able to get by not investing in Arizona. However, with regards to the Cubs efforts to build a spring training facility in Arizona versus the tax incentive

given to Daimlerchrysler in Ohio, it is important to note some differences. The tax credit offered in Ohio would reduce a company's tax liability. While in Arizona, the taxes would be collected from consumers. Unlike the credit in Ohio, the impact would be felt by consumers rather than businesses. Similarly, the Cubs are also not necessarily receiving any tax benefit at all, and are instead just receiving a benefit resulting from the tax. As the Cubs are the only business offered this benefit, it makes it even less possible that the tax could force other companies to do business in Arizona. As a result, it does not appear as though it would favor businesses located inside Arizona over businesses located outside of Arizona.

While the tax itself may not favor in-state companies over companies outside of Arizona, it could possibly be argued that such a tax would favor its own citizens. This may be the case because the impact of a tax on auto rentals would be shared disproportionately by people visiting Arizona from outside of the state. The added cost to ticket prices would be less likely to have the same impact. Arizona residents and all others to attend the games would share the cost to attend any spring training game. A tax that is primarily felt by residents of Arizona would not raise the same discriminatory constitutional issues raised in *Cuno*. A state decision that discriminates against its own citizens is better challenged by electing new legislators. Additionally, given that the tax would likely result in significant revenue exceeding the amount of tax charge to its citizens, it appears that the only better way would be to find a plan that does not involve a tax at all. Given, the net beneficial impact of an increase in ticket price, this appears to be a very good option for Arizona to fund a new Cubs spring training facility.

IV. Recommendation

The incentive of building a spring training facility for the Chicago Cubs does not appear to have the same ill effects that other tax incentives have when encouraging businesses to do business in a state. Arizona can also make a more informed decision with regards to convincing the Chicago Cubs to stay in whether or not it will be beneficial to its citizens. To further avoid the possibility that the tax be determined to be unconstitutional, Arizona should also consider raising all of the funds necessary by its increase in ticket prices. This will also have the effect of putting the burden on those most likely to make use of the new facility. As public funding for a recreational purpose is not at the top of everyone's list right now, the best option for Arizona would be to create a solution that does not require public funding. However if this is not possible increases in prices to see a popular team should be incurred by those likely to enjoy the improvements.

V. Conclusion

Arizona should build the Chicago Cubs a new spring training facility as doing so does not appear likely to have the negative impacts that other tax incentives for businesses or poor decisions to build stadiums in other places have had.

[1] Carrie Muskrat, *Clubs, MLB Prefer Different Cubs Financing,*MLB.COM, Feb. 18, 2010, *available at*http://mlb.mlb.com/news/article.jsp?ymd=20100218&content_id=8089818&vkey=news_chc&fext=.jsp&c_id=chc&partnerId=rss_chc.

[2] Carrie Muskrat, *Naples Serious Player in Wooing Cubs,* MLB.COMNov. 11, 2009, *available*

*at*http://chicago.cubs.mlb.com/news/article.jsp?ymd=20091111&content_id=7654274&vkey=news_chc&fext=.jsp&c_id=chc.

[3] *Id.*

[4] Muskrat, *supra* note 1.

[5] *Id.*

[6] Susan Gaffney & Barrie Tabin Berger, *Protecting Tax Exempt Bonds and Tax Incentives: A Recent Appeals Court Decision and the Ongoing,* ENTREPRENEUR, Aug. 2005, *available at*http://www.entrepreneur.com/tradejournals/article/135564957.html.

[7] *Mesa v. Naples – Cubs Spring Training Battle Alive & Kicking,*MYCUBSTODAY.COM Nov. 1, 2009, *available at*http://www.mycubstoday.com/2009/11/01/mesa-v-naples-cubs-spring-training-battle-alive-kicking.

[8] *Id.*

[9] *Update: Future Spring Training Site – Arizona v. Florida,*MYCUBSTODAY.COM Jan. 14, 2010, *available at*http://www.mycubstoday.com/2010/01/14/update-future-spring-training-site-arizona-v-florida.

[10] *Bringing the Cubs to Florida – Announcements,*FLORIDACUBS.COM, *available at*http://floridacubs.com/dnnuke/Announcements.aspx.

[11] Muskrat, *supra* note 2.

[12] Muskrat, *supra* note 2.

[13] Gregory W. Fox,Note, *Public Finance and the West Side Stadium: The Future of Stadium Subsidies in New York,* 71 BROOKLYN L. REV. 477, 478 (2005).

[14] *Id.*

[15] Gaffney & Berger, *supra* note 4.

[16] Mildred W. Robinson, *Public Finance of Sports Stadia: Controversial But Permissible … Time for Federal Income Tax Relief for State and Local Taxpayers,* 1 VA. SPORTS & ENT. L.J. 135, 139 (2002).

[17] *Id.*

[18] *Id.*

[19] Cuno v. Daimlerchrysler, 386 F.3d 738, (6th Cir. 2004).

[20] *Id* at 741.

[21] *Id* at 748.

[22] Kristen E. Hickman & Sarah L. Bunce, *Symposium:* Daimlerchrysler v. Cuno *and the Constitutionality of State Tax Incentives for Economic Development: Foreword:* Daimlerchrysler v. Cuno, 4. GEO. J.L. & PUB. POL'Y 15, 22 (2006).

[23] Gregory A. Castanias, *National Movement Against Economic-Development Incentives Makes Inroads in the Sixth Circuit and Raises Questions About Similar Incentives Elsewhere*, JONES DAY (Jones Day, Washington, D.C.), Feb.2005, *available at*http://www.jonesday.com/newsknowledge/publicationdetail.aspx?publication=1089.

[24] WALTER HELLERSTEIN, KIRK J. STARK, JOHN A. SWAIN, AND JOAN M. YOUNGMAN, STATE AND LOCAL TAXATION: CASES AND MATERIALS162 (2009).

[25] *Id.*

[26] *Cubs Mulling Over Proposal from Mesa, Arizona for Future Spring Training Site*, MYCUBSTODAY.COM Jan. 23, 2010, *available at*http://www.mycubstoday.com/2010/01/23/cubs-mulling-over-proposal-from-mesa-arizona-for-future-spring-training-site.

[27] *Id.*

MICROCREDIT PART 2

Application of Microcredit in the United States

Introduction:

In my last segment, I introduced the concept of microcredit and explained it's basic foundations. As I explained before, micro-credit is one such way in which stimulating development from below in the societal totem pole also serves to advance democracy and human rights.[1] Now I will put the system into perspective and confront the issues and problems of applying such a system to the United States. The United States in any given year has 10% to 17% living below the poverty threshold as determined by the US Census.[2] This number translates to about 30-40 million individuals. Furthermore, most Americans (58.5%) will spend at least one year below the poverty line at some point between ages 25 and 75.[3]These statistics seem to suggest that a microcredit system established in the United States would be very successful. However this is not the case. Despite the success of microcredit in other countries such as India, the adoption of this system of lending has not caught on as much in the United States.[4]

One of the earliest attempts at applying the concept of microcredit to the United States was when in 1985, Bill Clinton was governor of Arkansas and heard of Muhammed Yunus's work in India. However, the program, called the Good Faith fund, failed, because "the group lending model never caught on." Since then, dozens of similar attempts have been made, and while many have been successful, the scale pales in comparison to that of Bangladesh and other developing countries.[5]

Current situation

Currently the poor in the United States often turn to fringe financial groups, such as payday lenders or loan sharks who can charge interest rates of up to 400 percent annually. The Consumer Federation said the volume of payday loans has almost doubled to $48 billion in the past five years.[6] Traditional banks generally do not provide financial services or loans to individuals with little or no cash income or other forms of collateral.[7] Grameen America charges 15 percent interest but on a declining balance basis, which means that the effective rate is closer to 7.3 percent towards the end of the loan's term.[8] However to qualify for such a loan, under the microcredit system, borrowers must get together in groups of five people and if one person misses a weekly repayment or defaults, the whole group advances more slowly.[9]

Failure in current applications

So far, the results have been mixed when it comes to applying microcredit to present day society in America. The microcredit programs presently in place have generally not been self-sustaining, and they have been much less successful in preventing defaults on loans.[10] In part, this is a result of how the programs have been targeting populations (some focus more on new entrepreneurs or the unemployed, instead of individuals running small, but undercapitalized, enterprises). However, it is also in part because some of the tools used in developing countries where microcredit methods were first devised are not appropriate in all U.S. contexts.[11]

Many programs have suffered because of difficulty in understanding who they are trying to help. Many lenders also have had difficulty using the tools

developed originally for microcredit in poorer countries to manage the riskiness of their loans in the United States. In particular, these programs had problems when integrating peer groups into lending in lieu of tangible collateral.[12]

Many programs have also had difficulty crafting appropriate technical and training materials. In some cases, programs require training that is inappropriate for some borrowers. This is particularly the case for established businesses who need working capital to quickly take up an opportunity or deal with an immediate crisis.[13]

How to fix the problem

The most important element for success in a microcredit program is to have a clear understanding of who the target population is that you're trying to help, and what their specific needs are. Given a close and detailed knowledge of the target population, the lender can begin tailoring loans to the specific needs of different borrowers. For example, ACCION offers a stepped loan package that increases loan sizes based on demonstrated payback records and increasing capacity to absorb debt. After a self-evaluation, ACCION also began offering moderately larger loans to single borrowers (that is, borrowers not part of a peer group) who were already engaged in growing micro-enterprises, but who still have trouble accessing traditional credit. [14]Often times, borrowers need a place in which they can save their money in addition to getting loans. If a potential microcredit organization wants to succeed in the United States, they have to realize that building a relationship through microcredit can allow lenders to establish a deeper level of connection with their customers. This would allow organizations to provide advice and assistance to the borrower in savings which would further secure their financial situation.[15] Lenders can also benefit from

focusing more narrowly on these credit and savings services, and offering training and technical expertise through partners who specialize in those programs. Because these are different activities, both groups may be more successful if they can focus on one aspect, and work together to bring improvements to their respective services to their clients.[16]

Conclusion

As long as microcredit organizations in the United States can focus on the needs of the public who require their services, the problems that other countries have faced will not be repeated. The organizations must realize that they are not just another banking or lending organization. If they think this way, then their actions will be no different from traditional banks or loan sharks. Only when a deeper and more personal connection is established by these lending organizations can they succeed in a country where people are not used to good will in monetary lending situations such as the United States.

---

[1] Press Release – Nobel Peace Prize 2006 (Oct. 13, 2006) *available at* http://nobelprize.org/nobel_prizes/peace/laureates/2006/press.html

[2]Poverty 2005 Highlights (Sep. 29, 2009) *available at*http://www.census.gov/hhes/www/poverty/poverty05/pov05hi.html

[3]Hacker, J, "The great risk shift: The new insecurity and the decline of the American dream," *Oxford University Press* (2006).

[4]Muhammad Yunus, *Expanding Microcredit Outreach to Reach the Millennium Development Goal-Some Issues for Attention*, (2009)*available*

at http://www.grameen-info.org/index.php?option=com_content&task=view&id=218&Itemid=172&limit=1&limitstart=0

[5]Posner, Andy, *A Solution to the Limited Success of Micro-Credit in the United States?,* (2009) *available at*http://www.andyposner.org/index.php/posner/blog_main_comments.

[6]Sharmila Devi, *Grameen Bank offers Microcredit in New York,* 2008, *available at* http://www.thenational.ae/article/20080419/FOREIGN/509398152

[7]ING CR – Microfinance,http://www.ingforsomethingbetter.com/our_story/business/microfinance_/(last visited Nov. 9, 2009).

[8]*Id.*

[9]*Supra* at note 6.

[10]Gregory Claxton, *Microcredit Strategies for Assisting Neighborhood Businesses,* 2005 *available at*http://www.umich.edu/~econdev/microcredit/

[11]*Id.*

[12]*Id.*

[13]*Id.*

[14]*Id.*

[15]Nitin Bhatt and Shui-Yan Tang, "Making Microcredit Work in the United States: Social, Financial, and Administrative Dimensions,"*Economic Development Quarterly,* vol. 15, no. 3 (2001).

[16]*Id.*

THE BUSINESS OF STEROIDS IN BASEBALL

Introduction

For the past decade Major League Baseball has been forced to deal with the fact that at least one hundred of its players have been linked to steroid use, with the actual number probably far greater than that. [1] The Mitchell Report, an independent investigation into the illegal use of steroids in Major League Baseball done by George Mitchell of DLA Piper, alone uncovered forty seven players who have used steroids. [2] Surprisingly, steroids were not added to Major League Baseball's banned substance list until 1991, and testing of major league players did not begin until the 2003 season. [3] While the use of steroids and other performance enhancing drugs may be inherently wrong to some because of baseball's almost holy status of "The American Pastime," their use may also have strictly economic implications for players and Major League Baseball alike.

Steroid Use and the Economic Impact on Players

Setting aside ethical considerations, a player has the choice between using steroids and possibly increasing his production, but risk being caught, versus not using steroids and possibly sacrificing millions of dollars. Analysis done on the increase in offensive production with the use of steroids found that a player's OPS, a combination of a players on-base percentage and their slugging percentage, increased on average .104. [4] This is a significant increase considering an OPS of .900 is generally recognized as the elite cutoff level, with players like Ken Griffey Jr. having an OPS of .947. [5] Also, additional analysis done on a player's OPS and its impact on potential salary found that an increase

in OPS of .100 leads to a salary increase of $2 million. [6] With the average career of a major league baseball player lasting six years, using steroids can increase a player's total salary by $12 million. [7] Which such a powerful incentive, it is easy to see why many players have been tempted to use steroids. On the other hand, some argue that the use of steroids leads to an increase in the number and severity of injuries, thereby shortening a career and negating the benefits gained from steroids. "The principal reason for baseball injuries associated with steroid use is that the increase of muscle mass or increased speed associated with anabolic steroid use is not accompanied by a proportionate increase in strength of the tendons, ligaments and joints."[8] The types of injuries seen in baseball today result from muscles ripping away from tendons and joints that can no longer support them, which was typically not seen years ago. Although the negative effects of steroids are widely known, the use of Human Growth Hormone (HGH) may allow a player to realize the gains from steroids without incurring the costs. In the medical world, HGH is a post-operative recovery tool which helps patients with rehabilitation, while in the baseball world HGH allows players to recover faster, play longer, and is seen as more of a performance enhancer. [9] The combination of steroids and HGH allow a player to gain all that muscle mass with the steroids, while simultaneously increasing the size and strength their joints." [10]

Not only does HGH make the use of steroids more attractive by reducing the health concerns associated with them, but players are not even tested for HGH in Major League Baseball because league officials are skeptical about the validity and reliability of existing tests. [11] That all changed in February 2010 when a British rugby player became the first athlete publicly identified as having tested positive for HGH. [12] This prompted Major League Baseball officials to implement testing for HGH in the minor leagues. [13] Whether or not HGH

testing will be implemented in the Majors in years to come, and how this will affect the use of steroids, remains to be seen. Leaving ethical and moral considerations out, economically speaking it is easy to see why many Major League Baseball players have been tempted to use steroids. Using steroids can mean an additional $12 million, and with HGH reducing the health concerns, the incentive is even stronger. This simple cost-benefit analysis shifted dramatically in November 2005 when new penalties for steroid use were enacted. The first positive test is a fifty game suspension, second is a one hundred game suspension, and the third positive test is a lifetime ban from the sport. [14] Still, greed is a powerful motivator and these stricter penalties may just force a player to be more careful not to get caught.

Steroid Use and the Economic Impact on the League

Players are not the only group who stand to benefit from the use of steroids. "While franchise values fell during the early 90's, they increased dramatically during the Steroids Era, with the average MLB franchise value rising from $140 million in 1994 to $332 million in 2004." [15] In fact, steroids may have saved baseball after the 1994-1995 strike, which angered fans and resulted in attendance dropping by almost 10 million in both the National and American leagues. [16] .[16] It was not until Mark McGwire and Sammy Sosa's 1998 steroid fueled homerun race that the League began to recover. "Attendance in 1998 increased to almost 39 million in the National League, up seven million from the season before, and the fact is, the increase of almost seven million fans coincided with an increase of almost 400 home runs in the sport." [17] Despite Major League Baseball's current tough stance on steroids, individual franchises clearly had incentive to look the other way with regard to steroids in the mid-90's.

Conclusion

Rather than thinking about steroids as illegal and immoral drugs, it is interesting to think of steroids as high-risk, high-reward investments. Analyzing steroids in this manner provides insight into why every month it seems a new player has been implicated for using steroids, and why the League and individual franchises seemed oblivious to the rampant use of steroids in the mid-90's. Whether the cost of tougher penalties and increased testing can overcome the benefits, namely the millions of dollars a player stands to gain from using steroids, remains to be seen.

[1] *Players Linked to Steroids and Human Growth Hormone (HGH),* BaseballSteroidsEra.com,http://www.baseballssteroidera.com/bse-list-steroid-hgh-users-baseball.html .

[2] The Mitchell Report. MLB.com,http://mlb.mlb.com/mlb/news/mitchell/index.jsp (last visited Mar. 14, 2010).

[3] Mitchell Grossman, "Steroids and Major League Baseball,"http://faculty.haas.berkeley.edu/rjmorgan/mba211/Steroids%20and%20Major%20League%20Baseball.pdf .

[4] *Id.*

[5] *MLB: OPS – What Does it Mean?*, Buzzle.Com, http://www.buzzle.com/editorials/4-18-2001-3026.asp (last visited Mar. 14, 2010) .

[6] Grossman, *supra* note 3.

[7] *Id.*

[8] *The Correlation Between Steroids and Injuries in Baseball*, TheSteroidEra.com, Aug. 2006, http://thesteroidera.blogspot.com/2006/08/correlation-between-steroids-injuries.html.

[9] Tom Farrey, HGH: Performance Enhancer or Healer?, ESPN the Magazine, Sept. 2006. http://sports.espn.go.com/espn/news/story?id=2574291 .

[10] *The Correlation Between Steroids and Injuries in Baseball*, *supra*note 8.

[11] Michael S. Schmidt, *Baseball Plans to Test for HGH in Minors*, N.Y. Times, Feb. 2010.http://www.nytimes.com/2010/02/24/sports/baseball/24hgh.html .

[12] *Id.*

[13] *Id.*

[14] *Steroid Penalties Much Tougher With Agreement*, Nov. 2005. ESPN.com http://sports.espn.go.com/mlb/news/story?id=222483

[15] Grossman, *supra* note 3.

[16] Lucas Mayer, *How Steroids Saved Baseball*, Feb. 2010.http://iusportcom.com/2010/02/08/how-steroids-saved-baseball/ ,

[17] *Id.*

A VALUE-ADDED TAX: WHO IS THE JOKE ON?

It has been said that a value added tax (VAT) will not pass because liberals fear it is regressive and conservatives fear it will increase the size of the federal government. "However, the joke continues, a VAT will be passed when liberals recognize that it could be a money machine and conservatives recognize that it is regressive." But are the terms of the joke accurate? Would enacting a vat be trading a regressive tax for more government?

I. What Is a VAT

There is more than one way to implement a VAT and the intricacies of such implementation are beyond the scope of this article. Suffice it to say, a VAT imposes taxes at every level of production so that all taxes have been paid by the time the good reaches the consumer. This method of taxation gives each producer a tax credit equal to the tax levied on his portion of the production. Because the taxes are built into the price of the final good purchased by a consumer, the consumer pays no additional tax at the cash register and receives no corresponding credit. Though it sounds complicated, a VAT is actually quite simple and better explained with an example.

Alan owns a wheat farm and buys seeds for ten dollars. When Alan harvests his wheat and sells it to Bob for 110 dollars the government imposes taxes on the 100 value Alan added (110 – 10) but gives him a corresponding deduction for that tax; that is, at the end of the process Alan will not pay taxes. Bob takes the wheat and makes beer which he sells to Carl for 1000 dollars. Bob is taxed on the 900 dollar value he added, but like Alan, Bob is given a credit to offset this tax burden. When Carl buys the beer form Bob he

pays 1000 dollars and is not charged any additional tax at the register – because the tax is built into the price of the beer – and Carl gets no tax credit.

Essentially, a VAT imposes taxes on the value the business adds to the good or service he sells. Notably, when the consumer purchases the good he will pay the price on the good, not the price of the good plus an additional tax.

II. Effects of a VAT

It is difficult, if not impossible, to divide the effects of a VAT into categories of advantages and disadvantages because, as illustrated by the joke above, one person's advantage is another's disadvantage. Increasing government revenue or equality may be seen as an advantage to some while they may be viewed as a disadvantage to others. However, it might be possible to conclude whether a VAT would be a tradeoff between a more regressive tax system and more government intervention.

A. Would a VAT be Regressive?

At first glance, a VAT appears regressive. Wealthier people consume proportionately less of their income while less wealthy people may consume all or almost all of their income. However, people tend to consume about how much they earn so over a lifetime a VAT tends to be a lot less regressive than one might think. More importantly, one should start an analysis of whether a VAT would be regressive by asking: to what are we comparing a VAT? In the United Sates corporate and personal income taxes are progressive while payroll and excise taxes are regressive.

A second integral part of analyzing how regressive a VAT would be is defining what would be subject to the VAT. It is likely that if Congress passed a VAT, it would create a zero tax designation for a number of goods frequently purchased by low-income people. It is also possible that Congress would create a flat exemption for the VAT which might be aimed at alleviating a certain level of spending from the VAT thus insulating low-income Americans from the effects of a VAT.

Additionally, Congress might target small business for exemption from a VAT (partially due to high administrative costs). While the point of taxation is to raise revenue for the government, exempting small businesses, which are the "engine of job growth in America," would be politically popular while the specter of raising taxes on small business might be considered a political nonstarter, so this is a likely possibility. Importantly, exempting small business might relieve them from compliance cost which would make a VAT less regressive.

Finally, changing from our current system to a VAT would change incentives for saving. The current system in the United States taxes a person's savings twice: once when he earns money and a second time when his savings earns interest. Clearly this double taxation dissuades Americans from saving. However, a VAT would create an incentive to save. Recently, the personal savings rates of Americans has been cause for concern as the personal saving rate dipped into the negative for the first time ever in 2006. However, while it might have been wise to remove disincentives to personal savings in the past, it might be unwise to create incentives to save during a recession when the government needs people to spend their money. In terms of how regressive a VAT would be, it would create an incentive to save but that incentive could only be acted upon by individuals wealthy enough to have disposable income. At the same time, and mentioned above, in the long run individuals tend to spend the

money they earn so the effect on savings might be overstated.

Simply put, whether a VAT would be regressive is a bit more complicated than one might think.

B. Would a VAT Increase the Size of Government?

Whether a VAT would increase the size of government, at least partially, depends on if the VAT increases revenue, which in turn depends on the rate of the VAT, the spending habits of consumers, and the exemptions provided for by Congress. These variables are difficult to assess but two consequences for government of a implementing a VAT are noteworthy.

A VAT will decrease a consumer's association between taxes and increased costs because taxes are built in to the price of the good. When a consumer takes a good to a cash register he will only see the price he pays for, essentially eliminating the ability to take into account the cost of the good added by taxes. This disassociation will make it easier for government to raise taxes in the future because consumers will be less likely to notice the increase or if they notice the increase consumers will be less likely to blame government. Shrouding government taxes through a VAT makes it less likely that people will notice or oppose tax increases which might make it easier for government to grow.

This change in how consumer will assess the role of taxes in the price of a good has a corresponding upside: it makes collecting taxes less politically contentious (a problem noted by above) which might in turn help the government avoid a situations like California's current budget crises in which revenue cannot be raised without a referendum. Clearly, for proponents of smaller government

the way to avoid government growth would be to cut expenditures but a VAT might still help avoid a political stalemate.

Second, and related, consumers are better able to assess the cost of goods and therefore better able to make good decisions. That is to say, not having taxes add at the register and removing the possibility of owing the government taxes at the end of the year better equip a consumer to make smart choices.

III. Conclusion

Like most tax issues the VAT is complex. VATs are difficult to assess in the abstract because the "devil is in the details." However, two conclusions are worth making. First, VATs might not be as regressive as one might think because of life-time spending habits and thus the difference between our current tax system and a VAT might be "less than commonly imagined." Additionally, there are ways to implement a VAT that would minimize how regressive it might be in the short-term. Second, while a VAT hides taxes within the cost of a good and thus might make it easier to raise taxes, it also makes a consumer's choice better informed and therefore more efficient.

If liberals choose to oppose a VAT it should not be because it is necessarily regressive and if conservatives choose to oppose a VAT it should not be because it necessarily will grow government.

Endnotes:

[1] Gilbert E. Metcalf, *Value-Added Taxation: A Tax Whose Time has Come?* 9 JOURNAL OF ECONOMIC PERSPECTIVES 121, 123 (1995).

[2] Two common types of VATs are the subtraction method and the credit method. "Under a subtraction method VAT,
a business deducts business purchases, including capital outlays, from sales and pays tax on the difference. A subtraction method VAT, sometimes called a business activities tax (BAT), differs from a single-rate credit method VAT only in computation procedure, and the two taxes produce the same revenue if imposed at the same rate." J. Clifton
Fleming, Jr., *Sorting out the Uncertain*
Simplification (Complication?) Effects of VATs, BATs and Consumed Income Taxes
2 FLA. TAX REV. 390 (1995).

[3] *Id.*

[4] John K. McNulty, *Flat Tax, Consumption Tax, Consumption-Type Income Tax Proposals in the United States: A Tax Policy Discussion of Fundamental Tax Reform* 88 CALIF. L.
REV. 2095, 2147 (2000).

[5] *Id* at 2148; *see also,*
Gilbert E. Metcalf, *supra* note 1; see
also, Joseph Bankman and Barbara H. Fried, *Winners and Loser in the Shift to a Consumption Tax* 86
GEO. L.J. 539, 546-47 (1998).

[6] John K. McNulty, *supra* note 4.

[7] Sean Raft, *Imagining a Progressive and Comprehensive Consumption Tax* 86 OR. L. REV. 161, 177 (2007).

[8] Gary Chartier, *A Progressive Case for a Universal Transaction Tax* 58 ME. L. REV 1, 7 (2006).

[9] Gilbert E. Metcalf, *supra* note 1.

[10] Jesse Lee, "The Engine of Job Growth in America" White House Blog, *available at* http://www.whitehouse.gov/blog/2010/02/02/jumpstarting-small-businesses-engine-job-growth-america.

[11] Barry M. Freiman, *The Japanese Consumption Tax: Value-Added Model or Administrative Nightmare?* 40 AM. U.L. REV. 1265, 1299 (1991).

[12] Michael J. Graetz, *Taxes that Work: A Simple American Plan*58 FLA. L. REV. 1043, 1054 (2006).

[13] Gilbert E. Metcalf, *supra* note 1 at 131.

[14] Bureau of Economic Analysis,
Comparison of Personal Saving in the NIPAs with Personal Saving in the FFAs, http://www.bea.gov/national/nipaweb/Nipa-Frb.asp.

[15] Sean Raft, *supra* note 7 at 198.

[16]
Joseph Bankman and Barbara H. Fried, *supra*
note 5 at 546.

DOING BUSINESS IN THE MIDDLE EAST

I. INTRODUCTION

The Middle East with a fast growing population of over 300 million, abundant supply of natural resources, and governmental efforts aimed at privatizing and expanding country industries has cultivated this region into a growing, lucrative market for U.S. companies. Middle Eastern countries have undertaken globalization efforts to facilitate foreign direct investment and encourage trade with other regions. The economic importance of the Middle East along with these globalization efforts suggests that any U.S. company wishing to become a global business leader should have a presence in this Region.

This article provides an overview as to the state of U.S. investment and business in the Middle East, while detailing some of the industry areas and cultural issues that U.S. companies should consider prior to investing in the Region. The six member states of the Gulf Cooperation Council (GCC), Saudi Arabia, Kuwait, Bahrain, Qatar, Oman, and the United Arab Emirates (UAE) have become important trading partners with the U.S. [1] This article additionally focuses on foreign investment in two of the GCC countries, Saudi Arabia and United Arab Emirates, as well as the issue of Dubai's request for the delay in repayment of bonds announced on November 25, 2009. Furthermore, the article reviews the region as a future force of market opportunity for U.S. companies.

II. BACKGROUND

The Middle East encompasses a variety of cultures as well as being the home of three dominant religions born from this region, Christianity, Islam, and Judaism. To prosper in this region U.S. companies should be culturally sensible to the local customs and norms of the region. Although the countries can vary as to acceptable social norms, the dominance of conservative behavior and traditional values are synonymous in most Middle Eastern countries. Therefore, U.S. companies that have entered or are interested in entering the Middle Eastern market must pay close attention and operate with sensitivity in ways that are not offensive to the public norms of traditional roles for men and women. [2] Additionally, U.S. companies must understand the social interrelations in the Middle East, such as understanding that handshakes are a common form of greeting in the Middle East at the start and end of a business meeting or that interpersonal exchanges with colleagues may vary from accepted norms in the West, especially when Middle-Eastern women are involved. [3] Furthermore, generous forms of hospitality should be expected and accepted from Middle-Eastern business colleagues. [4] Demonstrating sensitivity to cultural norms not only destroys misunderstandings and stereotypes between regions of the world in this global marketplace, but also provides U.S. companies with further opportunities for business relationships with our top trading partners.

In 2009, Saudi Arabia, United Arab Emirates, and Israel were among the top 30 trading partners for the U.S. [5] In addition, various factors demonstrate that the continued expansion of the Middle East means potential growth for U.S. companies in this region. These factors include, a steady growth in people being more interested in U.S./Western culture, which means a larger demand for U.S. products in the region [6]; a greater dependence on U.S./Western Products in countries like Oman, to give but an example, which require imports to predominantly supply its

essential products to their economy [7]; a regional shift towards privatization of state-owned industries; the economic expansion from the predominant industry of oil into technology information and services; and the integration efforts between the countries through free trade agreements and foreign direct investment laws. [8]

Similarly, in 2009, the World Bank reported that, "the Middle East and North Africa picked up the pace of business regulatory reform faster than any other region in a year of global financial uncertainty." [9] In the World Bank's ranking of the ease of doing business in 181 countries, Saudi Arabia ranked #13, while United Arab Emirates jumped from a 47 to a #33 ranking and "became one of the world's 10 most active reformers for the first time by eliminating the minimum capital requirement for business start-ups and simplifying registration." [10]

III. ANALYSIS

The Middle East presents lucrative business opportunities in various industries for U.S. companies to supply their goods and services, including in areas such as finance, manufacturing, technology, and infrastructure. Nonetheless, there are risks in investing within foreign regions. These risks are usually translated in political strife, civil and international conflicts (with Iraq serving as the main location for the past 20 years), and nationalization of industries by the government. In light of these risks, U.S. companies must undertake a due diligence analysis to determine which Middle Eastern countries present the most opportunities by weighing the risks of operating in certain areas of the region and the benefits of doing so. In spite of these risks, certain Middle Eastern countries have modern economies and stable governments that reduce the probability that these risks would ever arise, making them, thereby, a very attractive destination for U.S. investment. Two countries where the risk associated with foreign direct investment has been greatly reduced

are Saudi Arabia and the United Arab Emirates (UAE). Saudi Arabia not only holds the largest oil reserves in the world, but additionally the largest GCC economy. [11]

Saudi Arabia's policies have allowed the expansion of its markets to foreign investment. For example, foreign investors have the ability to repatriate their investments. [12] Also, SA has facilitated a wave of privatization of certain sectors such as, "telecommunications, electricity, and airline industries, postal services, railways, port services, and water utilities," providing U.S. companies a potential market for their goods and services. [13] Furthermore, U.S. companies have an advantage with the use of technology and personnel that assist Saudi Arabia in its desired agricultural expansion, with the ability to use Saudi Arabia government funds through loans to promote agriculture in a mostly desert country. [14]

The UAE also serves as a great example of successful U.S. investment. Indeed, the seven city-states that make up UAE continue as a role model of expanding financial district with its modern skyline, impeccable amenities, and with the one of the most developed economies in the region. The main focus for foreign direct investment in regard to the United Arab Emirates includes its capital city, Abu Dhabi, and the second largest Emirate, Dubai. Although Abu Dhabi functions as the financial stronghold of UAE with over 90% of the country's oil reserves, Dubai has expanded UAE's manufacturing and finance industries. [15] The Jebel Ali Free Trade Zone has become increasingly attractive to U.S. companies as they can expand their businesses in this area without requirement of licensing with the government, enjoy corporate tax exemption, and have the ability to repatriate capital and profits. [16]

Despite all the great economic opulence of the UAE, on November 25, 2009 (or 25/11 as it is commonly known), the beaming economic epicenter known as UAE

took a hit when the state owned conglomerate, Dubai World, requested a delay in repaying US$26 billion in bonds that were coming due. [17] Although this announcement sent fears of market crashes in the Abu Dhabi and Dubai stock exchanges and gloom and doom predictions from some financial analysts, the vitality of this region expects a rebound. As with the world economy the main factor in the Dubai crisis stemmed from its real estate arm, Nakheel, which does not have the cash flow to meet payments due on bonds. [18] Nonetheless, other Dubai companies in various sectors such as port operations, the London Stock Exchange, hotels, airlines, and stakes in buildings around the world support that this city-state has the assets to sell along with potential cash flow in order rebound and grow in the future. [19]

The future for business opportunities continues to be bright in the Middle East despite the effects of the Dubai announcement and subsequent market activity. In February 2010, the Prime Minister of UAE announced a new vision of growth for the country through the year 2021, which included a focus on moderate economic growth, healthcare, and education. [20] Furthermore, although analysts cut 2010 growth forecasts for UAE, the Economy Minister announced an expected growth forecast of 3% in 2010 for the country. [21] The high oil-reserves contribute to the GCC States continued creditworthiness based on Standard & Poor's (S&P), although the rating agency expects further corporate defaults in the region. [22] S&P has slashed GCC' companies ratings based on "deterioration in GCC companies' asset quality among worsening economic conditions and concerns over the impact of debt defaults at Saudi conglomerate Al Gosaibi and Saad Group," as well as due to the Dubai loan delay announcement. [23] In a world economy that is facing similar woes, these issues appear to be more representative of the times versus systematic problems indicating a lack of growth. As demonstrated by the work of the Middle East Council of American Chambers of Commerce, which

represents over 700 U.S. companies doing business in the Middle East, a vital role exists for trying to level the playing field for U.S. companies due to strong global competition over the lucrative Middle Eastern market. [24]

In addition to the six countries that make up the GCC, the need for rebuilding the infrastructure and modernize the oil refineries in Iraq places it as an additional future business opportunity. [25] These developments have led U.S. companies to continue their operations in Iraq or recently enter the market in hopes of acquiring large government contracts for pipeline repairs and potentially the operation of a new port. [26] Although this provides U.S. companies with further opportunity in the country, it also provides the same or new U.S. companies to redeem themselves from past practices of overcharging for work not up to par or not finishing projects U.S. companies have started in Iraq. [27] Instead of taking advantage of a country that has been ravaged by years of horrific international sanctions, war, and a government suffering from corruption and the inability to regulate so many contracts, foreign companies should expand upon the opportunities in the country in a legitimate manner.

Furthermore, in May 2010 Israel will receive an upgrade from the status of "developed from emerging market" in the MSCI World Index and the MSCI EAFE Index, which means potentially more investors in Israel's equity market. [28] The country imports items varying from petroleum, coal, to aerospace and defense products from U.S. manufacturers. Additionally, the free-trade agreement Israel entered with the U.S. provides further justification for expanding U.S. sales into the country. [29]

IV. CONCLUSION

There is a potential for U.S. companies to grow and expand in various industries in the Middle East. From the traditional oil industry to rebuilding infrastructure in Iraq, finance and telecommunication services in the GCC States, as well potential for agriculture development in Saudi Arabia. The keys to success in this region, as with others in this global market, includes performing a thorough due diligence as to the country's atmosphere and political and legal stability as well as obtaining expert assistance on understanding the culture and sensitivity to the traditional norms of the region. Saudi Arabia is a strong example of the investment success that U.S. companies can achieve with proper due diligence prior to investing in the Middle East. [30] Furthermore, strong growth prospects, as more U.S. companies expand their operations, workforce, and infrastructure in the Middle East, as well as the continued creditworthiness of the GCC States indicates the lack of impact from 25/11.

End Notes:

[1] John H. Donboli & Farnaz Kashefi, *Doing Business in the Middle East: A Primer for U.S. Companies*, 38 CORNELL INT'L L.J. 413, 415 (2005).

[2] Maria Mussler, *Doing Business in the Middle East and North Africa*, U.S. DEPARTMENT OF COM., MIDDLE EAST NORTH AFRICA BUS. INFO. CENTER (2005), http://www.export.gov/middleeast/Doing%20Business%20in%20the%20Middle%20East.pdf.

[3] *Id*.

[4] *Id*.

[5] INT'L TRADE ADMIN., TOPU.S. TRADE PARTNERS (2009), HTTP://ITA.DOC.GOV/TD/INDUSTRY/OTEA/TTP/TOP_TRADE_PARTNERS.PDF

[6] Donboli & Kashefi, *supra* note 1, at 414.

[7] *Id*. at 444.

[8] *Id*. at 414.

[9] THE WORLD BANK, DOING BUSINESS 2010: MIDDLE EAST-NORTH AFRICA SETS BUSINESS REGULATORY REFORM PACE (2009), HTTP://WWW.WORLDBANK.ORG/MENA.

[10] *Id*.

[11] Donboli & Kashefi, *supra* note 1, at 431-32.

[12] *Id*. at 432.

[13] *Id*.

[14] *Id*. at 434.

[15] *Id*. at 438-39.

[16] *Id*. at 440.

[17] Simeon Kerr, *Dubai Offered an Alternative Future*, FT.COM, Feb. 8, 2010, http://www.ft.com/cms/s/0/be4c185c-14c7-11df-9ea1-00144feab49a.html

[18] Richard Spencer, *Dubai's Financial Crisis: A Q&A*, TELEGRAPH.CO.UK, Nov. 27, 2009, http://www.telegraph.co.uk/finance/financetopics/financialcrisis/6668281/Dubais-financial-crisis-a-QandA.html.

[19] *Id*.

[20] Kerr, *supra* note 16.

[21] TRADE ARABIA, UAE ECONOMY 'TO GROW BY UP TO 3PC', Feb. 15, 2010, http://www.tradearabia.com/news/ECO_174932.html

[22] Mirna Sleiman, *S&P Sees More Defaults in Middle East*, WALL ST. J., Feb. 9, 2010, http://online.wsj.com/article/SB10001424052748704820904575054740931380412.html

[23] *Id*.

[24] Middle East Council of American Chambers of Commerce, http://www.mecacc.org/aboutus.html (last visited Feb. 21, 2010).

[25] Timothy Williams, *U.S. Companies Join Race on Iraqi Oil Bonanza*, N.Y. TIMES, Jan. 13, 2010, at A4, *available at* http://www.nytimes.com/2010/01/14/world/middleeast/14rebuild.html

[26] *Id.*

[27] *Id.*

[28] *Israel: MSCI to Raise Rank to Developed Market*, N.Y. TIMES, June 15, 2010, at B5, *available at* http://www.nytimes.com/2009/06/16/business/global/16fobriefs-MSCITORAISER_BRF.html

[29] *Id.*

[30] Saudi Arabian General Investment Authority, http://www.sagia.gov.sa/en/Key-sectors/ICT/Success-Stories/ (last visited Feb. 21, 2010).

REGULATION E: ARE THE PROBLEMS WITH OVERDRAFT PROTECTION PROPERLY ADDRESSED?

I. Introduction

In 1984, in the earliest days of the debit card, legal commentators were already considering the need for the legislature to curtail the banking practice of "Insufficient Fund Check Charges," now colloquially referred to as overdraft fees. [1] The battle against overdraft fees failed in the 1980s when the courts largely agreed that overdraft fees were a competitively-priced "service" and therefore not subject to rules against unconscionability or penalties. [2] The battle against such fees, however, is ongoing. Twenty five years later, the latest battle in the war against overdraft fees came to a victorious end when the Federal Reserve Board, at the behest of President Obama, created a new regulation limiting the practice in significant ways. [3] This article will begin by summarizing the overdraft protection scheme typically used by banks. It will then consider the arguments against these practices, and finally, consider whether the Federal Reserve Board regulation addresses these arguments and problems.

II. How it works

As it currently stands, the system relies on a scheme known as overdraft protection, which has the banks protecting consumers from bouncing checks and transactions for a fee. The effects of overdraft protection on consumers and consumer checkbooks are exacerbated by a practice known as high-to-low check posting, in which banks post checks and transaction to customer accounts in the order that will lead to the highest number of charges possible.

A. Overdraft Protection

Overdraft protection, often called bounce protection, is a "service" offered by banks. If a bank consumer with overdraft protection overdraws on a checking account, the bank will pay the money owed for the consumer; the consumer will then be charged a fee for this service.[4] Oftentimes, consumers are enrolled in these programs automatically, and are not aware of their ability to opt out. [5]

This operates to mean that overdraft protection is a lending scheme. The bank makes a small loan for every overdrawn transaction to prevent consumers from bouncing checks or having declined card purchases.[6] However, these "loans" are not considered to be lending as such and therefore not subject to the Truth in Lending Act. [7]

The Truth in Lending Act was passed in 1968 as an attempt to protect and inform consumers in credit transactions. [8]Particularly, the act requires the disclosure of the key terms and costs of lending agreements. [9] Lenders and creditors are required to provide consumers with a standardized accounting of the real costs of their lending arrangements. [10] This is done through APR, annual percentage rate, which includes not only interest but all the associated costs of a loan to determine the annual cost as a percentage of the original loan. [11] Simplified, this means that if a lender lent $100, with $20 in interest, with a $5 fee, that lender is required to inform the customers that while the interest rate is 20%, the actual costs of the loan actually amount to 25%. However, overdraft protection is not currently covered under this act. [12] This means that banks are not required to present consumers with information regarding the effective cost of borrowing through overdrafts. Customers are

therefore not informed of the true cost of the loan the bank makes when they overdraw.

Before the new regulations, consumers were typically automatically enrolled unless they affirmatively chose to opt out. [13]Banks offered overdraft protection to consumers, ostensibly under the theory that nearly all consumers would want to avoid the embarrassment of having a transaction denied or a check bounced. [14]

B. High-to-Low Check Posting

One of the practices of banks that has a very significant effect on overdraft protection is what is typically known as high-to-low posting.[15] High-to-low posting is a method of posting checks and transactions to accounts from highest to lowest amount.[16]Posting method has little effect on the average consumer. However, when the consumer has written a check that will overdraw his account, high-to-low posting can serve to maximize the number of overdraft transactions [17], and therefore the number of itemized fees collected by the banks.

In practice, this means an increase in overdrafts. Because checks and electronic transactions are not immediately posted to an account, but in fact posted at the end of the business day, banks have discretion in choosing the order in which they are posted. Going from highest to lowest generates the highest amounts of overdraft.

For example, if an account has $100 in it, and 4 checks are written for $10, $16, $48, and $92, there could be as many as three overdraft transactions, or

as few as one. If the checks are processed from lowest to highest, there is $26 left in the account when the $92 check is posted, and the account overdraws a single time, incurring one fee. If the $92 check is posted first, the account will overdraw when each of the subsequent checks are posted, leading to three transaction fees.

This means that the banks purposely chose a posting order that would maximize overdraft transactions, and therefore fees and profits. Some have suggested that this practice is unfair and unjustly punishes consumers much more than necessary for overdrawing their accounts. [18]

III. Arguments against Overdraft Fees

There has been much writing on the issue of overdraft fees. The appearance of the debit card as a "check-like" device created some legal challenges in the 1980s. The recession and recent credit crisis has led to a renewal of critical interest in overdraft practices, leading to a new body of academic thought on the issue.

A. The 1980s and the Contract Argument

In the 1980s, several legal challenges were brought against overdraft fees as the advent of debit cards made the fees much more economically relevant. [19] The legal arguments turned on points of contract law, with the opponents of overdraft fees claiming that the fees were either unconscionable, unenforceable, or punitive and therefore barred by contract law. [20]

Legal commentators noted that the contracts that banks used to charge overdraft fees were questionably enforceable.[21] In part, they charged the banks

with forcing contracts of adhesion on clients while unfairly surprising them with fees that were not disclosed up front and that were generally excessive, thereby creating an issue of unconscionability. [22]

Furthermore, they argued that the overdraft fees were penalties for breach rather than any sort of recuperation for the bank. [23] The belief was that the fees were being unlawfully charged as a penalty because banks incurred costs believed less than a dollar for each overdraft and yet charged much, much more. [24] The courts, however, disagreed, voicing the opinion that the overdraft was not a fee but rather a service, where banks charged a fee to honor consumer transactions instead of declining them out right. [25]

B. The 2000s and the Misinformation Argument

More recently, commentators have focused on overdraft fees from a different angle. Several have focused on the misinformation surrounding overdraft practices. A significant recurring argument is one that centers on overdraft protection's omission from Truth in Lending disclosure requirements. [26]

Critics argue that banks operate overdraft protection at great profit by misinforming their consumers. [27] Particularly, they believe, the unavailability of APR figures prevents consumers from understanding the true costs of overdraft protection. [28] One commentator noted that the average consumer with average bank fees would, in the average repayment period of two weeks, incur what works out to an 884% annual percentage rate. [29] This same commentator further notes that many ATMs have been known to list the bounce protection limit of an account as available funds, thereby fooling consumers into bouncing checks and transactions. [30]

Other academic arguments center not on whether banks have been misinforming customers, but rather on what banks should need to tell consumers about these fees. [31] Their debate is largely framed in light of the new rules regarding the advertising of overdraft services and whether or not they are sufficient for consumers to make fully informed decisions.[32]

Others still argue that high-to-low check posting itself constitutes misinformation because it is done without clear notice to consumers and against their basic expectations. [33] They further contend that it is perpetrated against the consumers in bad faith, for the sole purpose of collecting profits. [34] For example, the Texas State Bar Committee has suggested that it is unlawful for a bank to implement high-to-low posting simply for the purpose of collecting more fees. [35]

IV. **The New Rule**

The new rule by the Federal Reserve Board, Regulation E, provides that, on July 1, 2010, all overdraft protection schemes are to be opt-in only, rather than opt-out. [36] The rule will further require that banks broadly explain the terms of overdraft protection and the fees associated with it. [37] It also provides that a consumer's choice not to take part in overdraft protection cannot be cause for different account terms, such as different interest rates. [38]

The new regulation does not put overdraft fees under the requirements of the Truth in Lending Act. It also does not control overdraft fee amounts, or the effective interest rate and APR of the loans made by the banks under the guise of overdraft protection. Finally, it does not control any overdraft-related bank activities such as high-to-low check posting.

By making overdraft protection an opt-in proposition, the arguments made in the early days of the fees, in the 1980s, are generally addressed. Consumers will now be willingly entering into a contract for overdraft protection with the banks and will therefore be forewarned of the possibility of fees. However, the later arguments are not addressed by this regulation. Exclusion from Truth in Lending disclosures means that consumers may not have a clear idea of the actual cost of overdraft protection. Furthermore, the allegedly unfair check posting practices that maximize these potential fees continue to exist. As such, only part of the problems previously identified have been rectified.

V. Recommendation

The new Federal Reserve rule regarding overdraft fees remedies in great part the biggest and most obvious flaw with overdraft fees: misinformation. By forcing consumers to actively seek overdraft protection, and therefore overdraft fees, and by forcing to fully inform consumers as to the terms of such an agreement ahead of time, consumers are now forming informed contracts with their banks. However, some problems remain.

First, the amount of the fees remains unchecked. Banks argue that they use fees to incentivize consumers to act prudently vis-a-vis their checking accounts. However, it is unclear whether the amount charged is optimal to incentivize good consumer behavior. If lower fees would create the same incentives, they should be put in place. Banks and consumers have entered a contract. Breach by the consumer in the form of an overdraft cannot and should not, according to contract law, lead to punitive damages and a windfall for the bank. If the banks are not incurring damages of a magnitude similar to that of the fees, and if their fees are not necessary to incentivize consumers to practice good

banking, then it may be the case that the Federal Reserve should revise their regulations to control the amount charged in fees.

Second, banks are still allowed to continue other practices that have generally been regarded as unfair, unnecessary, or ill-advised. The new regulations only requires consumers to be aware that they are agreeing to overdraft protection, but it does not provide with more information as to how it actually works. Particularly, they are still not fully informed as to the terms because overdraft protection is not subject to Truth in Lending disclosures. As such, the Federal Reserve's rules fail to fully account for the problems created by overdraft fees and new regulations should be put in place to require disclosures for overdrafts, by either including overdraft protection in the Truth in Lending Act provisions, or creating a similar regulation tailored more specifically to overdraft protection.

Thirdly, the practice of high-to-low check posting has not been addressed under this new regulation. While giving the banks their autonomy in such practices is important, the current methods of check posting seem to be designed solely for the purpose of maximizing overdraft fees. The Federal Reserve Board should at least consider the effects of potentially altering this practice. If the banks can maintain a healthy level of profit without it, the practice should be outright eliminated. If not, it should be scaled back and more closely monitored and controlled to prevent abuse of the system.

VI. Conclusion

The Federal Reserve Board has taken a great step towards informing the general public about the finer points of overdraft practice with their new rule. By

forcing banks to require active approval of overdraft protection, the rule forces banks to educate their clients. It further requires clients to actively agree and therefore eliminates the possibility of being blind-sided by overdraft fees. However, some of the arguments brought up against overdraft fees in the past remain unaddressed. The regulation is a fair start in addressing the obfuscation in the realm of overdraft policies, but it is not a coup-de-grace against what legal commentators describe as deceitful banking practices.

---

[1] Daniel K. Weiss, *Insufficient Fund Check Charges: The Need for Legislative Action,* 45 OHIO ST. L.J. 1003 (1984).

[2] *See e.g.* Shapiro v United Cal. Bank, 133 Cal. App. 3d 256 (1981).

[3] Stephen Labaton, *New Rules Would Restrict Overdraft Fees on Debit Cards,* N.Y, TIMES, Nov. 12, 2009.

[4] Sarah Tennant, *Bounce Protection Plans: Consumer Convenience or Disguised Deception?* 21 LOY. CONSUMER L. REV. 540, 540 (2009).

[5] *Id.*

[6] *Id.*

[7] *Id.* at 543.

[8] *See generally* Comptroller of the Currency, TRUTH IN LENDING: COMPTROLLER'S HANDBOOK (Oct 2008) *available at http://www.occ.treas.gov/handbook/til.pdf*

[9] *Id*

[10] *Id*

[11] *Id*

[12] *Id*

[13] *Id.*

[14] *Id.*

[15] Willie E. Spruill, *The Exploitation of Bank Charges and Undermining of Consumer Protection: Exploring the Realms of High-to-Low Check Posting*, 13 NC BANKING INST. 433 (2009).

[16] *Id.*

[17] *Id.*

[18] *Id.*

[19] Weiss, *supra* note 1.

[20] *Id.*

[21] *Id.*

[22] *Id.*

[23] *Id.*

[24] E. Robert Wallach, *Banks Fight Class Actions on Surcharges*, 3 Cal. Law. 14, 15 (Jan. 1983).

[25] *See e.g.* Perdue v Crocker Nat'l Bank, 141 Cal. App. 3d 200, 209 (1983).

[26] *See* e.g. Tennant, *supra* note 4; Jennifer S. Martin, *How your $4 coffee can cost you $39 or more if you use your debit card! Federal level consumer protection and modern payments transactions*, 39 U. MEM. L. REV. 805 (2009).

[27] *Id.*

[28] *Id.*

[29] Tennant, *supra* note 4, at 543.

[30] *Id.* at 543-44.

[31] *See e.g.* Carolyn M. Gillikin, *Overdraft Protection Programs: Consumers Still in the Dark after Regulation DD*, 10 N.C. BANKING INST. 231, 234 (2006).

[32] *Id.*

[33] Spruill, *supra* note 11, at 439-42.

[34] *Id.*

[35] Tex. Bus. & Com. Code Ann. §4.303 (2007).

[36] Press Release, Board of Governors of the Federal Reserve System (November 12, 2009) (*available at*http://www.federalreserve.gov/newsevents/press/bcreg/20091112a.htm).

[37] 12 CFR §205 (2009)

[38] *Id.*

Is the NCAA Fulfilling its Tax-Exempt Status?

I. Introduction

In late 2006, Congress challenged the NCAA's tax-exempt status, questioning the organization's lucrative commercial contracts and alleged lack of emphasis on higher education. [1] Some point out that Division I football and basketball are looking more like minor leagues for the pros that benefit only a tiny portion of a university's student body and may actually be more "detrimental to the overall education of the athlete given the amount of time they consume, and so forth."[2] Smith College economist Andrew Zimbalist claims that "college sports has grown into a standard commercial enterprise — with only a tip of the hat to the academic environment they exist in."[3] This article will first provide background to clarify the manner in which tax rules are applied to organizations such as the NCAA, an analysis on whether the NCAA is actually fulfilling its tax-exempt status, and some possible solutions for tax-exempt compliance.

II. Background

The National Collegiate Athletic Association ("NCAA") is an unincorporated organization that governs more than 1200 colleges, universities, athletic conferences, and sports organizations, while managing 360,000 student-athletes and eighty-eight championship events in three divisions.[4] The NCAA institutes a "principle of amateurism" in that student-athletes are amateurs and their participation should be primarily motivated by participation in their intercollegiate sport.[5] It further vows to protect student-athletes from professional and commercial enterprises,[6] and look after the best interests, education, and athletic participation of student-athletes.[7]

Because the NCAA avails itself to these principles, the Internal Revenue Code ("IRC") recognizes it as a tax-exempt organization.[8] The NCAA and private universities rely on an exempt status under "§501(c)(3), which provides exemption for charitable organizations such as religious and educational institutions."[9] In 1976, Congress passed an amendment to this section to make perfectly clear that "national or international amateur sports competition" serve a charitable purpose under the IRC.[10] However, the statute is not without limitations.

Treasury Regulations, Internal Revenue Service ("IRS") interpretations and judicial opinions all attempt to define situations in which charitable organizations may lose their tax-exempt status.[11] For example, the IRS takes the position that a charitable organization loses its exempt status if it confers an "excessive benefit" upon parties outside its charitable class.[12] The "charitable class" in the NCAA's case would refer to student-athletes.[13] Furthermore, when a charitable organization bases its actions on "substantial" commercial activities, in order to keep its tax-exempt status, Treasury Regulations require the organization to be "in furtherance of" an exempt purpose.[14] In theory, it can be argued that Division I football and basketball programs are providing 'excessive private benefit' to television networks and professional sports leagues in relationship to the educational benefits provided to the charitable class.[15]

III. Analysis

Critics point out that the NCAA is not acting "in furtherance of" its exempt purpose of advancing amateurism, education, and the best interests of student-athletes when it is conducting itself like "minor leagues for the pros, organized to produce maximum entertainment revenues."[16] Today, NCAA

licensing deals alone are estimated at more than $4 billion [17] – a figure that has increased by forty percent since the early 1980s. [18] Furthermore, in 1999, the NCAA contracted with Columbia Broadcasting System ("CBS"), giving the company the exclusive right to broadcast March Madness for eleven years at roughly $ 6.2 billion or $ 560 million per year. [19] Broadcast and marketing contracts have accounted for nearly 90% of the NCAA's overall budgeted revenues from 2008-09, [20] and business partner, Thought Equity Motion, self-described as the world's largest provider of online motion content, declares that the NCAA's video content archive is "one of the most unique and valuable content collections in the world."[21]

In addition, there is transparency in the way in which "professional football and basketball benefit from avoiding the costs that would be associated with "minor league" development programs such as those funded by Major League Baseball."[22] With escalating coach salaries and state-of-the-art facilities, [23] universities end up churning out prime candidates for the big leagues. This in turn confers a "secondary benefit" for professional leagues that save on the high costs of sending players to the minor leagues. [24] Perhaps a flaw in this argument is that only about 1.8% of student-athletes who play college football under the National Collegiate Athletic Association ("NCAA") actually make it to the professional level, with reports of even lower percentages among men's college basketball. [25] Therefore, this benefit may not be as "excessive" when compared to the benefits conferred to private enterprises like CBS. However, this does bring up a secondary issue in that while a select few receive an astronomical benefit from the NCAA, the greater portion of student-athletes may face an overall detriment.

Student-athletes seem to be harmed by the way in which the NCAA focuses its efforts in maximizing private businesses instead of acting "in furtherance of" for example, academic pursuits. Student-athletes miss classes and precious study time when they are forced to juggle rigorous travel and training schedules. [26] A 2004 report on graduation rates revealed that nearly twenty percent of Division 1 men's basketball teams had graduation rates under fifty percent. [27] A more recent 2009 survey taken by the NCAA indicated that the University of Texas was facing the same reality among its football team with a graduation rate of less than fifty percent as well. [28] While there is evidence that the NCAA has threatened member universities with attempts to take away scholarships and postseason eligibility, [29] this arguably only increasespressure upon professors and athletic faculty to inflate the scholastic progress of athletes, causing some student-athletes to lose out on a basic education. [30] To determine whether the NCAA is really focusing its efforts on benefiting student-athletes, it is important to analyze how much funding actually reaches student-athletes on a more individual level.

The NCAA claims to benefit student-athletes by using billions of its revenue and profits towards funding scholarship aid and expanding opportunities for students in nonrevenue sports. [31] This claim would arguably confirm the NCAA's tax-exempt title even though no bright line rule exists concerning how much money the NCAA must allocate towards student-athletes. However, the NCAA financial disclosure requirements are vague and allow an aggregate reporting of revenue expenditures. [32] Therefore, it is difficult to determine exactly how much student-athletes are benefiting (at least financially) through the NCAA's funding.

IV. Solution

The NCAA needs to refocus its efforts on protecting student-athletes from commercial enterprises [33] and make sure it is looking after the best interests of its athletes, predominately their future and education. [34] It is important that "watchdog" groups such as the Coalition of Intercollegiate Athletics and the Drake Group continue to push for a more complete breakdown of NCAA financial data to determine where funding is really being allocated. [35] Congress should mandate not only detailed financial disclosures on NCAA expenditures, but also reports and studies indicating how much student-athletes are benefiting academically and so forth. [36]

Reform groups suggest that the NCAA should be required to report on academic matters affecting student-athletes, including student-athletes' academic majors, their advisors, required courses in their majors, their grade point average (GPA), SAT and ACT scores, independent studies, grade changes by professors, and missed classes because of extracurricular demands.[37] The University of Michigan has even taken it upon itself to create a committee to monitor whether or not student-athletes are unjustly being given higher grades and accepted in easier classes in order to maintain eligibility.[38] While these reform groups and committees provide a starting point, Congress ultimately needs to step in to ensure that the NCAA is acting in compliance with its tax-exempt status and specifically benefiting its charitable class of student-athletes.

[1] Steve Wieberg, *NCAA's Tax-Exempt Status Questioned*,USA TODAY, Oct. 5, 2006, a*vailable at*http://www.usatoday.com/sports/college/2006-10-04-ncaa-tax-status_x.htm.

[2] *See* John D. Colombo, The NCAA, *Tax-Exemption and College Athletics*, 2010 U. ILL. L. REV. (forthcoming Jan. 2010) (manuscript at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=13367 27) (looking at the tax-exempt status of the NCAA and other big-time college sports programs).

[3] Wieberg, *supra* note 1.

[4] Christian Dennie, *An Antitrust Action the NCAA Cannot Afford to Lose*, 7 VA. SPORTS & ENT. L.J. 97, 125 (2007).

[5] Nat'l Collegiate Athletic Ass'n, 2006-2007 NCAA DIVISION I MANUAL: Operating Bylaws Art. 2.9 (2007) [hereinafter NCAA Manual].

[6] *Id.*

[7] NCAA, About the NCAA, http://www.ncaa.org/wps/portal/ncaahome?WCM_GLOBAL_CONTEXT=/ncaa/ncaa/about+the+ncaa (last visited Feb. 8, 2010).

[8] Colombo, *supra* note 2, at 113.

[9] *Id.*

[10] *Id.* at 118.

[11] *Id.*

[12] *Id.* at 122.

[13] *Id.* at 125.

[14] *Id.* at 127.

[15] *Id.* at 125.

[16] *Id.* at 138.

[17] Pete Thamel, *N.C.A.A. Fails to Stop Licensing Lawsuit*, NY TIMES, Feb. 8, 2010, *available at*http://www.nytimes.com/2010/02/09/sports/ncaabasketball/09ncaa.html.

[18] Nathan Crabbe, *Profiting Off the Gators: A Fine Line Between What's OK and Not*, Gainsville.com, Sept. 26, 2009,http://www.gainesville.com/article/20090926/articles/909259893.

[19] Dennie, *supra* note 4, at 100.[20] Jennifer A. Mueller,*Student-Athlete Amateurism Should Not Become a Fantasy*, 2009 U. ILL. J.L. TECH. & POL'Y 527, 560 (2009).

[21] Thought Equity Motion, About Us, http://www.thoughtequity.com/video/shell/txp/about.do?title=About+Us (last visited Feb. 8, 2010).

[22] Colombo, *supra* note 2, at 125.

[23] *Id.* at 111.

[24] *Id.* at 125.

[25] Percentage of Going Pro, http://www.athleteconnections.org/Articles.aspx?id=20&title=News%20and%20Media (last visited Feb. 8, 2010).

[26] Melissa Kelly: Teaching the Star Athletes,http://712educators.about.com/cs/characteredu/a/starathletes.htm (last visited Feb. 8, 2010).

[27] Derrick Z. Jackson, *Calling Athletes on Poor Grades Stops Foul Play in Universities*, TRI CITY HERALD, Mar. 3, 2005,*available at* http://news.google.com/newspapers?nid=1951&dat=20050303&id=LTsiAAAAIBAJ&sjid=EasFAAAAIBAJ&pg=4178,387627

[28] Shabab Siddiqui, *NCAA Survey Reveals UT Football Players Have Low Graduation Rates*, THE DAILY TEXAN, Nov. 20, 2009, *available at* http://www.dailytexanonline.com/top-stories/ncaa-survey-reveals-ut-football-players-have-low-graduation-rates-1.2093044.

[29] Jackson, *supra* note 27.

[30] Kelly, *supra* note 26.

[31] Colombo, *supra* note 2, at 133.

[32] *Id.* at 159.

[33] NCAA MANUAL, *supra* note 5.

[34] NCAA, *supra* note 7.

[35] Colombo, *supra* note 2, at 159.

[36] *Id.* at 163.

[37] *Id.* at 160.

[38] Caitlin Schneider, *Committee to Investigate Academics for Student-Athletes*, THE MICH. DAILY, Sept. 16, 2008, http://michigandaily.com/content/committee-investigate-academics-student-athletes

A CORPORATE DUTY TO HEDGE? DISTINGUISHING BETWEEN SPECULATION AND HEDGING (PART II)

I. IS THERE A CORPORATE DUTY TO HEDGE?

In light of the preceding section it is clear that when derivatives are properly and cautiously used they create benefits to a busines. Current US case law is unclear in establishing whether or not directors of a corporation should consider at least the use of derivatives to hedge a material market risk, in other words, whether the fiduciary duties owned by directors to the shareholders of a corporation impose an implicit obligation to hedge.

The conclusion reached by the Court of Appeals of Indiana in *Brane v. Roth**[1]*** offers important clues as to the scope of the use of derivatives in companies dealing with agricultural commodities.

A. The Point of Departure

In *Brane v. Roth*[2] the Court of Appeals of Indiana was confronted with a derivative lawsuit involving a dispute between a group of shareholders and the directors of a rural grain elevator cooperative (Co-op). [3] Pursuant to the facts of the case, approximately 90% of Co-op's business was devoted to the purchase and sale of grain.[4]Since Co-op had economic difficulties, the directors decided to implement a new strategy.[5] Under the new strategy, Co-op would hedge its grain position to protect itself from the volatility of the grain market. Although Co-op's directors authorized the manager to hedge, only a minimal amount was effectively hedged (US$20,500 out US$7,300,000 of Co-op's total grain sales)[6].

Shareholders brought a suit alleging that director's failure to adequately hedge in the grain market had caused the losses to Co-op.[7]

The lower court found in favor of the shareholders and stated that Co-op's directors had breached their fiduciary duty by retaining an inexperienced manager, by failing to maintain reasonable supervision over him, and by failing to attain knowledge of the fundamentals of hedging to be able to direct the hedging activities and supervise the manager.[8]

The Court of Appeals reaffirmed the lower court's decision stating that Co-op's losses resulted from the failure to hedge.[9] The position taken by the court was corroborated by both a witness and an outside expert in the grain market who testified that grain elevators cooperatives should engage in hedging activities to protect themselves from the fluctuations of the gain industry. [10]

B. Aftermath of Brane v. Roth, delimitations of the obligation to hedge

The conclusions of the court in *Brane v. Roth* highlight that speculation is not welcomed at a corporate level since shareholders are by principle, risk averse[11]. Since Co-op's hedging strategy was only limited to a small portion of Co-op's total grain sales, it is argued that the large non-hedged portion was used by Co-op for mere speculative purposes and therefore such speculation should be actionable at the corporate level. Accordingly, the case suggests that given the existence of price protection in the market, directors of a corporation have a duty to at least explore the use of derivatives to protect risk exposure because otherwise, they would be speculating on the future price of such commodity.

The decision of the court, although innovative in the derivatives market, reflects the general common law standard of care developed by US courts. Pursuant to such standard, a director wishing to invoke the protection of the business judgment rule is in the obligation to inform himself prior to making any business decision.[12] Once informed, said director has the additional duty to act with requisite care in the discharge of their duties.[13] Directors who comply with their duty of care (and with their duty of good faith and loyalty) are protected by the benefit of the business judgment rule.[14]

This article posits that the obligation to hedge is intimately attached to the standard of care developed by US courts and therefore, should not be seen as a complete stranger. Putting it bluntly, the liability of Co-op's directors resulted from failing to comply with their duty of care by not properly hedging in the grain market. Nonetheless, the duty to hedge should be seen as a sub-category of the duty of care. For that reason, the extension, implementation and scope of the obligation to hedge should not only be circumscribed by the duty of care parameters but also, should be bounded by narrower conditions of applicability, three of which are identified in this article: level of information; level of sophistication, and level of risk.

1. *Level of Information*:

U.S. courts have long stated that in order to determine if directors' decisions fall within the protection granted by the business-judgment rule a fact finder must analyze the type of information available to such directors at the time the decision was taken.[15]While directors are not required to be informed of every fact, especially those deemed immaterial or out of director's reasonable reach, they are

responsible for considering all material information reasonably available to them prior to making a business decision.[16]

Determining the type of information that is deemed to be material depends in turn on the industry standards required for directors in the field where the company undertakes its activities.[17] Industry standards provide minimum levels of skill and expertise that directors must have when presiding a business in a specific industry.[18] Industry standards are, thus, quintessential in establishing if directors are properly informed and if they have an obligation to hedge.
While courts have not imposed liability on directors for failure to follow specific standards; there are various examples where other *fiduciaries* have been held liable for failure to comply with industry regulations.

In *Gilbert v. EMG Advisors*,[19] the court, highlighting that the ERISA fiduciary duties were the highest known to the law, held that an investment manager had breached his fiduciary duties for failing to conduct a thorough investigation before investing certain assets belonging to a retirement fund in a complex derivatives scheme.[20]Similarly, in *Evanston Bank v. Commodity Services Inc*,[21] the district court held that a broker could be liable for speculative trading conducted in a client's hedge account where those trades resulted in a violation of federal banking policy.[22]

These are but two examples that illustrate the general view of the courts as to the importance of the industry standards in assessing the type of information directors should consider when taking a business decision. These cases are instrumental in showing that: (1) The standard to which directors may be found accountable differs greatly from one industry to another. Therefore, such differences should be taken into consideration when deciding whether or not directors have to consider

the use of derivatives to reduce risk exposure; (2) When directors or fiduciaries analyze and gather information they are compelled to fulfill the requirements imposed by industry standards; (3) Expectations as to the knowledge and expertise of fiduciaries differ depending on the industry in which the company operates.

2. Level of *Risk*:

In addition to the information factor, the level of risk to which a company is exposed determines whether or not a director has the duty to consider the implementation of hedging strategies. This article posits that directors should consider hedging strategies only in cases where lack of hedging results in a material risk to the company[23].

In the context of the duty of care, the Delaware Supreme Court has defined materiality as any event that is relevant and of such magnitude that directors must take into account in performing their fiduciary duties.[24]

A perfect example of a material risk can be found in *Brane v. Roth*. The risk exposure of a grain elevator cooperative, like Co-op, was so material that implementing hedging trough derivatives seemed necessary for the business (approximately 90% of Co-op's business was buying and selling grain).[25] By contrast there are a handful of examples where such materiality may not be present, for instance, when the risk is not closely related to the main purpose of a corporation but instead is secondary and insubstantial to the business. In these latter cases there should not be an obligation to hedge.

A hypothetical may be useful to illustrate this point: ALFA is a corporation that produces furniture. 85% of ALFA's furniture derives from wood. ALFA cuts trees in Region A and transports its trees to Region B. The cost of gasoline for the transportation of the wood from A to B is marginal and amounts to less than 0,01% of the total costs of production of the furniture. ALFA has learned that a group of environmentalists are lobbying a law that would prohibit the cutting of trees in certain regions where ALFA and most of its competitors operate. Though it is not certain that the environmentalist would be successful, there is a potential risk that the price of wood would increase. Parallel to this, the government is drafting a preliminary decree that would raise the gasoline tax with the aim of financing the construction of a hospital in Region C. Assuming that ALFA's board of directors has taken the necessary steps to analyze the above situations, is ALFA's board obliged to hedge (i) the price of gasoline; (ii) the potential passage of the law (ii) both? It is argued that while ALFA should enter into a derivative contract (e.g. a forward) to hedge the negative effects the law may on the price in wood; ALFA's board should not be obliged to hedge the price of gasoline because the increase of such price does not represent a material risk to its business.

3. *Level of Sophistication*:

Another factor that conditions the applicability of the duty to hedge as a sub-category of the duty of care is the level of sophistication. The sophistication factor stems from the right of the shareholders of a corporation to elect the members of the board of directors. Presumably, when the shareholders of a corporation are sophisticated, the members of the board of directors will also be sophisticated and should be capable of understanding the sometimes complex world of derivatives. Conversely, when the shareholders of a corporation are not sophisticated it is likely that the members of the board would not have the same qualities and

understanding of derivatives than that of the sophisticated board. It is therefore argued, although not in absolute terms, that the shareholders of the latter board (non-sophisticated) may not imply in its elected directors a complete understanding of derivatives.

4. *Other limitations*

In addition to the delimitations exposed in this section, the business judgment rule constitutes an additional delimitation of the duty to hedge. Since it is argued that the duty to hedge is a sub-category of the duty of care, to hold a director liable for failure to use, or at least consider the use of derivatives it is necessary to follow the tortuous steps of the business judgment rule. This means that a plaintiff would have to assume the burden of providing evidence that directors, in reaching their business decision, breached any one of the triads of their fiduciary duties.[26] Failing to meet this evidentiary burden implies that the courts will concede full authority to the decision reached by the directors and grant the protection of the business judgment rule.

Furthermore, plaintiffs must show that the losses sustained are attributed to the failure of directors to use derivatives due to their gross negligence.[27] Since the duty of care focuses on the procedures taken by directors rather than the results, directors would not be held liable for mere errors of judgment in their decision-making but instead, they would be liable for losses occurring due to their gross inattention to the business or their willful violation of their duties.

II. CONCLUSION

The duty of directors to consider the use of derivatives is limited by various elements. First, the question as to whether directors should or should not use derivatives should revolve only around the hedging rather than the speculative practices. While speculation plays an important role in the derivative market, it is argued that such practices should be limited, at least theoretically, to corporations whose corporate purpose is to speculate in the market. Accordingly, the obligation to consider the use of derivatives by directors should be narrowed to the hedging activities. Highly publicized scandals serve as evidentiary support of this argument.

Second, the use of derivatives to hedge is in turn restricted by at least three factors that condition its applicability and scope. Departing from the assumption that the obligation to hedge is a sub-category of the duty of care, this article shows that the levels of information, risk and sophistication play a major role in determining whether or not directors have an obligation to hedge. Even when all the conditions of applicability of the duty to hedge are fulfilled; a plaintiff must still overcome the requirements of the business judgment rule. Since the obligation to hedge is a sub-category of the duty of care, a plaintiff must sustain the burden that in reaching a business decision the directors failed to comply with their fiduciary duties. Thus, while this article argues in favor of the existence of an implied obligation to hedge, it shows that its applicability, extension and scope is restricted and will depend upon on the applicability of the business judgment rule.

---

[1] Brane v. Roth, 590 N.E.2d 587 (Ind. Ct. App. 1992).

[2] *Id*. at 589.

[3]*Id.*

[4] *Id*.

[5] *Id.*

[6] *Id*.

[7] *Id.*

[8] *Id.* at 589-90.

[9] *Id.* at 591.

[10] *Id.*

[11] WILLIAM BRATTON, *supra*, note 21.

[12] Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

[13] *In re* Toy King Distributors, Inc. 256 B.R. 1, 43 U.C.C Rep Serv. 2d 23 (Bankr. M.D. Fla. 2000).

[14] *See* Aronson v. Lewis, 473 A.2d 805 p. 812.

[15] *In re* Dalen, 259 B.R. 586 (Bankr. W.D. Mich 2001).

[16] *Id.*

[17] *See e.g.* Saumel Fraidin, *Duty of Care Jurisprudence: Comparing Judicial Intuition and Social Psychology Research*, 38 U.C. DAVIS L. REV. 1, 9 (2004) (stating that judges should consider evidence of dissent as correlated with careful decision making in duty of care cases).

[18] Francis v. United Jersey Bank, 432 A.2d 814, 825 (1981), (holding that a director had breached her fiduciary duties for failure to get acquainted with the operations of a reinsurance company).

[19] *Gilbert v. EMG Advisors, Inc.*, 172 F.3d 876 (Table), 1999 WL 160382, at *1 (9th Cir., Mar. 17, 2004)

[20] *Id.*

[21] *Evanston Bank v. Conticommodity Serv. Inc.*, 623 F. Supp. 1014, 1024 (N.D. Ill. 1985).

[22] *Id.*

[23] Pursuant to the Capital Asset Pricing Model (CAPM), the risk of a security is divided into two components: systematic, or risk associated with the price

changes occasioned by movements on the market as a whole; and unsystematic, or risk related to events that are unique to the firm itself, e.g. management, labor issues among others. This section of the paper limits the analysis to the materiality of the systematic risk.

[24] Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

[25] *Brane vs. Roth*, 590 N.E.2d at 589.

[26] Cede & Co. V. Technicolor Inc., 634 A.2d 345 (Del. 1993).

[27] Coddington v. Canaday, 61 N.E. 567, 573 (Ind. 1901).

AMERICA'S FAVORITE PASTIME: ADDING UP THE STATS FOR A FANTASY SUCCESS

INTRODUCTION

As pitchers prepare to report to training camp, America's favorite pastime is gearing up for the 2010 season. While players begin competing and vying for a coveted spot on the team roster, many Americans participating in fantasy baseball leagues are preparing to draft their own "dream team." Each year fantasy baseball leagues gain more attention and participation, with an average of 29.9 million active users spending over $800 million dollars directly on fantasy sports products as well as $3 billion of sporting goods. [1] Within this lucrative field, the Major League Baseball Association ("MLB") as well as the Major League Baseball Players Association ("MLBPA") worry that the financial success of the fantasy sports industry may hinder potential revenue possibilities. Through the use of professional baseball players' performance statisics to determine the overall success of the fantasy teams, issues of copyright infringement as well as violation of the right to publicity arise, resulting in lawsuits against licensing deals and the overall leagues. Although professional athletes claim to have a right of publicity in their name as well as performance statistics, fantasy baseball leagues should continue as is because performance statistics are not copyrightable under the Federal Copyright Act and litigation in this matter would far exceed the benefits received by the MLB.

This article will examine the contractual obligations of fantasy sports leagues to the MLB, copyrightable material and how performance statistics do not fall under such a category, and how the right to publicity has been trumped by First Amendment rights by cases such as *C.B.C. Distribution and Marketing, Inc.*

v. Major League Advanced Media, L.P. as well as statutory interpretation.

BACKGROUND

With an impact of $4.48 billion in 2008, fantasy sports leagues have revolutionized the way individuals experience the game. [2] Although fantasy sports are not a new phenomenon, it now proves easier and less costly for individuals to follow on the internet rather than through newspapers and other periodicals, creating a greater following through increased access. [3] To participate in fantasy league sports, individuals create teams and compete against one another by maintaining rosters of actual professional athletes and use players' real game statistics to score points. [4] These statistics are gathered and input into online databases, leading to the ultimate question of who owns them and how the rights to any profits such statistics produce. [5]

As the success and popularity of fantasy sports grew throughout the 1990s and early 2000s, the question of whether or not fantasy league operators were required to obtain licenses for the right to use athlete names and statistics became the subject of significant dispute. [6] Although fantasy providers must obtain licensing from the professional team organizations for any use of protected marks, such as team names and logos, the notion of fair use and statistics still drifted with uncertainty. [7] To combat this confusion, a groundbreaking 8th Circuit case brought this issue to the forefront of the public eye. In *C.B.C. Distribution and Marketing, Inc. v. Major League Advanced Media, L.P., ("CBC")* one online fantasy sports provider challenged this issue, considering whether ownership over professional performance statistics was possible. [8] The majority opinion held that the First Amendment trumped Major League Baseball Player's right to publicity and allowed licensing of statistics for use in online fantasy sports. [9] Since this case's holding, the professional baseball players as well as the

MLB have come to terms with the fact that their statistics are found within the public domain, unable to be protected by copyright, and the licensing First Amendment agreements overcome any right to publicity arguments regarding the legality of the league. [10]

ANALYSIS

Despite the fact that the earliest fantasy leagues were unlicensed, by the mid-2000s a bifurcated industry developed in which the larger, more established fantasy leagues were licensed and paid royalties whereas the smaller companies operated unlicensed games. [11] Through the balance of the competing interests of MLB players, including their rights of publicity against the public interest as well as statistical ownership, the *CBC* holding demonstrated that statistics are within the realm of public domain and a *prima facie* right to publicity does not exist in such leagues. [12] Although *CBC* was merely a fantasy league case based on professional baseball, subsequent cases such as *CBS Interactive v. National Football League Players' Association*, upheld the *CBC* standard, noting the lack of differences between fantasy football and fantasy baseball in terms of statistical ownership and publicity rights. [13]

Under court analysis, there is no valid copyright ability in facts. [14] In baseball, these facts come in the form of statistics, including: home runs, runs batted in, steals, and wins by pitchers. [15] A sports statistic by itself is a fact; there exists no author because the player causing the event to occur through the action of "hitting a baseball can no more claim ownership over that event than a driver could claim ownership over a report of her automobile accident." [16] Furthermore, these statistics are readily available in the public domain and like all First Amendment issues, the right of information within the public domain is accessible by all. [17] Because these statistics are facts and

readily available, they lack originality vital to its copyright potential along with fixation. [18] A copyright grant has traditionally been viewed as an incentive to encourage new works by assuring authors that they will reap the benefits of their intellectual labor, however, no originality to produce a copyrightable idea is available and no incentive to reproduce this statistic exists. [19] The reproduction incentive does not apply to professional sports statistics, because as a compilation created through the collection and assembling of preexisting materials or of data, the facts are merely arranged in no manner resembling a new or original product. [20] Furthermore, the originality in the arrangement of facts is essentially a non-factor for online fantasy sports providers because fantasy sports databases allow their customers to search every statistic contained in the database in any order and fashion as that user pleases. [21]

In conjunction with the MLBA's copyright argument against *CBC*, a right of publicity claim also served at the forefront of the opinion. The right of publicity centers around "one who appropriates the commercial value of a person's identity by using without consent the person's name, likeness, or the other indicia of identity for the purpose of trade." [22] This right is recognized under the common law of eighteen states and of those eighteen, eight have statutory counter-parts that are broad enough to encompass the common law right of publicity. [23] In determination of the right to publicity in fantasy sports leagues, the district court in *CBC* explained that "use of athlete information does not give them something free which it would otherwise be required to pay; players' records are readily available in the public domain." [24] Therefore, since the public can look up these statistics free of charge within the public domain and the supplier of such information does not make a profit from listing these numbers, the players are not missing out on a chance to make revenue and therefore not within the publicity right.

RECOMMENDATIONS

After the holding in *CBC*, it is evident that a professional athlete has no ownership over his performance and the right to professional sports statistics is held within the public domain. Litigation over the licensing and the right of publicity within the fantasy sports league industry would prove ineffective and overall costly to the parties involved. Overall, the average MLB player's career is 5.6 years, one in five of all position players play only a single season in the majors, while less than half of the players remain in the league long enough to play five seasons. [25] Furthermore, the *CBC* court concluded that professional baseball players are so well rewarded that the elimination of revenue from fantasy league licensing fees would have virtually zero impact on the players' ability to enjoy the fruits of their labor. [26] Hence, the players remaining in the league long enough to build up their statistical background for the sports industry league would reap little to no benefits from litigation matters. Therefore, the fantasy league industry should remain as is and allow the individuals involved to enjoy America's Favorite Pastime should be left to its entertainment value.

CONCLUSION

The world of sports entertainment has taken on a myriad of changes since the introduction of the internet. Some of these changes come from the ability to follow favorite teams through their websites to watching sporting events in real time, and finally the ability to track fantasy sports leagues with great ease. Through the use of fantasy sport leagues online, professional associations of

players as well as of the sports themselves, questions as to ownership of certain rights arose. With the court holding that professional statistics are not copyrightable and exist within the public domain, fantasy leagues can continue to utilize such information as well as maintain their licenses to continue the success of a phenomenon that has flourished over the past few decades. The internet has alleviated much of the stress of finding information and condensing it into a compatible medium. Therefore its use has tremendously helped the worlds of sports entertainment to continue its steadfast grip and fascination of the population.

[1] Fordham Intellectual Property Media & Entertainment Law Blog, http://iplj.net/blog/archives/354 (last visited Feb. 8, 2010); Fantasy Sports Trade Association, http://www.fsta.org/ (last visited Feb. 10, 2010).

[2] Fordham Intellectual Property Media & Entertainment Law Blog;Matthew G. Marrari, *When Fantasy Meets Reality: The Clash Between On-Line Fantasy Sports Providers and Intellectual Property Rights*, 19 Harvard Journal of Law & Technology 443, 452 (2006).

[3] Richard T. Karcher, *The Use of Players' Identities in Fantasy Sports Leagues: Developing Workable Standards for Right of Publicity Claims*, 111 Penn St. L. Rev. 585, 561 (2006-2007).

[4] Michael J. McSherry, *The Right of Publicity and Fantasy Sports: Should Professional Athletes Wield Control Over Their Identities or Yield to the First*

*Amendment?, available at*http://www.kentlaw.edu/perritt/courses/seminar/papers%202009%20fall/mike%20mcsherry%20-%20final%20-%20The%20Right%20of%20Publicity%20and%20Fantasy%20Sports.pdf(last visited Feb. 8, 2010); Matthew G. Marrari, *When Fantasy Meets Reality: The Clash Between On-Line Fantasy Sports Providers and Intellectual Property Rights,* 444.

[5] Brandon T. Moonier, *Legal Game behind Fantasy Sports: Copyright Protection and the Right of Publicity in Professional Performance Statistics*, 26 St. Louis U. Pub. L. Rev. 129, 130(2007).

[6] Scott Hervey, *Fantasy Sports League Hits It Out of the Park in Challenging MLB's Ownership Of Player Statistics*, Nov. 23, 2007,*available at* http://www.theiplawblog.com/archives/-trademark-law-fantasy-sports-league-hits-it-out-of-the-park-in-challenging-mlbs-ownership-of-player-statistics.html.

[7] Matthew G. Marrari, 446.

[8] Id.

[9] Fordham Intellectual Property Media & Entertainment Law Blog*;C.B.C. Distrib. & Mktg. v. Major League Baseball Advanced, L.P.*, 505 F.3d 818 (8th Cir. 2007).

[10] Fordham Intellectual Property Media & Entertainment Law Blog

[11] Michael J. McSherry, *The Right of Publicity and Fantasy Sports: Should Professional Athletes Wield Control Over Their Identities or Yield to the First Amendment?.*

[12] *C.B.C. Distrib. & Mktg. v. Major League Baseball Advanced, L.P.*, 505 F.3d 818 at 823.

[13] *CBS Interactive v. National Football League Players' Association*, 2009 WL 1151982 (D. Minn. Apr. 28, 2009).

[14] *Feist Publications, Inc. v. Rural Telephone Service Co*., 499 U.S. 340 (1991).

[15] Brandon T. Moonier, *Legal Game behind Fantasy Sports: Copyright Protection and the Right of Publicity in Professional Performance Statistics*, 137.

[16] Matthew G. Marrari, 447-8.

[17] *C.B.C. Distrib. & Mktg. v. Major League Baseball Advanced, L.P.* at 825.

[18] Copyright Act, 17 U.S.C. § 102(a)(2000).

[19] Brandon T. Moonier, 134.

[20] Id. at 133.

[21] Id. at 137.

[22] Restatement Third of Unfair Competition § 46.

[23] Brandon T. Moonier, 141.

[24] *C.B.C. Distrib. & Mktg. v. Major League Baseball Advanced, L.P.* at 824.

[25] Fordham Intellectual Property Media & Entertainment Law Blog

[26] *C.B.C. Distrib. & Mktg. v. Major League Baseball Advanced, L.P.* at 825.