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M & A'S- I'LL DRINK TO THAT

I. Introduction

Amidst the economic downturn over the world, many industries have seen a stunt in growth. In fact, during recessions, often consolidation among competing businesses within an industry is the only alternative to extinction. This is evidenced in the banking industry (i.e. Merrill Lynch sold to Bank of America in order to avoid bankruptcy) [1] as well the auto industry (i.e. Government gives Chrysler thirty day deadline to merge with Fiat). [2] Yet, in recent years, it is the beer industry that has seen more mergers and acquisitions than arguably any other sector. This article will discuss the reasoning behind the consolidation within the industry, examine the strategic approaches taken in the industry when merging with or acquiring a competitor, and finally, the future of mergers and acquisitions (M&A's) within the brewing industry.

II. Discussion

The increasing consolidation within the beer industry is attributed to a multitude of factors. One of the primary factors is the rising costs of key commodities like grain, glass and aluminum, all of which results in a lower profit margin for the producer.[3] Consolidating companies believe a larger share in the market will allow them to use this as leverage in negotiating more favorable prices for the commodities.[4] Perhaps even more compelling than the rising costs of commodities, is the falling demand for beer in Western Europe and the U.S. which has caused many struggling companies to seek consolidation in order to remain viable.[5] The falling demand for beer in these countries has been caused by rising competition from wines and spirits.[6] These shifts in beer drinking habits over the globe, coupled with rising costs, are why some of the largest breweries in the world have decided to merge in the past few years. For instance,

in 2007 SABMiller and Coors Brewing Companies, the United States second and third largest brewing companies respectively, decided to merge operations to become a more fierce competitor with rival number one brewer Anheuser-Busch.[7] However, these mergers are also taking place on a global scale. In November of 2008, Anheuser Busch announced its own merger with rival Belgium brewer InBev to form the world's largest brewing company.[8] Mergers and acquisitions are currently the ongoing trend within the beer industry. As mentioned earlier, the leading competitors in the industry have consolidated to their advantage. Why have these leading companies been so successful with this method of operation? The strategic approaches taken by leaders like SABMiller and InBev can be accredited to their success. These approaches are broken down into a three phase acquisition strategy.[9] The first phase of the strategy is what Malcolm Wyman, CEO of SABMiller, refers to as "land grab."[10] This strategy consists of acquiring as many companies as possible, particularly in emerging economies, where privatization is beginning.[11] The next phase of the strategy involves a merging of companies on "equal grounds." For SABMiller, it was merging with rival brewing company Peroni.[12] Similarly, Anheuser-Busch merged with European beer titan, InBev.[13] Finally, the last phase of the strategy is to buy out joint-ventures.[14] Before Miller was a part of South African Breweries (SAB), it was a domestic joint venture with Coors in the United States.[15] SABMiller has also purchased partnerships in Latin America and India as well.[16] It is approaches like the three-phased strategy referenced above that have led Anheuser-InBev and SABMiller to be the first and second largest brewing companies in the world, respectively.[17]

So what does the future hold for M&A's within the beer industry? I believe brewing companies will look to expand by establishing themselves in emerging

countries like India, China, and Russia. For instance, beer sales in India are forecast to grow at an annual growth rate of 17% over the next few years due to strong economic growth resulting in disposable incomes.[18] These forecasts have caused top brewing companies like SABMiller and Anheuser-InBev to establish production facilities in that region.[19] Some analysts have predicted that by 2010, China and Russia will amass half of the world's beer market.[20] Since 1997, China's beer consumption has risen by 40%.[21] In fact, Carlsberg, another leading brewer in Europe, has confirmed its plans to shut down roughly half of its European breweries in order to focus on the rising market in the East, specifically China.[22] The beer market in China will become even more competitive. A booming economy, as well as foreign investment have led China to emerge as the largest national beer market in the world, surpassing even the United States.[23] China is already the world's biggest producer of beer.[24] However, the Chinese beer market remains dominated by domestic brewing companies.[25] Accordingly, analysts believe that although there is clearly room for international investment, it will be done via joint ventures between brewing titans like Anheuser or SabMiller along with some of the more local breweries already established in the Chinese markets. [26] In 2002, Anheuser followed this strategy by acquiring roughly 30% of Chinese brewer Tsingtao Beer.[27] As the economies of countries like India, China, and Russia expand, these types of acquisitions will only increase.

III. Conclusion

The brewing industry is changing constantly. It appears the trend of consolidation is becoming more and more prominent as the world's brewing rivals combine forces. Reasoning behind such consolidation is to cope with rising commodity prices, as well as the opportunity for these businesses to operate with a larger cash flow in order to compete with other rivals. However, the international landscape of brewing consumption is increasing rapidly. Countries like India, China, and

Russia are becoming major targets for investment and expansion within the industry. It seems evident that M&A's will play a heavy role for major brewing companies looking to establish themselves within those markets. Therefore, as long as the world continues to consume beer, M&A's will always play a significant role within the brewing industry. There are a few driving factors behind this trend. Some experts believe it is rising costs. Others believe it's because of factors like marketability and name recognition. Whatever the reason, most believe these mergers will help to drive down prices for consumers, and I believe that's one result to which we can all raise our glasses.

End Notes

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NATIONALIZED TREASURE

I. Introduction

On February 27, 2009, the United States government announced that it was taking measures that could result in it taking as much as a 36% equity stake in Citigroup, Inc.[1] This would make the federal government the largest shareholder in Citibank.[2] By converting \$25 billion in preferred shares into common stock, the federal government hoped that the move would stabilize Citibank in a tumultuous market.[3] As a result of this move, a number of people have voiced a growing concern over the federal government taking further steps to nationalize other major financial institutions.[4]

Through taking a 36% stake in Citigroup, the federal government did not fully nationalize Citibank. As a result, Citibank is now caught between the private markets and governmental interests. While nationalization could seriously undermine confidence in the financial system, as Bank of America Chief Executive Officer Kenneth Lewis suggests,[5] this scenario poses some unique potential difficulties that financial institutions such as Citigroup might face. In reality, this move may ultimately serve to further destabilize Citibank. Using the recent AIG bonus scandal as a baseline, this paper will descriptively analyze how political and business interests can come into conflict under these circumstances and how these conflicts affect the corporate governance of these institutions.

II. Forced Statesmanship

In his seminal article, *The Higher Criticism of the Modern Corporation*, Professor Henry Manne discussed a concept known as “business statesmanship.”[6] Essentially, business statesmanship refers to actions taken on the part of firms and managers that sacrificed profits in order to carry out good deeds, such as through

making charitable donations.[7] However, executive efficiency does not automatically imply these managers were skilled in determining how their firms could best carry out those profit-sacrificing missions.[8] In other words, managers are chosen for their ability to make their firms profitable; they do not necessarily have the necessary expertise to meet the goals of those profit-sacrificing missions. This conclusion is logical, given that managers have a duty to operate their firms for profitable purposes.[9]

In a previous article, I discussed some of the issues with sovereign wealth funds; primarily those issues resulting from these funds acting as the investment arms of sovereign entities.[10] One of the primary concerns underlying sovereign wealth funds is that these entities will use sovereign wealth funds for political purposes, rather than for the creation of profit.[11] Having political actors in the markets represents a shift from market capitalism to state capitalism, where commercial motives become mixed with or replaced with political motives.[12]

Where political motives and commercial motives become mixed, an issue comes up under the business statesmanship model. Political motives and commercial motives can be in opposition to one another. A course of action that makes a firm profitable may not be politically desirable. Conversely, a politically beneficial course of action may not be profitable. This not only creates a problem with managers, who may not have the expertise necessary to effectively meet those political goals, but also with politicians, who may not have the expertise and incentives necessary to make a firm profitable. Much like managers may lack statesmanship, politicians may lack business acumen. The results in these situations can be catastrophic for firms that are subject to political influence.

III. The March of the Bonus Army

The recent controversy with American International Group (AIG) is one example of where political and profit-driven motivations can come into conflict. On September 16, 2008, AIG announced that the Federal Reserve Bank of New York was providing AIG with an \$85 billion secured revolving credit facility in order to resolve a liquidity crisis facing AIG.[13] In return for this facility, the federal government received warrants that could be converted into nearly 80% of AIG's common stock.[14] A little over a month later, AIG had used \$90.3 billion from the credit line.[15] In spite of these loans, AIG posted a \$61.7 billion loss for the fourth quarter of 2008, which was a record for the largest quarterly loss in United States history.[16]

All of these events came to a head in March 2009. On Sunday, March 22nd, AIG executives were slated to receive \$165 million in bonus payouts.[17] When reports of those payouts were leaked, the political response was ferocious. Iowa Senator Charles Grassley suggested the AIG executives should take "the Japanese approach": resignation or suicide.[18] President Barack Obama promised that his Administration would take every measure possible to prevent AIG from paying those bonuses,[19] despite the fact that a successful lawsuit initiated by AIG employees under Connecticut's wage act could have resulted in \$330 million in damages for abrogation of those contracts.[20]

Things only got worse for AIG managers from there. New York Attorney General subpoenaed AIG for information on the bonuses, revealing that, while these bonuses were paid out to 73 people for retention purposes, 11 of the people had left AIG.[21] Furthermore, on March 19th, the House of Representatives approved a 90% tax on bonuses paid to employees of firms earning more than \$250,000 that have received federal government bailout money, including employees of AIG.[22] Death threats to AIG executives became sadly

common.[23] The negative publicity surrounding these bonuses became so bad that, as of March 24, 15 of the 20 top bonus recipients at AIG gave back their bonuses.[24]

IV. Fair Consideration

This series of events illustrates how business and political interests can come into conflict. On the one hand, AIG can claim that it had legitimate business arguments for paying out these bonuses. First, AIG originally made these bonuses in order to retain their managers. While they were facing a liquidity crisis, they needed to keep their managers aboard to help plug the holes in their sinking ship; rather than have their managers abandon ship. Replacing these managers would have been a costly and difficult endeavor, given the bad press AIG received at the end of 2008. Second, if AIG broke these contracts, they would have faced lawsuits that would have caused them to incur damages and substantial legal costs. Both of these reasons would have substantially detracted from their profits. On the other hand, Congress and other groups had legitimate political arguments behind preventing AIG from paying out these bonuses. AIG received tens of billions of dollars from the federal government to save them from a possible bankruptcy. This money did not come without strings attached. While all of AIG's managers were not responsible for AIG's massive losses, many of those managers made poor business decisions and at least some blame could be assigned to them. Given that 11 of the managers who received these bonuses left AIG, these bonuses may not have been simply for retention purposes. The public outcry over these bonuses suggested that these bonuses either reflected poor business decisions adversely affecting taxpayers or that the bonuses were self-serving. In either case, the taxpayers were the ones who ultimately paid these bonuses. Politicians representing their constituents, if not pandering to them, had numerous reasons to decry those bonuses.

In the end, the political interests prevailed. Many of AIG's executives returned their bonuses. Congress is on the verge of passing a 90% tax on comparable bonuses paid to employees of firms receiving federal bailout money. There is nothing keeping these political interests from once again exercising their influence, both direct and indirect, over AIG. The current managers at AIG have numerous incentives to leave if they wish to avoid this political influence. People who could be future managers of AIG have similar incentives to avoid seeking work with AIG. Considering the tremendous resources at the disposal of political actors, commercial interests will probably not come out on top in any conflict between the two. By skewing corporate governance away from profit maximization and towards meeting political goals, this influence could seriously alter current incentives and norms within the corporate governance of firms receiving federal money. Statesmanship may become the new reality at those firms.

V. Conclusion

This article is not about whether political or business interests are equitable, legitimate, or just. Instead, this is an article about what happens when the focus of a firm shifts from profitability to satisfying political goals. While the federal government might think it is stabilizing financial markets through purchasing these shares in Citigroup, it is opening the door to a whole host of problems that could detract from Citigroup's profitability. The federal government could take measures that would seriously harm Citigroup and financial markets across the world. As illustrated by the AIG bonus flap, these conflicts can seriously alter the incentives of managers. This shift away from profitability could similarly reshape the incentives of shareholders and creditors. Corporate governance structures that are in place at firms subject to political influence may not be able to adequately handle the effects of conflicts between profit and politics.

This is a serious issue which private firms and the federal government need to take into consideration as the federal government continues to increase its involvement in the actions of private firms. The AIG bonus scandal may have only been a sign of things to come.

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[3] *Id.*

[4] *See, e.g.*, Kenneth Lewis, Op-Ed, *Some Myths about Banks*, Wall St. J., Mar. 9, 2009, <http://online.wsj.com/article/SB123655575807665985.html>.

[5] *Id.*

[6] Henry Manne, *The "Higher Criticism" of the Modern Corporation*, 62 Colum. L. Rev. 399, 413 (1962).

[7] *Id.* at 416-417.

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- [22] The U.S. Senate is currently considering a similar measure. It should be noted that the Constitutionality of this tax is in question, but that issue will not be

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THE FUTURE OF THE MERCK AND SCHERING-PLOUGH MERGER

I. Introduction

On March 9, 2009 Merck Co., Inc. ("Merck") and Schering-Plough Corporation ("Schering-Plough") announced that a merger agreement had been unanimously approved by each corporation's Board of Directors [1] and is worth \$41.1 billion dollars. [2] Furthermore, the merger of these two pharmaceutical giants is expected to increase efficiencies and result in cost savings of approximately \$3.5 billion annually. [3] This merger agreement is constructed as a reverse merger, under which Merck and Schering-Plough will merge, under the name Merck. [4] The purpose of the unusual manner of the merger is to ensure that Schering-Plough's joint venture agreement involving Remicade with Johnson & Johnson is not terminated. [5] This article discusses the uniqueness of the reverse merger. Part II analyzes the structure of the reverse merger and the purpose of the merger. Part III evaluates the advantages and disadvantages of the merger of these two pharmaceutical companies. Part IV concludes that the merger of the two pharmaceutical giants is beneficial and that the drug rights to Remicade will not be lost.

II. Background

In its merger, Merck and Schering-Plough devised a unique reverse merger. In the following section, the reverse merger will be analyzed to determine its structure and purpose.

A. Structure of the Reverse Merger

Under the Merck and Schering-Plough reverse merger, although Merck is the larger corporation, Schering-Plough will be "acquiring" Merck. Schering-Plough will form two subsidiaries (subsidiary 1 and subsidiary 2) in order to complete the reverse merger. [6] Schering-Plough will move \$10 billion into subsidiary 1 and 1.5 billion shares into subsidiary 2. Subsidiary 1 will merge with and into Schering-Plough, paying its shareholders \$10.50 in cash and 0.5767 of a share of Schering-Plough. [7] Finally, Merck will merge with subsidiary 2. [8] Each stock of Merck will be converted into a stock of Schering-Plough. [9] Thus, Merck will be a wholly-owned subsidiary of Schering-Plough, but Schering-Plough will take the name of Merck. [10] In other words, on paper a subsidiary of Schering-Plough will be acquiring Merck. In reality, Merck will be acquiring Schering-Plough.

B. Why a Reverse Merger?

Schering-Plough and Johnson & Johnson have a joint venture agreement on the marketing of Remicade, a drug for the treatment of rheumatoid arthritis. [11] Under the joint venture Schering-Plough has overseas rights to market Remicade while Johnson & Johnson markets the drug in the United States. [12] Remicade is a very profitable venture for Schering-Plough. In 2008 it represented \$2.1 billion in sales revenue for Schering-Plough. [13] A termination clause exists within the joint venture agreement stipulating that rights to Remicade would revert to Johnson & Johnson if change in control of Schering-Plough occurs. [14] As a result, potentially Merck and Schering-Plough could lose \$2.1 billion annually as a result of the merger. [15] Therefore, Schering-Plough and Merck devised an unusual merger strategy so that ownership of Schering-Plough does not theoretically change hands. Instead, under the reverse merger a subsidiary of

Schering-Plough will be acquiring Merck and thus, bypass the change of control clause.

III. Benefits and Costs of the Merger

Benefits from the merger include large annual savings, [16] an increase in presence abroad, [17] and complementary product portfolios. [18] As mentioned previously, the Merck and Schering-Plough merger will result in \$3.5 billion in annual savings. [19] Furthermore, the deal would increase Merck's presence abroad as 70% of Schering-Plough's revenues are made overseas. [20] In addition, Merck and Schering-Plough have complementary product portfolios and both focus on "biologics." [21] Also, the combined entity would have a more diverse portfolio in the therapeutic areas of cardiovascular, respiratory, oncology, neuroscience, infectious disease, immunology, and women's health. [22] Finally, the transaction would double the number of Merck's potential medicines. [23]

There are costs to this transaction as well: job reductions [24] and the potential loss of rights to Remicade. [25] Although both companies have already announced job cuts last fall, the merger will result in even greater job reductions as the surviving entity will consolidate the two pharmaceutical corporations and cut down on labor costs. [26] According to the Dow Jones Newswires, Merck expects to reduce about 15% of its work force. [27] Also, Remicade drug rights may be lost to Merck. [28] Even though the reverse merger technically bypasses the change of control clause to protect the arthritis drug, Johnson & Johnson could litigate this matter. [29] If Merck does lose Remicade, this would result in a nearly \$2 billion loss annually. [30]

IV. Conclusion

The merger between Merck and Schering-Plough is beneficial. First, both corporations complement each other through their medicinal product portfolios and therapeutic areas. Second, this deal will result in billions in annual savings for the merged entity. Although job reductions will result, this had already been expected last fall. Finally, most likely drug rights to Remicade will not be lost to Johnson & Johnson because the structure of the reverse merger bypasses the change of control clause. Therefore, Johnson & Johnson cannot terminate the joint venture. Even if Johnson & Johnson does choose to litigate the matter in court, the courts have consistently focused on the form of the merger and not the spirit of the transaction. [31] As a result, most likely if the matter is litigated, the courts will recognize the reverse merger and hold that the change of control clause was not triggered. Therefore, the merger is advantageous.

[1] Press Release, Merck & Co., Inc, Merck and Schering-Plough to Merge, Mar. 9, 2009.

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[14] Mintz, *supra* note 10; Kennedy *supra* note 5.

[15] Herper and Langreth, *supra* note 12.

[16] Press Release, *supra* note 1.

[17] Kennedy & Lagorce, *supra* note 2.

[18] Press Release, *supra* note 1.

[19] *Id.*

[20] Kennedy & Lagorce, *supra* note 2.

[21] *Id.* Press Release, *supra* note 1.

[22] *Id.*

[23] *Id.*

[24] Kennedy & Lagorce, *supra* note 2.

[25] *Id.* Herper and Langreth, *supra* note 12.

[26] Kennedy & Lagorce, *supra* note 2.

[27] *Id.*

[28] *Id.* Herper and Langreth, *supra* note 12.

[29] *Id.*

[30] *Id.*

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HONKING AND SWEARING NEVER WORK: AN EXAMINATION OF URBAN TRAFFIC CONGESTION REMEDIES

I. Introduction

As any city grows and develops a strong central business district (CBD), congestion is going to become a matter of concern for those who both live and work in that area. While this pain has been universally felt amongst metropolitan areas, the handling of this problem has varied. Despite the recognition of the issue, as the United States Department of Transportation (USDOT) has noted that congestion has nearly tripled in the last twenty five years, that same time period has seen an 239 percent increase in highway spending. [1] A recent English study estimated that a five percent reduction in travel time could generate five billion U.S. dollars in savings per year. [2] While no similar research has been commenced in the United States, American urban citizens lost 3.7 billion hours of time and wasted 2.3 billion gallons of fuel sitting in congested streets in 2003. [3] The approaches to alleviating congestion can be divided into two main schools of thought: 1) traditional, demand based responses, and 2) creative, alternative means of reducing congestion through innovation. This article will advocate and focus on the later by noting procedures that have been implemented with commercial vehicles, congestion pricing, and by discussing lessons for possible future policy implementation.

II. Commercial Vehicles

With American cities advocating for greener construction standards (i.e. LEED) and community members fighting to maintain green space, the urban environmental movement is not focusing enough upon the roadways. [4] Reducing traffic within urban areas could have a dramatic impact upon the health of city residents. [5] Specifically, urban traffic is a large contributor to carbon dioxide emissions, with freight traffic representing more than a quarter of such emissions. [6] Freight transportation, in particular (no pun intended), generates between 20 and 60% of local transport-based pollution. [7] While cities may try to enhance the efficiency of freight traffic through the relocation of freight hubs, what dictates how often and what deliveries are made is dependent upon the sector being served by the delivery, not specific characteristics of the city. [8] No matter where transport centers are located, grocery stores are going to be receiving fresh milk every night, and banks will see the armored truck every few days. The question is not how do we reduce the demand for such deliveries: the question is how do make such deliveries smarter and healthier for the urban landscape.

Given the historically small proportions of European roadways, European cities have by and large been the innovating force behind transportation reform. In general, such initiatives have focused upon the width and dimensions of delivery vehicles. Taking into account the space needed for deliveries limits the congestion in normal traffic lanes and parking areas. [9] Urban freight regulation in the United States has largely been cemented upon the tonnage of vehicles making deliveries, and the hours when such deliveries are made. Oddly, the environmental impact of such vehicles has been absent for such regulation, as have incentives for more innovative delivery methods. [10] If an American city is serious about reducing its urban traffic problem and cleaning its air, it must not

only punish those who make deliveries. It must make it more desirable for companies to improve their delivery mechanism.

Taking this extra step of addressing the systematic problems in urban freight transportation requires American cities to examine initiatives that have been implemented elsewhere. In Genoa and Lyon, electric delivery vehicles are allowed to use bus lanes to deliver outside of designated areas. [11] Urban planning initiatives in Bordeaux, Lille, Nice, and Lyon require for delivery zones to be inside of structures, while Paris has specified for certain industries to create internal delivery areas. [12] Bordeaux has also implemented a “local delivery space” in its CBD where delivery companies can leave their trucks to be watched by city attendants. This allows for traffic to remain unobstructed, and for deliveries within a close proximity to be made by foot, and frequently in a timelier manner. [13]

With regards to actually regulating the freight trucks themselves, European cities have also taken the lead. Some European municipalities require registration of delivery trucks within certain zones, providing lower rates for clean, small, and silent delivery vehicles. Based upon the identification of high-density “environmental zones” or “low-emission zones,” benefits are granted to freight vehicles that are environmentally friendly. For example, Copenhagen implemented a scheme where trucks with engines less than eight-years-old, and which are loaded with over 60% of capacity are granted a “green certificate, offering the truck access to areas in the city not available to more conventional trucks. London, the poster child for Congestion Pricing, has exempted electric vehicles and naturally gas fueled trucks from the much-debated tax. [14] If a successful congestion reduction program is to be established within an American

city, surely the commercial vehicles that are an integral part of the city's economic activity must be taken into account.

III. Personal Vehicles & Congestion Pricing

As the rate of vehicle ownership has increased in the United States, so has the amount of miles traveled. Every household in 1969 traveled approximately 12,400 miles per year. By 2001, that figure had nearly doubled to 21,200 miles. [15] With the sheer quantity of vehicles increasing dramatically, the USDOT has recognized the consensus among economists that congestion pricing is the most viable approach to reducing congestion and establishing a relative equivalent between the cost of driving and the related externalities from this activity. [16] Ranging from charging varying toll prices at different times of the day, to electronic taxation, to flexible parking meter rates, congestion pricing takes into account the high demand for certain roadways, and charges accordingly. Based upon William Vickrey's idea that traffic jams occur when drivers are not charged for the full costs they impose upon others the theory dates back to 1952. [17] While most proposals to end congestion focus upon the construction of new roadways, this is not an efficient way to address traffic congestion. [18]

Roads are a public good that can be abused as in any typical tragedy of the commons scenario, but what makes them unique is that they are "congestible public goods." [19] In this sense, the externalities of traffic arise because of the differential between the cost to the user and the actual cost (including time lost, wear on the road, environmental impact, etc.). By utilizing congestion pricing, the taxation system is forcing drivers to internalize part of the externality that they impose the roadway, thereby allowing the roads to be utilized at a more efficient level. [20] As it currently stands, individuals who would pay to use a non-

congested thoroughfare would not because it is not worth the time investment. [21] Roadways, instead, are used by those who value roadways even less, but who also value their time at a relatively low rate. [22]. While the historic solution to congestion has been to construct more roads, oddly, this approach has lead to an inverse incentive structure and actually more traffic. The construction of new roads actually induces more travel and overall, congestion is either no better or even worse then previously experienced. [23] Juxtaposed with the construction of new roads, congestion pricing regimes simply remedy the externality of congestion by changing drivers for access to the roadways at issue. [24]

While congestion pricing may be a worthwhile proposal, it has run into its fair share of opposition. [25] In 1987, As New York attempted to charge all drivers \$10 per day to go south of 59th Street, the parking garage workers, the teamsters, and the tourism, hotel, and entertainment industry workers banded together to appose the plan. [26] Needless to say, Mayor Koch backed down. Furthermore, the ambitious plan New York City Mayor Michael Bloomberg proposed in April of 2007 ran into political problems from within the legislature. The system proposed would have been in operation from 6:00AM to 6:00PM Monday through Friday and would have charged cars \$8 to go south of 86th Street, while trucks would have paid \$21. Utilizing a series of radio frequency identification tags and cameras to capture those who had not paid, the system would have also exempted taxis, transit vehicles, handicapped vehicles, and emergency equipment. [27] Like in 1987, the political backlash was intense, with new worries stemming from those who lived just north of 86th Street, worrying that the plan would simply turn their neighborhood into a parking lot for individuals who would drive to the edge of the congestion zone, and then walk the rest of the way. [28] While such programs may not have been as successful as initially intended, that by no means that the idea is not viable. On the contrary, the implementation of

congestion pricing must be done in a manner more cognizant of those impacted by the new pricing mechanism.

IV. Future Implementation

Despite the feasibility of a congestion pricing plan, the first element that has to be taken into account is the exceptions. For any large-scale plan to succeed lower rates or exemptions would have to be offered to those who actually reside within the district. Furthermore, the frequent players in downtown deliveries would have to be brought on board with the program. Discounts for congestion pricing credits, especially for companies that recognize the frequency upon which they will be traveling in the congestion zone, could additionally be offered to those who buy such credits in bulk. Of course, pilot programs would first have to be implemented so as to test the response of the public and feasibility of the system.

The lesson to take from previous implementations of congestion pricing is largely focused upon the destination of the funds and the flexibility of the program. Allowing for individuals to have alternatives to paying the tax is key to the program's success. One must keep in mind that the goal of the mechanism is not to raise funds, but is to reduce the congestion within the urban area. Therefore, funding from the congestion pricing should, excluding operational costs of the system, go towards improving the public transportation network. [28] Furthermore, the pricing scheme must be variable with time, season, route and type of vehicle. [29]. Not only would rates be lower at off-peak times, but also discounts could be given to transportation that is environmentally conscious. Due to technological advances, it is now conceivable to place a higher price on streets with more traffic, and a lower price tag on lesser-used alternative routes. [30] Given the fact that traffic patterns change over time the pricing

scheme should change as well. Keeping in mind that London re-evaluates its pricing scheme every few years, while Singapore does the same every few months, such a procedure is necessary in maintaining the effectiveness of the program, especially when introducing new fees. [31] Furthermore, the extensive use of I-Pass and E-Z Pass in other provides many cities with the technological base necessary to shift fee structures easily. If individuals, especially commuting in from the suburbs, are used to paying tolls in their home municipalities via electronic tolling, the extra toll within the city will be less difficult to implement.

V. Conclusion

While it may not be a realistic to imagine Americans no longer utilizing their cars, yet it is reasonable to propose a system upon which vehicle users would be charged for the negative externalities they impose while driving. Coupled with creative solutions to freight movement, congestion pricing offers a unique and affective means of handling heavy vehicular traffic. Regardless of what solution is adopted, a successful transportation policy should reduce congestion, lower energy consumption, and decrease air pollution while improving the speed and efficiency of the transportation network. [32] It is with high hopes that we, as an urban society, enter the second decade of the millennia with an awareness of our environmental impact and a desire to lessen its negative consequences.

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THE LENDING TREE: HOW TO SNAG A SMALL BUSINESS LOAN FROM A BANK

I. Introduction

Unless a new business owner is a millionaire or has an angel investor, a small business loan is almost always a necessity to get the business off the ground. The amount of labor that goes into starting a small business is a feat in and of itself. However, without the financial backing of a small business loan issued from a bank, all other efforts at starting the business may be fruitless. This article will discuss how to obtain a small business loan from a bank by discussing the preparation that goes into receiving a small business loan from a bank and discussing how to manage debt.

II. Loan Meeting

Before receiving a small business loan from a bank, the new business hopeful will have to present his or her case to a lending officer from the bank. [1] While the presentation to the lender may be a determining factor in whether or not the business owner will get a loan, the preparation that goes into the presentation is key. [2] The lender will look at many different factors including “your personal financial history and credit rating, your history with a particular bank, the purpose of your loan request, your experience in managing a business, particularly the business for which you need financing, your personal investment and commitment to the business, how you intend to repay the loan, and your preparedness and ability to convince the lender that you are a good credit risk.”

[3] A lender will look towards a positive combination of these factors in determining whether to lend money. [4]

A. Personal Credit History

Many potential small business owners do not realize how much weight personal credit history carries. [5] A good credit history shows the bank that the potential lender is responsible and will be able to successfully get a new business off of the ground. [6] While getting a loan in the midst of the current economic crisis may seem impossible, it simply takes more work on the part of the potential lender. [7] “In the wake of all these corporate bankruptcies, banks are carefully reviewing all lending practices and trying to mitigate the risks. Before you go into a financial institution for a loan, know your credit history.” [8] Additionally, if an individual has a positive history with the lending bank, he or she may have a better chance of getting the loan application approved. [9]

B. Documentation

The purpose of a request for a loan must be communicated to the lender in a manner that is both professional and comprehensive. [10] “Be prepared to have several key documents on hand before you even set foot in a bank. These should include personal financial statements, tax returns, monthly cash flow projections, and a well-prepared business plan. Established businesses should also produce references from suppliers and customers.” [11] Additionally, while enthusiasm goes a long way towards showing commitment to opening a new business, potential lenders should be careful not to exaggerate facts in writing or during the meeting because the bank can easily check for errors. [12] Errors in reporting will greatly diminish an applicant’s credibility. [13]

C. The Business Plan

It is often helpful to combine the above documentation into a single portfolio called a “business plan.” [14] “Having gone through the exercise of documenting the business plan will leave you much better prepared to explain your business, how you intend to manage it, what your projected income and expenses will be, how soon you expect to start generating a profit, what your cash flow will look like, and finally, how you intend to repay the loan.” [15]

III. Managing Debt

A key issue when taking out any kind of loan revolves around what would be considered acceptable terms. [16] Often such a decision whittles down to the personal choice of the individual taking out the loan. [17] “It is important to think carefully about the amount you are requesting, and over what term you want to repay the loan. It may be tempting to extend the loan over a longer term and thereby reduce your monthly payments, but you will be paying a lot more interest over the long run, thus cutting into your business profits and reducing your return on equity . . . You should not overburden your business with debt.” [18] However, new business owners must remember that it is important to make sure to take out sufficient financing for the new business from the onset of the loan. [19] If the original loan falls short, the owner will be forced to take out a second loan. [20]

Interest rates are often a source of confusion among new business owners. [21] Often, the lowest interest rate does not equate with the best loan terms. [22] “Trade- offs,” or “giving up one thing in return for another” must be considered before picking the best loan. “The most normal application is when a lower interest rate is given up in return for more favorable terms such as a longer

business loan.” [23] It may be helpful to seek the advice of a business loan advisor when making such a decision. [24] It is also important to shop around for the best loan terms. [25] Some banks specialize in lending to certain types of businesses and may therefore offer better terms and conditions depending on the business. [26]

Once the terms of the loan have been agreed upon, the bank will require the lender to sign numerous documents, including a loan agreement, promissory note, and a guarantee and surety agreement. [27]

IV. Conclusion

While obtaining a small business bank loan in this economy might not be the easiest feat, it is still possible. With the appropriate planning before requesting a bank loan and a proper understanding of how to manage debt, starting a new business is completely feasible.

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THE BIG THREE: BAILOUT OR BANKRUPTCY?

I. Introduction

The auto industry's troubles have recently come to light in mainstream American news. The big three automakers, comprised of GM, Chrysler and Ford, have seen slumping sales and are in need of major financial help to avoid going under. In 2008, GM's sales were down 21% in North America. [1] Ford reported a loss of \$14.6 billion dollars in the same year. [2] Chrysler's sales were down 30% in 2008, which was the largest reported loss of the major auto makers last year. [3] Both GM and Chrysler have requested help in the form of federal loans from the US government, while Ford has made an effort to stay afloat without federal help. [4]

II. Government Intervention

The auto industry is a private industry and is thus driven by market forces. Generally, the government allows these market forces to determine which companies will thrive and which will fail. However, some have claimed that certain companies are just too large for the government to sit back and allow them to fail. GM, Chrysler and Ford would fall into this category. Because of this, the government stepped into the equation in September of 2008. In September, the U.S. Department of Energy promised to provide \$25 billion in loan guarantees to auto makers that will be making more fuel efficient vehicles. [5] Auto makers were to submit requests for this money by the middle of December of 2008, and many have done so. [6] In December of 2008, the government also provided billions of dollars in loans to the struggling automakers. Chrysler received \$4

billion in federal bridge loans. [7] In the same effort to revive the failing industry, GM was granted \$9.4 billion in federal loans and a Treasury Department loan of \$6 billion. [8] While Ford has taken a backseat to GM and Chrysler in this bailout, they too requested a \$9 billion line of credit from Congress. [9] The auto makers were granted these loans on a promise that they would begin turning a profit by 2012.

While these loans are by no means small, they are only a small percentage of what will be required to keep these companies running. Because of this, the troubled automakers are requesting even more money from Congress. Congress and the current administration are determined to keep these companies afloat. In a recent speech to a joint session of Congress given in February, President Obama stated that "[he] believe[s] the nation that invented the automobile cannot walk away from it." [10] While this statement is incorrect, considering it was a German engineer, and not an American who invented the automobile, it demonstrates the current administration's stance on the issue. [11] By March 31, 2009, GM and Chrysler will have to present a plan to congress laying out what steps it plans to take in order to remain viable, at which time Congress will again decide whether to loan the automakers more money. [12]

III. The Auto Industry's Long Standing Problems

With all of the recent attention to the automaker's financial troubles, it might be presumed that the financial problems are of a recent nature. The auto industry would like to tie its current problem into the recent economic downturn and have the public believe that their problems are economic in nature. Clearly this is not the entire truth. While the current economic crisis has surely affected the auto industry, their financial problems go back much further and deeper. Automakers

have been reporting losses for the last several years and at different points throughout the last several decades. [13] These long term troubles stem from major defects in the way that the automakers are structured and their inability to effectively compete with foreign manufacturers. One of the biggest problems in the Big Three's structure is their contract with The International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW). [14] The UAW is one of the largest unions in America, with approximately 513,000 active members. [15] The fact that the employees of the Big Three belong to this Union means that they have incredible bargaining power. If the Union decides to go on strike because of a disagreement, this greatly affects the auto industry's ability to conduct business. Because of this fear, and because of a period of good business in the 1990's, the UAW's requirements of the automakers are far too demanding and cost the automakers far too much money. A huge portion of the Big Three's expenses are benefits paid out to employees, former employees, and retirees. While job security is of course important, the UAW has gone too far in its demands, which have cost the auto industry dearly. [16] The increased costs that the Big Three incur due to the contracts with the UAW make it difficult to compete with foreign manufacturers dealing in this country. [17] With lower production costs, these foreign companies can create an equal car at far less cost to the consumer. While there is little likelihood the UAW will go anywhere anytime soon, especially if the government decides to bailout the industry, automakers must find a way to reduce the costs associated with UAW contracts. Further adding to the Big Three's problem is their huge amount of products and dealers. With so many different products, and not enough demand, the companies will surely lose money in producing different vehicles, some of which do not sell.

IV. Risk of Further Governmental Intervention

If the Big Three fails, it could be disastrous to the US economy, but a government bailout is not the only option. The failing automakers also have the option of filing bankruptcy with a comprehensive bankruptcy plan in place. While bankruptcy is a possible solution, the auto industry and the current administration have been arguing that receiving government loans is the auto industry's best chance of surviving their financial disaster. [18] Automakers have already received a large governmental bailout, but Congress should refuse their further requests for more money. The risks involved in providing more bailout money are numerous and large. First, there is a giant risk to the automobile industry itself, in that a bailout plan would not require enough restructuring and oversight to actually fix the automakers problems. As shown above, the automakers do not simply need money. They need to completely restructure their current contracts with the UAW in order to be able to price their vehicles competitively with foreign automakers and turn a profit. A second major risk is that Americans will begin to assume that the government will involve itself whenever a large company fails. This would defeat the purpose of having a private sector and could just prolong the company's problems rather than solve them. Further, when the government steps into the private sector, that sector becomes politicalized, something the private sector should not be. Another major risk is that the taxpayers will not be repaid the loan money, and that the automakers will still end up folding. This might impact the way the public views the government and whether they trust the government to make decisions with their tax dollars, especially since 75% of American's already oppose the bailout. [19]

V. The Bankruptcy Option

The automakers claim that their other option, filing bankruptcy, would affect consumer confidence, further impacting their sales and hurting them even more.

[20] They argue that consumers will be hesitant to purchase vehicles from a company that may not be around to honor warranties or be able to service those vehicles. While it is true that consumers may have less faith in a company who has declared bankruptcy, the automakers have already lost their consumer confidence. The public is well aware of the financial problems of these companies, and declaring bankruptcy would probably not further any consumer hesitation. Filing Chapter 11 bankruptcy would allow these automakers to restructure themselves and attempt to become profitable. [21] There are several Sections of Chapter 11 that are of particular significance to the failing automakers. The first is Section 363 which allows a debtor who files bankruptcy to sell off its assets free and clear of all liens, claims and encumbrances. [22] This would allow buyers to purchase GM and Chrysler's distressed assets with clean title. This could not necessarily happen outside of a bankruptcy filing and could give consumers confidence in purchasing a Big Three product. Another important section is Section 365 which allows a debtor in bankruptcy to reject an executor contract release. [23] This is important because it would allow the automakers to breach some of the enormous amount of dealer agreements which are not easy to break outside of Bankruptcy. Breaking dealer agreements would benefit the automakers because there are currently many more dealers than necessary to supply the demand for vehicles. Furthermore, Section 1113 would allow the automakers to deal with their collective bargaining agreements. [24] This means that they would have a chance to renegotiate their Union contracts or argue for a judicially imposed change in those agreements if the Union will not renegotiate. Because these Union contracts are such a hindrance to generating profits for the Big Three, renegotiation of these contracts should place the automakers in a much better financial situation.

IV. Conclusion

Filing bankruptcy does not come without risk, but these risks are much more tolerable than those created if Congress provides the failing automakers with more loans financed with taxpayer dollars. The automakers will likely come out of bankruptcy smaller and able to provide fewer jobs. Losing some jobs is not the perfect solution, but it is the preferred solution when the other possibility is to lose all the jobs provided by the companies. Losing all the jobs provided by these companies is a real risk with the bailout plan because the bailout plan will only prolong the problem, not fix it. The risk that the companies will lose consumer confidence if bankruptcy is filed is greatly exaggerated by the automakers and is probably more of a fiction than reality here. Bankruptcy is the automakers' best option, providing them with a chance to restructure their companies in a way that will make them sustainable and profitable in the long run.

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THE U.S. FINANCIAL CRISIS: IS LEGISLATIVE ACTION THE RIGHT APPROACH?

[A few short years ago, there was a country experiencing significant prosperity. The flow of credit within the economy was fluid, stock prices were at all time highs, and many people were becoming wealthy in due part to real estate speculation and appreciation. As the economic outlook in the real estate market was bright, banks began granting increasingly risky loans. Eventually the bubble burst. Inflated real estate market values began to decline, lenders found themselves unable to pay back their risky loans, and the credit markets froze. As a result, government intervention came in the form of subsidizing failing banks and businesses.]

In the middle of this financial crisis facing our country, one would assume this passage is referring to the United State of America. However, this is the very similar story of the Japanese housing bubble that burst and led to what is known as the “the lost decade.” This article will briefly describe the legislative responses taken by the Japanese government to address their crisis, compare those to any similar one’s being taken by the US government in response to its own, and comment which legislative actions may succeed or fail, and why.

The financial crisis that led to Japan’s “lost decade” is very comparable to the crisis our country is currently facing. Overnight Japan became one of the wealthiest countries in the world. In fact, just before the Japanese economy fell into a deep recession, it was experiencing unprecedented prosperity. This prosperity was attributed to the success Japanese businesses were experiencing in the exporting of Japanese goods, as well as economic policies implemented by their government discouraging the importation of goods.[1] This led to a massive buildup of the Yen, which in turn led to easily obtainable credit for Japanese

citizens and businesses which resulted in real estate and stock speculation.[2] At its peak, Tokyo's Ginza District was selling for \$139,000 a square foot.[3] Eventually the bubble burst. Houses were selling for 1/10th their peak value, and the stock market at one point lost roughly 70% of its value.[4] Many of the problems causing the deep recession were risky loans and lack of oversight and regulation in the real estate and financial markets.[5] Although this lack of regulation and oversight was the catalyst behind the deep recession, many economists believe it was the Japanese government's inaction that led to their great depression. [6]

Traditional capitalists believe the government is overstepping its bounds when it intervenes in the private market to rescue failing banks and businesses. This phenomenon has become to be known as "the bailout." Although in Japan's case, many believe it was their government's opposition towards the bailout, and policy of "do nothing" while Japanese banks were swallowed by unrecoverable debt that caused 'the Lost Decade.' [7] As a result consumer confidence fell, Japanese citizens saved, and their economy became stagnant.[8] It was not until 1999 when the government finally responded with legislative action forming the Resolution and Collection Corporation to handle the "toxic" debt. [9] Unfortunately, by this time, the Japanese economy had already fallen into a negative spiral for nearly ten years which is why this time frame was labeled "the lost decade." One particular critic of the Japanese government's inaction was a Princeton University professor who, at the time of the crisis, accredited "exceptionally poor monetary policymaking" for the resulting "lost decade." [10] That professor was Ben Bernanke, now head of the U.S. Federal Reserve.[11]

Currently, a little over a decade later, the United States is facing a very similar issue, a real estate market in shambles, and a financial system in crisis. Recognizing the dangers of sitting idle, the United States, now stuck in its

own recession, has moved swiftly with legislative action. In October of 2008, the Bush Administration implemented a \$700 billion bill known as the Economic Stabilization Act of 2008 in order to assist financial banks and institutions that were bogged down with “toxic” debt. [12] This act is aimed at purchasing troubled assets from banks (specifically mortgage backed securities) as well as injecting large stakes of capital into financial institutions to ease the flow of credit. [13] President Obama opined the need for additional legislative action, warning of the United States own “lost decade” if congress did not pass a stimulus bill for the economy. [14] As a result, congress passed another \$800 billion stimulus plan. [15] This bill includes aid to states and local governments, tax provisions, and mass spending for programs like health, education, and renewable energy. [16] In all, the rescue efforts are estimated to total almost \$2.5 trillion.[17]

Suffice it to say, government inaction has not been the route taken amidst the U.S. financial crisis. This immediate legislative action is a starkly different approach from the “do nothing” policy taken by Japan’s government. Not until 1997, when one of Japan’s largest financial institutions failed, did government bailout opposition soften, but by then, the damage had already been done. [18] In contrast, the U.S. has taken the stance that failure is not an option for large financial institutions. One specific case was the government bailout of financial giants “Fannie Mae” and “Freddie Mac.” [19] In fact, some believe it is this legislative response that will help the U.S. economy weather the financial storm much better than Japan did during “the lost decade.” Taro Aso, Japan’s prime minister, cautioned the United States that procrastination prolonged his country’s financial crisis. [20] However, some legislative action taken by the United States government has been met with criticism. During Japan’s economic downturn the government increased spending on public works programs like infrastructure investment that had no beneficial

effect of pulling the economy out of the recession. [21] These are exactly the types of projects President Obama plans to implement to steer off the deepening crisis. [22] Economists from the Cato Institute, a non-profit public policy research foundation, have voiced their opinions that government spending is not a way to improve economic performance. [23][24] If this approach will work for the U.S. remains to be seen.

Whether or not the U.S. government has taken the right approach with its legislative action will be decided in the next few years. One thing this government cannot be criticized of is its inaction to address the crisis. We can only hope this response will prevent our country from falling into a “lost decade” of our own, just as Japan suffered as a result of its own real estate bubble.

End Notes:

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[3] *Id.*

[4] *Id.*

[5] Justin McCurry, *Japan’s Lost Decade*, GUARDIAN, Sept. 30, 2008, available at <http://www.guardian.co.uk/business/2008/sep/30/japan.japan>.

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] Eric Weiner, *What the US Can Learn from Japan’s ‘Lost Decade,’* NPR, Mar. 13, 2008, <http://www.npr.org/templates/story/story.php?storyId=88156284>.

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[13] *Id.*

[14] Laura Meckler and Jonathan Weisman, *Obama Warns of 'Lost Decade,'* WALL ST. J., Feb. 10, 2009, *available at* [http://online.wsj.com/article/SB123419281562063867.html?mod=rss_Today's Most Popular](http://online.wsj.com/article/SB123419281562063867.html?mod=rss_Today's_Most_Popular).

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[17] *Id.*

[18] McCurry, *supra* note 5.

[19] Statement by Federal Reserve Board of Chairman Ben Bernanke, Board of Governors of the Federal Reserve System, *available at* <http://www.federalreserve.gov/newsevents/press/other/20080907a.htm>.

[20] McCurry, *supra* note 5.

[21] Weiner, *supra* note 10.

[22] *Economic Stimulus*, *supra* note 15.

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[24] David Nicklaus, *Economists Say Stimulus Won't Work*, ST. LOUIS POST-DISPATCH, Jan. 29, 2009, *available at* <http://www.stltoday.com/blogzone/mound-city-money/us-economy/2009/01/economists-say-stimulus-wont-work/>.

INVESTING IN CHINA THROUGH A HONG KONG, SAR ENTITY – TAX CONSIDERATIONS FOR RIDING THE NEXT WAVE

I. Introduction.

It is well known that the big movement of capital in the next decade is going to be to Eastern Asia, the People's Republic of China (PRC) and India being the two world's most preferred targets due to the size of their consumer markets. This article will only focus on the PRC, and Hong Kong due to its proximity to the Chinese Mainland. As it will be further explained, although foreign capitals may be invested in the PRC directly; the Hong Kong tax system is lower and simpler than the Chinese one, and therefore, from a taxation view point it makes sense to manage assets located in the PRC through a Hong Kong, SAR entity. Hong Kong became a Special Administrative Region (SAR) of the PRC on July 1, 1997. However, it has a high degree of autonomy, except in the areas of defense and foreign policy, and retains its own currency, laws, and border controls.

II. Investing in the Chinese Mainland directly vs. Investing in China through a Hong Kong entity.

Even though, the United States has not entered into a comprehensive double-taxation avoidance agreement with Hong Kong [1] this jurisdiction is still attractive for investors to incorporate a company to manage assets in the PRC. Indeed, Hong Kong has a tax regime different and completely separate to the Mainland of China. It even has its own independent tax authority known as the Inland Revenue Department. [2] As it will be explained later it has a low tax

structure which imposes tax liability separately on different types of income.

[3] Moreover, tax rate is the same for foreign and local companies. [4]

As opposed to the PRC, [5] Hong Kong does not have any capital gains tax, sales tax, withholding tax in dividends and interest, inheritance tax, value-added tax, and it only levies on very few items (e.g. tobacco). [6] Moreover, unlike the U.S. and Mainland China, Hong Kong operates a territorial basis of taxation under which only income sourced in or from Hong Kong is taxable. [7] Therefore, foreign income is not taxable even if remitted to Hong Kong. In contrast, under the Chinese Law, individuals and/or companies who are Chinese residents are also taxed on their income outside China and receive a credit for overseas taxes. [8]

III. Hong Kong tax system.

There are three direct taxes imposed in Hong Kong: i.e. profit tax on business profits, salaries tax on income from employment and pensions, and a property tax on income from real estate. [9] Profit tax for individuals is at the standard rate of 16% since 2004-2005, [10] Corporate Tax is at a rate of 17.5% on assessable profits, [11] and business other than corporate entities pay a rate of 16.5%. [12] With respect to the shipping business, shipping profits meeting the conditions of the double taxation agreement with the USA are exempt from profits tax in Hong Kong. [13]

In Hong Kong, personal income tax is known as Salaries tax and it is governed by the provisions of the Inland Revenue Ordinance (IRO). Salaries tax of 15% (calculated after deduction of expenses and personal allowances) is imposed on income arising in or from a Hong Kong employment. [14] This tax is demanded on a yearly basis.

Property tax is also governed by the provisions of the IRO. Under these provisions, tax is only chargeable on rental income from owned property situated in Hong Kong, and the rate ranges from 16% of the assessed annual rental income from owned property situated in Hong Kong. [15] Likewise, the rate ranges from 16% of the assessed annual rental income from the land or buildings and an allowance of 20% for repairs and maintenance. [16]

Hong Kong does not levy a general consumption tax. However, it has several indirect taxes including rates on property, betting duty and various other selective taxes and charges (e.g. hotel accommodation tax and airport tax). [17] Besides, a stamp duty is levied on documents relating to transfers of real estate and Hong Kong stocks and shares. [18]

IV. Double Taxation Agreement between the PRC and Hong Kong.

On August 21, 2006, the Hong Kong and PRC tax authorities signed a comprehensive double tax "arrangement" which deals with dividends, interest and royalties, transfers pricing, tax credits, and exchange of information (the Arrangement). [19] Under this new Arrangement, foreigners investing into the Chinese mainland should seriously consider using Hong Kong-based structures. The most relevant provisions of the Arrangement are commented as follows:

1. There is no limitation of benefits or anti-conduit provision. Thus, non-Hong Kong investors can utilize the arrangement by establishing entities in Hong Kong, or outside Hong Kong if they are permanently established (i.e. managed and controlled) from/in Hong Kong. [20] It should be kept in mind that even if the legal entity is managed and controlled in Hong Kong, this does not necessarily mean that the company will be subject to Hong

Kong tax. This is because Hong Kong does not impose tax based on incorporation or residency criteria.

2. The Arrangement limits PRC withholding tax on dividends to 5% if the Hong Kong resident legal entity holds at least 25% of the capital of the Mainland enterprise, and 10% in all cases. [21] Hong Kong is an attractive location in which to base a holding company because it does not impose a withholding tax on dividends or interest, or on profits remitted by a branch.
3. There Arrangement recognizes the taxing right of both the Mainland and Hong Kong. But, it limits PRC withholding tax on interest to 7% (whether paid to a financial institution or other lender). [22] Again, Hong Kong does not tax interest if the borrower first received the loan funds outside Hong Kong, thus, it is a good business to base a lending operation in Hong Kong.
4. The Arrangement limits PRC withholding tax on royalties to 7% of the gross amount of the royalties in all cases. [23]
5. the Arrangement specifically exempts capital gains tax from the sale of shares in a mainland company when a foreign investor disposes of shareholdings and other assets in China, so long as the holding is less than 25%. [24] Gains realized by a Hong Kong resident from the disposal of a shareholding of 25% or more in a foreign invested enterprise will remain subject to capital gains tax in the mainland. [25] Since Hong Kong does not tax capital gains, good tax planning strategy could result in gains not taxed in either jurisdiction.
6. Other taxes, such as Stamp duty, business tax, land appreciation tax, and other indirect taxes are not covered by the arrangement, and therefore, the liability for those mainland taxes still remain enforced. [26]

V. Conclusion.

From a tax perspective, Hong Kong is an attractive jurisdiction for investments in the PRC. It provides reduced taxes and a simpler tax regime compared to the Chinese one. Moreover, Hong Kong provides a double-taxation avoidance arrangement with the Mainland. Therefore, it is highly advisable for foreign capitals to explore alternatives in the Hong Kong jurisdiction as a vehicle to manage assets in the Chinese Mainland.

[1] <http://www.legislation.gov.hk/table6ti.htm> (last visited Feb 27, 2009) The U.S.A. and Hong Kong only have signed a Double Taxation Relief with respect to income from shipping operations.

[2] <http://www.ird.gov.hk/eng/abo/mis.htm> (last visited Feb 27, 2009).

[3] <http://www.lowtax.net/lowtax/html/hongkong/jhktax.html> (last visited Feb 27, 2009).

[4] <http://www.hketo.ca/invest/tax.html> (last visited Feb 27, 2009).

[5] http://www.worldwide-tax.com/china/china_tax.asp.m (last visited Jan 27, 2009).

[6] http://www.ird.gov.Hong Kong/eng/pdf/tax_guide_e.pdf (last visited Jan 27, 2009).

[7] *Supra* note 4, at 1.

[8] http://www.worldwide-tax.com/china/china_tax.asp.m (last visited Jan 27, 2009).

[9] *Supra* note 4, at 1.

[10] *Id.*

[11] <http://www.doingbusiness.org/ExploreTopics/PayingTaxes/Details.aspx?economyid=43> (last visited Feb 27, 2009).

[12] *Supra* note 4, at 1.

- [13] <http://www.legislation.gov.hk/table6ti.htm> (last visited Feb 12, 2009).
- [14] <http://www.gov.hk/en/residents/taxes/taxfiling/taxrates/salariesrates.htm#sr> (tax rate for the period 2008-2009) (last visited Feb 27, 2009).
- [15] http://www.ird.gov.hk/eng/tax/ind_ppt.htm (last visited Feb 27, 2009).
- [16] *Id.*
- [17] <http://www.hketo.ca/invest/tax.html> (last visited Feb 27, 2009).
- [18] <http://www.ird.gov.hk/eng/tax/sdu.htm> (last visited Feb 27, 2009).
- [19] <http://www.ird.gov.Hong Kong/eng/pdf/pam71e.pdf> at page 2. (last visited Jan 27, 2009). The arrangement took effect after the completion of certain formalities in both jurisdictions. With respect to income derived on the mainland on or after January 1, 2007, and income derived in Hong Kong on or after April 1, 2007.
- [19] *Id.*
- [20] *Ibid.* at page 7.
- [21] *Id.*
- [22] *Id.*
- [23] *Id.* at page 6-7.
- [24] *Id.*
- [25] *Id.*
- [26] *Id.*

GREY AREA ANATOMY: TAX EXEMPTIONS FOR NONPROFIT HOSPITALS

I. Introduction

A key battle over America's healthcare future is being fought in one of the most unlikely of places: Urbana, Illinois. Scheduled for argument in front of the Illinois Supreme Court in mid-2009, *Provena Covenant Medical Center v. Department of Revenue* is poised to set the bar regarding the tax exempt status of nonprofit hospitals.[1] Nonprofit hospitals, such as Provena, account for near sixty percent of the hospitals in the U.S., while the others are either for-profit or government-owned.[2] Oddly, these nonprofit hospitals are actually faring better than their for-profit counterparts. Seventy-seven percent of the 2033 U.S. nonprofit hospitals are "in the black", while sixty-one percent of for-profit hospitals are profitable.[3] One of the reasons for such high success rates is the ability of non-profit hospitals to receive significant tax exemptions. The Congressional Budget Office reported in 2006 that nonprofit hospitals receive an estimated \$12.6 billion in annual tax exemptions on top of the \$32 billion in federal, state and local subsidies the hospital industry receives each year.[4] Given such figures, it is not surprising that many hospitals do not make up for the exemptions they receive with the charitable services they provide. This article delves into the federal income tax code applications for nonprofit hospitals and resulting litigation.

For an organization to receive federal income tax exemptions it must be both organized as a nonprofit entity and meet certain operational standards. As

dictated by section 501(c)(3) of the Internal Revenue Code (I.R.C), certain organizations, such as schools and religious entities, are enumerated as being exempt from federal income tax.[5] Those that are not enumerated must have a charitable purpose, as dictated by certain standards within the code. This analysis of charitable purpose falls under the categories of Organizational Requirements and Operational Requirements. For Organizational Requirement to be satisfied, the non-enumerated entity cannot further non-charitable purposes. Operational Requirements examine the manner in which charitable care is delivered.[6]

II. The Federal Code

The code dictates that a tax-exempt entity must be established exclusively for charitable purposes, yet courts have not strictly followed this language.[7] A number of different principles have arisen to test the charitable nature of such so-called charitable purposes.

The Commerciality Doctrine examines the services provided, looking at whether they are performed for a profit.[8] Largely fact-specific, the Commerciality Doctrine is based upon the profitable nature of the activity,[9] the magnitude of the activity in relation to the organization's other exempt activities,[10] how the activity supports or furthers the exempt purpose(s) of the organization,[11] whether the activity is one that is ordinarily conducted by for-profit entities,[12] and the business and marketing practices employed in conducting the activity.[13] Inconsistent in its application and outcome, the Commerciality Doctrine was utilized in the famous *Trinidad* opinion, which spurred the Destination-of-Income Test.[14] The Destination-of-Income Test from *Trinidad v. Sagrada Orden de Predicadores* focused upon how a funding source is irrelevant as long as the money goes towards the establishment of charitable purposes. The Destination Test was largely utilized until 1954, when I.R.C. section 502 changed the

perspective of the Internal Revenue Service (IRS). The Commerciality Doctrine today disregards the final resting place of funds and examines the manner of the organization. An organization that does not engage “primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3)” does not qualify for federal income tax exemption.[15] While organizations are required to carry the burden of proof in determining their tax-exempt standard, hospitals have essentially written themselves in as a per-se charitable organization, almost rising to the enumerated classification of churches and schools.

III. Debate

While there are policy rationales for giving hospitals tax-exempt status, such as the promotion of scientific innovation and indigent care, the question of how “charitable” many hospitals actually are has spurred significant debate.[16] Revenue Ruling 56-185 set the standard as to whether or not hospitals should receive exemptions for their charitable care, allowing the exemptions as long as hospitals performed charitable activities to the extent that their finances allowed.[17] Revenue Ruling 69-545 modified Revenue Ruling 56-185 and introduced the “community benefit” standard.[18] Under the community benefit standard, a hospital can maintain its exempt status by operating for the benefit of the community “as a whole.”[19] Revenue Ruling 83-157 further modified Revenue Ruling 69-545, removing emergency room care from the community benefit standard.[20] This hodge-podge of subjective standards and exceptions to the code is what is employed today, making the overall policy very murky.

While legislative actions have been taken in an attempt to make hospitals I.R.C.-enumerated exemptions, differing political factions have largely thwarted such efforts.[21] Judicially, patients, like those in *E. Ky. Welfare Rights Org. v. Schultz*, have taken actions claiming that the I.R.S. had “acted unlawfully in approving tax exemptions for hospitals without regard to their provision of care for the indigent.”[22] Although the district court held for the plaintiffs Schultz, the D.C. Circuit Court of Appeals reversed the ruling, finding that the I.R.S.’s interpretation was “not contrary to any express Congressional intent.”[23] [24] The Schultz case was dismissed by the Supreme Court for lack of standing, and the Sixth Circuit also rejected a similar claim in *Lugo v. Miller*. [25] In 2004, litigation surrounding hospital exemptions began anew, proceeding on the theory that tax-exempt hospitals had breached their fiduciary duty under I.R.C. section 501(c)(3) to act on behalf of the public.[26] Largely unsuccessful, these claims have failed because the courts have held that I.R.C. section 501(c)(3) does not permit a private right of action against organizations for failure to fulfill their charitable mandates.[27]

IV. Provena

The Provena case has garnered national attention, as it pits a local governing body against hospital interests. Claiming that its purposes are charitable, and that it is a healthcare ministry of the Roman Catholic Church, Provena Covenant protested the \$1.1 million in property taxes that was required by Champaign County.[28] Focusing upon the charitable purpose claim, the appellate court noted that Covenant devoted only 0.7% of its total revenue to charity.[29] Interestingly, such figures are not particularly unusual; even those hospitals that are the most charitable put in less than fifteen percent of their revenue towards charity.[30] Echoing an argument made throughout the nation, Provena pointed

out the difficulties and meager payment rates of Medicare and Medicaid.[31] The court outlined the necessity for Provena to prove “clearly and conclusively” that it was entitled to the exemptions[32], and that the revenue director had to revolve the ambiguous points in the law to be in favor of taxation.[33] Furthermore, the court approached the issue of charitable tax exemption by noting that there are both statutory and state constitutional requirements for the exemptions.[34] Applying standards from *Methodist Old Peoples Home v. Korzen*, the court established six distinctive characteristics of a charitable institution: (1) the institution gives benefits upon an indefinite number of people for their welfare, or reduces said individuals dependence on the government; (2) the organization has no shareholders or capital structure; (3) the funds come from charitable gifts; (4) charity is dispensed to all who need it and apply for it; (5) the institution puts no obstacles to those seeking the charity; and (6) the primary use of the property is for charity.[35] Overall, Provena argues that it is a charitable organization because they provide the community with the invaluable service of health care.[36] The appellate court did not agree, saying that “[b]y holding medical care to be, in and of itself, charity, we effectively would excuse charitable hospitals from their ongoing mission of giving.”[37]

IV. Conclusion

Regardless of how charitable functions are defined by individual states, the conflicts between non-profit hospitals and revenue departments are likely to be convoluted and extensive. By examining the code structure surrounding hospital tax-exemptions, and the litigation that has arisen in the path of such tax-exemptions, cases such as Provena can be understood more thoroughly. While hospitals are to serve the communities where they are located, to what degree

such service is charitable is the focal point of the ongoing debate, and why events in small towns, such as Urbana, Illinois command national attention.[38]

[1] *Provena Covenant Med. Ctr. v. Dep't. of Revenue*, 384 Ill. App. 3d 734 (App. Ct. 2008).

[2] John Carreyrou, *Nonprofit Hospitals, Once For the Poor, Strike It Rich*, WALL ST. J., Apr. 4, 2008, <http://online.wsj.com/article/SB120726201815287955.html#articleTabs%3Darticle>.

[3] *Id.*

[4] *Id.*

[5] I.R.C § 501(c)(3) (2000).

[6] Terri L. Brooks, *Billions Saved In Taxes While Millions Underserved – What Has Happened to Charitable Hospitals?*, 8 Hous. Bus. & Tax L.J. 391, 396 (2008).

[7] *Id.*

[8] Bradley Myers, *Revisiting the Commerciality Doctrine*, 10 J. Affordable Housing & Cmty Dev. L. 134, 138 (2001).

[9] *See Scripture Press Found. v. United States*, 285 F.2d 800 (Ct. Cl. 1961); *B.S.W. Group, Inc. v. Comm'r*, 70 T.C. 352, 358 (1978).

[10] *Scripture Press Found.*, 285 F.2d at 805-06.

[11] *See S.F. Infant Sch., Inc. v. Comm'r*, 69 T.C. 957, 966 (1978).

[12] *B.S.W. Group, Inc.*, 70 T.C. at 358.

- [13] W. Marshall Sanders, *The Commerciality Doctrine is Alive and Well*, 16 Tax'n of Exempts 209, 210 (2005).
- [14] Fides Publishers Ass'n v. United States, 263 F. Supp. 924, 935 (N.D. Ind. 1967).
- [15] Treas. Reg. § 1.501(c)(3)-1(a)(1) (1959).
- [16] See Daniel M. Fox & Danile C. Schaffer, *Tax Amdinistration as Health Policy: Hospitals, the Internal Revenue Services and the Courts*, 16 J. Health Pol. Pol'y & L. 251, 255-56 (1991); Rev. Rul. 69-545, 1969-2 C.B. 117 (citing Restatement (Second) of Trusts § 368 and § 372 (1959)); Rosemary Stevens, *In Sickness and in Wealth* 17-51 (Basic Books 1989).
- [17] Douglas M. Mancino, *Income Tax Exemption of the Contemporary Nonprofit Hospital*, 32 St. Louis U. L.J. 1015, 1040 (1988).
- [18] John D. Colombo, *The Role of Tax Exemption in a Competitive Health Care Market*, 31 J. Health Pol. Pol'y & L. 623, 625 (2006).
- [19] *Id.*
- [20] See Rev. Rul. 69-545.
- [21] Rev. Rul. 83-157, 1983-2 C.B. 93-95.
- [22] See I.R.C. § 501(c)(3) (2000).
- [23] E. Ky. Welfare Rights Org. v. Schultz, 370 F. Supp. 325, 326 (D.D.C. 1973).
- [24] E. Ky. Welfare Rights Org. v. Simon, 507 F.2d 1278, 1290 (D.C. Cir. 1974).
- [25] Lugo v. Miller, 640 F.2d 823, 831 (6th Cir. 1981).

[26] Beverly Cohen, *The Controversy over Hospital Charges to the Uninsured – No Heroes, No Villains*, 51 Vill. L. Rev. 95, 98-103 (2006).

[27] McCoy v. E. Tex. Med. Ctr. Reg'l Healthcare Sys., 388 F. Supp. 2d 760, 769-70 (E.D. Tex. 2005).

[28] Provena Covenant Med. Ctr. v. Dep't. of Revenue, 384 Ill. App. 3d at 736.

[29] *Id.* at 737.

[30] Carreyrou, *supra* note 2.

[31] Provena Covenant Medical Ctr., 384 Ill. App at 737.

[32] Illini Media Co. v. Dep't. of Revenue, 279 Ill. App. 3d 432, 435 (App. Ct. 1996).

[33] *Id.*

[34] Provena Covenant Med. Ctr., 384 Ill. App at 740-741.

[35] S.H.A. 35 ILCS 200/15-65(a); Provena at 742.

[36] Crerar v. Williams, 145 Ill. 625, 643 (1893).

[37] Provena Covenant Med. Ctr. at 748.

[38] School of Domestic Arts & Science v. Carr, 322 Ill. 562, 569 (1926).

WEEKEND AT BERNIE'S

I. Introduction

The past few months have seen numerous financial frauds uncovered. Two of these frauds are particularly noteworthy. On December 11th, 2008, the largest of these financial frauds was unveiled when Bernard Madoff admitted to a \$50 billion fraud through his firm, Madoff Securities.[1] On February 17th, the Securities and Exchange Commission (SEC) filed charges against Stanford International Bank relating to an allegedly fraudulent \$8 billion certificate of deposit (CD) scheme.[2] Other alleged frauds have come to light, often in highly publicized and dramatic fashion.[3] These frauds suggest something is amiss in the markets.

In the midst of the current economic crisis, these alleged financial frauds have further destabilized a badly shaken market. While fraud is an unfortunate fact of the market, the allegations against Madoff and Stanford paint a picture of frauds that have reached massive proportions and that have been ongoing for years. The intention of this article is to examine the faults in the legal and regulatory systems that allowed for the aforementioned frauds to exist for so long and to become so large.

II. How Madoff Made off with Billions

In order to understand Madoff's crime, a basic understanding of a Ponzi scheme is necessary. A Ponzi scheme is an illegal investment scheme offered by a promoter who promises unrealistic returns on investment capital, depending on new investors and reinvestment for its operation.[4] These schemes will eventually collapse, as they will inevitably grow too large to pay off all prior investors according to the returns.[5]

The ongoing story of Bernard Madoff's downfall has caught the attention of the global media. When Madoff turned himself in and admitted his misdeeds, he was one of the most powerful men on Wall Street. He was a former chairman of NASDAQ. His firm was well-respected. Yet, this titan of Wall Street was running a multi-billion dollar Ponzi scheme.

Madoff's story begins in the 1960s. Following a year at Brooklyn Law School, Madoff left to pursue a career on Wall Street.[6] His firm, Madoff Investment Securities LLC, started out matching the buyers and sellers of penny stocks in the over-the-counter market.[7] Eventually, his firm climbed the ranks and began trading in higher value stocks.[8] His firm was instrumental in the growth and development of NASDAQ.[9]

Using his success as a market maker, Madoff launched an asset management firm in the 1990s.[10] With his large social network and

reputation,

Madoff built up a large investment base, to the point where his Application for Investment Adviser Registration listed his total assets under management of over \$17 billion.[11] While the market dropped 2008, Madoff's firm continued to report their funds were up.[12] In spite of this, investors in Madoff's firm began demanding redemptions in the billions of dollars.[13] Unable to continue these returns, Madoff admitted to running a Ponzi scheme and now finds himself facing criminal charges.[14]

Despite these recent revelations, a cloud of suspicion had followed Madoff's investment firm for years. In 2000, fraud investigator Harry Markopolos contacted the SEC regarding Madoff's suspicious investment strategies, but was rebuffed at numerous turns.[15] In his Congressional testimony, Markopolos said that it took him four hours of running mathematical analyses to determine Madoff was running a fraudulent operation.[16]

Yet, the SEC never examined the investment adviser arm of Madoff's firm.[17] An SEC examination of the broker-dealer arm of the firm in 2005 yielded only three minor technical violations.[18] No one knew that the firm kept several sets of books and made numerous false disclosures despite allegations of fraud.[19]

As more information comes out about Madoff, it is clear that he had developed a close relationship with financial regulators.[20] During his stints as NASDAQ chairman,[21]

he cultivated close relationships with NASDAQ's internal regulators. He even boasted that he was so close to regulators that his niece married one of the SEC's compliance officials.[22] Essentially, the regulators' ties to Bernard Madoff and their ineffectiveness in handling this fraud raises serious questions as to the quality of financial regulation in the United States.

III. Cricket

Impresario Finds Himself on a Sticky Wicket

The most recent major financial fraud to break involves R. Allen Stanford, who is most well-known abroad for his sponsorship of cricket series.[23] Once the SEC locates Stanford,[24] he will face charges for fraud relating to his offshore financial operations through Stanford International Bank (SIB). According to an SEC complaint filed on February 16, 2008, Stanford International Bank (SIB), using Stanford Group Company (SGC) resources, sold roughly \$8 billion in CDs.[25] These CDs offered "improbable" rates of return over the past 15 years through the bank's investment portfolio.[26] While the portfolio claimed it was invested heavily in liquid investments, the portfolio was in fact tied up in illiquid investments.[27] In an unusual twist, SIB's portfolio had exposure to losses resulting from Madoff's fraud, despite their assertions to the contrary.[28] One of the major red flags in this case was raised when a lawyer for the Antiguan affiliate backed out of the case, disaffirming everything he told authorities about the bank.[29] Shortly thereafter, federal authorities took action.

Much like with Madoff, there were a number of concerns with how effectively Stanford's financial institutions were regulated. In 2007, the Financial Industry Regulatory Authority (FINRA), a self-regulatory organization, conducted an investigation on SGC, resulting in a \$10,000 fine for distributing marketing material that misrepresented the risks associated with CDs last year.[30] The investigation was criticized for not digging any deeper given how much of a warning sign this misrepresentation was regarding SGC.[31] The \$10,000 fine also received criticism as a "slap on the wrist." [32]

However, the most worrying aspect of this alleged fraud is the offshore component. According to the SEC complaint, SIB informed investors that Antigua's Financial Services Regulatory Commission audited financial statements.[33] However, in truth, a small Antiguan accounting firm was responsible for auditing SIB's investment portfolio.[34] Furthermore, while Stanford was ordered to repatriate his assets and Antiguan authorities are cooperating with the SEC, it can be enormously difficult to fully repatriate those assets to the United States, especially in offshore jurisdictions which are financial centers.[35] As this instance illustrates, these offshore jurisdictions only make it more difficult for regulators to properly carry out their functions.

IV. Regulators, Mount

Up!

Without belaboring the point, financial regulation in the United States needs reform. While these two alleged frauds may not be the norm

within the regulatory community, these frauds have exposed a number of financial regulatory shortcomings. In both cases, FINRA and the SEC looked foolish for their lack of effective oversight. These frauds went on for years, yet regulators overlooked the red flags. Something needs to change.

Harry Markopolos' testimony offers two interesting possibilities for reforming financial regulation that merit discussion. One of his suggestions is to provide for an increased regulatory role for the New York Attorney General's Office and the Massachusetts

Securities Division, both of which he believes have done a fantastic job.[36]

While these two regulators handle cases in two of the largest financial centers in the world, there is a major problem with this approach. In his testimony before the United States Senate's Committee on Governmental Affairs, former New

York Attorney General Eliot Spitzer discussed the contingent commission scandal among insurance brokers. One of the things Spitzer outlined in this scandal was how difficult it was for States to effectively supervise firms that moved their operations to offshore jurisdictions.[37]

Jurisdictional competition would be the primary difficulty with increasing State financial regulation. Firms worried about the increased costs of regulation could simply move their operations to other countries that provide favorable laws to them. The

Massachusetts Securities Division would have an enormously difficult time investigating financial crimes stemming from operations overseas. The current global economy requires the federal government's influence, authority, and resources to carry out these investigations overseas.

Thus, the best option Markopolos puts forth is to rebuild the SEC. While attorneys are important for investigating and litigating financial crimes, the SEC needs to expand its resources to include more people who have industry experience and who have professional expertise in areas such as finance and accounting. Giving the SEC a diverse skill set would enable it not only to prevent frauds from becoming massive in scope, but it also would provide it with more points of view in formulating policy. Providing compensation for attending industry conferences and workshops would also provide enormously valuable information to the SEC. While the SEC might still have problems, at the very least it would have a much more skilled and capable workforce.

V. Conclusion

As this article has shown, there is not a single cause behind the failings of United States regulators. Setting aside the question of whether regulators are incompetent, corrupt, or somehow impeded from carrying out their duties, the fact remains that these financial frauds are blights on the market. What is especially disturbing

about these frauds is not that they existed, but that they went on for so long and became so large. Red flags went ignored.

An unsettling reality is that there are other frauds comparable to these that are ongoing. Further revelations about these frauds will be forthcoming. It is likely that these frauds will only further expose the shortcomings of current financial regulatory regimes. It is abundantly clear that the Obama Administration needs to overhaul these regimes in order to better detect, investigate, and prosecute fraud. Rebuilding the SEC would be a good start to restoring confidence in the markets. If President Obama does not take these measures, Madoff's alleged \$50 billion fraud may soon look like chump change compared to the next big fraudster who comes along.

[1] Stephen Gandel, *Wall Street's Latest Downfall: Madoff Charged with Fraud*, TIME, Dec. 12, 2008, <http://www.time.com/time/business/article/0,8599,1866154,00.html>.

[2] Press Release, Sec. and Exchange Commission, SEC Charges R. Allen Stanford, Stanford International Bank, for Multi-Billion Dollar Investment Scheme (Feb. 17, 2009), <http://www.sec.gov/news/press/2009/2009-26.htm>.

[3] One of the more colorful stories to come out in recent months is the story of Marcus Schrenker, who was under investigation in Indiana for allegedly defrauding investors. In January, Schrenker allegedly faked his own death in a plane crash, where he sent a distress signal and parachuted from his plane to a

waiting motorcycle. *Pilot Pleads not Guilty in Plane Crash Death Hoax*, CNN, Jan. 22, 2009, <http://www.cnn.com/2009/CRIME/01/22/fugitive.pilot/index.html>.

[4] Frauds and Scams, Ponzi v. Pyramid; A

Comparison, <http://www.fraudsandscams.com/ponzipyramid.htm> (last visited Feb. 17, 2009).

[5] Frauds and Scams, Ponzi

Schemes, <http://www.fraudsandscams.com/ponzi.htm> (last visited Feb. 17, 2009).

[6] Julie Creswell and Landon Thomas, *The Talented Mr. Madoff*, N.Y. TIMES, Jan. 24, 2009, http://www.nytimes.com/2009/01/25/business/25bernie.html?_r=1.

[7] *Id.*

[8] *Id.*

[9] Stephen Gandel, *Wall Street's Latest Downfall: Madoff Charged with Fraud*, TIME, Dec. 12,

2008, <http://www.time.com/time/business/article/0,8599,1866154,00.html>.

[10] *Id.*

[11] Bernard L. Madoff Securities LLC, Uniform Application for Investment Adviser Registration (Form

ADV), http://www.adviserinfo.sec.gov/IAPD/Content/ViewForm/ADV/Sections/iapd_AdvAllPages.aspx?ORG_PK=0262B11C0008014200BE1FE001EB5709056C8CC0&STATE_CD=&TOTAL_DRPS=2&Print=Y. It is worth noting that the

information on this Form ADV may be false or misleading, meaning the \$17 billion could be smaller or greater in reality.

[12] Stephen Gandel, *Wall Street's Latest Downfall: Madoff Charged with Fraud*, TIME, Dec. 12,

2008, <http://www.time.com/time/business/article/0,8599,1866154,00.html>.

[13] *Id.*

[14] *Id.*

- [15] Jesse Westbrook, David Scheer, and Mark Pittman, *Madoff Tipster Markopolos Cites SEC's 'Ineptitude'*, Bloomberg, Feb. 4, 2009, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a_UBDG13Gld0.
- [16] *Testimony of Harry Markopolos, CFA, CFE, Chartered Financial Analyst, Certified Fraud Examiner before the U.S. House of Representatives Committee on Financial Services* at 10-11 (Feb. 4, 2009), http://www.house.gov/apps/list/hearing/financialsvcs_dem/markopolos020409.pdf[hereinafter Markopolos Testimony].
- [17] Stephen Labaton, *S.E.C. Image Suffers in a String of Setbacks*, N.Y. TIMES, Dec. 15, 2008, <http://www.nytimes.com/2008/12/16/business/16secure.html>.
- [18] *Id.*
- [19] Joseph Major, *Madoff Kept Multiple Books, False Documents: SEC*, INT'L BUS. TIMES, Dec. 16, 2008, <http://www.ibtimes.com/articles/20081216/madoff-kept-multiple-books-false-documents-sec.htm>.
- [20] Julie Creswell and Landon Thomas, *The Talented Mr. Madoff*, N.Y. TIMES, Jan. 24, 2009, http://www.nytimes.com/2009/01/25/business/25bernie.html?_r=1.
- [21] *Id.*
- [22] Brian Ross and Joseph Rhee, *SEC Official Married into Madoff Family*, ABC News, Dec. 16, 2008, <http://abcnews.go.com/Blotter/WallStreet/story?id=6471863&page=1>.
- [23] Kara Scannell, Miguel Bustillo, and Evan Perez, *SEC Accuses Texas Financier of 'Massive' \$8 Billion Fraud*, WALL ST. J., Feb. 18, 2009, <http://online.wsj.com/article/SB123489015427300943.html>.
- [24] Randall Mikkelsen, *Stanford Whereabouts Unknown after Charges: SEC*, Reuters, Feb. 18, 2009, <http://www.reuters.com/article/topNews/idUSWAT01100020090218>.

- [25] Complaint at ¶2, *Sec. and Exchange Commission v. Stanford International Bank, Ltd.*, Feb. 16, 2009, <http://online.wsj.com/public/resources/documents/Stanfordcomplaint20090217.PDF>[hereinafter *Stanford Complaint*].
- [26] *Id.* at ¶¶3-4.
- [27] *Id.* at ¶8.
- [28] *Id.* at ¶8.
- [29] David Scheer and Alison Fitzgerald, *Stanford Attorney's Exit 'Screams Fraud,' Spurred SEC*, Bloomberg, Feb. 18, 2009, http://www.bloomberg.com/apps/news?pid=20601087&sid=a7cCkC33mzb_g&refer=home.
- [30] Jesse Westbrook and Ian Katz, *Finra's Stanford Probe Raises Questions on Oversight*, Bloomberg, Feb. 18, 2009, <http://www.bloomberg.com/apps/news?pid=20601087&sid=ahaUscXNr5wY&refer=home>.
- [31] *Id.*
- [32] *Id.*
- [33] *Stanford Complaint*, *supra* note 25, at ¶ 43.
- [34] *Id.*
- [35] *See, e.g.*, *Sec. and Exchange Commission v. Brennan*, 230 F.3d 65, 68-69 (2nd Cir. 2000) (providing an overview of how easily the defendant could move money from one offshore jurisdiction to another).
- [36] Markopolos Testimony, *supra* note 16, at 47-49.
- [37] *Testimony of New York State Attorney General Eliot Spitzer on Insurance Brokerage Practices before the United States Senate Committee on Government Affairs* at 14-15 (Nov. 16, 2004), http://hsgac.senate.gov/public_files/SpitzerTestimony.pdf.

THE WALL STREET BONUS CULTURE: WELL-DESERVED BENEFIT OR UNNECESSARY WASTE?

Recent headlines that Wall Street investment banking executives have received billions of dollars in bonuses, just months after the federal government has given these same firms billions of dollars in bailout money, has greatly increased skepticism about acceptable methods of awarding bonuses. [1] President Obama condemned the awarding of these exorbitant bonuses. "That is the height of irresponsibility. It is shameful. And part of what we're going to need is for the folks on Wall Street who are asking for help to show some restraint and show some discipline and show some sense of responsibility." [2] However, many individuals on the flip side of the coin believe these bonuses are imperative to the success of the banking business. [3] This article will discuss the arguments for and against seemingly inflated bonus plans by delving into the most common types of compensation plans and their relation to the current economic crisis on Wall Street.

In order to fully understand the issue of inflated executive compensation, it is helpful to be familiar with the most common types of bonus plans in the marketplace. There are five main types of bonuses: the sign-on bonus, mission bonus, retention bonus, current profit sharing bonus, and gain sharing bonus. [4] A sign-on bonus is used to attract employees to a business. [5] "Given to new employees who have just joined the company, this award serves two purposes: to establish goodwill and to buy out any compensation 'left on the table' from a previous employer." [6]

A mission bonus, or task bonus, on the other hand, is given to a team of employees who reach certain set goals. [7] These have been increasingly in popularity, particularly within businesses that specialize in software and hardware development. [8]

Retention bonuses, on the other hand, are given to employees for no purpose other than to retain them within the business.[9] "Retention bonuses are given to employees in unusual circumstances, such as a merger or acquisition . . . These bonuses are designed to provide continuity when there is potential uncertainty about an employee's continued employment at the company." [10] With the current turmoil in the banking industry, firms such as Bear Sterns, Merrill Lynch, Bank of American Corporation, Wachovia Corporation, Morgan Stanley, and Smith Barney have all utilized retention bonuses to keep their employees on board and ensure the smooth running of the business in the midst of mergers, acquisitions, and restructuring. [11] However, retention bonuses are generally used to retain mid- level employees who keep the company running, and are not given to executives. [12]

Current profit sharing bonuses are bonuses based upon the company's profits. [13] In a profit sharing bonus program, "[a] company sets aside a predetermined amount, usually between 2.5 and 7.5 percent of payroll but sometimes as high as 15 percent, as a bonus on top of base salary." [14] Additionally, some companies take into account the base salary of the profits, giving employees with a higher salary a higher share of the profits. [15] This type of bonus is not based upon the performance of a single employee, but, rather, is based upon the success of the business, as a whole. [16]

Gain sharing is a type of bonus program whereby an employee is rewarded for "productivity and improved product quality." [16] "Gain sharing programs pay out bonuses for statistical improvements in production and quality on a quarterly or sometimes monthly basis, providing a sense of excitement for participants."

[17] These bonus programs put the ability to achieve goals and receive bonuses almost completely in the hands of eligible employees. [18]

The types of bonuses outlined above are all based upon certain factors within the workplace, be it meeting a certain individual task or a companywide goal. Typically, bonuses for Wall Street executives may fall under a combination of profit sharing, mission, and a general bonus. However, there has been much controversy surrounding the bonuses given to Wall Street banking executives because they do not appear to be tied to relevant factors, such as the success, or profitability, of the businesses they work for. [19]

Wall Street bankers, including top executives, were awarded 18.4 billion dollars in bonuses this past year. [20] Many institutions, including Lloyds Banking Group, claim that such bonuses are necessary to award employees for meeting certain targets. [21] "Lloyds . . . said its employees deserved 'financial recognition' for hitting targets." [22] Additionally, proponents of the bonus system argue, many institutions are cutting back or completely eliminating executive bonuses while still paying bonuses to those lower and mid-level employees who seemingly deserve them. [23]

Some proponents of this argument who take it one step further to claim that top executives deserve the millions each they received in bonuses point to the fact that banking executives generally take a small salary in exchange for a large bonus. [24] For example, "In fiscal year 2000, the CEO of Goldman Sachs earned a base salary of \$600,000 and a bonus of more than [14 million dollars]". [25]

While this salary may seem excessively high in itself, CEOs in similar sized, non-banking corporations generally make at least three times this base salary. [26]

Some blame Wall Street bankers for the repeated failures of the American financial system, including the technology bubble burst of 2001 and the recent housing bubble burst. [27] Those who believe individuals in the banking industry should not receive bonuses look to the current state of the American financial

system. [28] "The bankers are bellyaching about a 44 percent decline in bonuses from 2007 levels. That's like complaining about being served a 40-ounce porterhouse instead of a 70-ounce one." [29]

President Obama's stimulus package limits the amount executives can receive as bonuses to "no more than a third of their annual compensation" [30] These limits would be applicable to the highest paid employees, including top executives, at all banks that have received government aid. [31] While many in the banking industry argue that the provision impedes on the financial incentive structure of the financial sector, proponents of the bill believe it is the only way Congress will agree to designate more money towards saving the financial sector.

[1] CC Holand, Are Bonuses Good Motivation- or Bad Business?, Jan. 30, 2009, <http://blogs.bnet.com/teamwork/?p=616..>

[2] *Id.*

[3] *Id.*

[4] Salary.com, Bonuses, http://www.salary.com/advice/layouthtmls/advl_display_nocat_Ser82_Par171.html (last visited Feb. 17, 2009).

[5] *Id.*

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] Salary.com, *supra* note 4.

[11] Smartmoney.com, Political Storm Threatens Wall Street Bonuses by Joe Bruno, Annie Gasparro, Jessica Papini, and Brett Philbin, <http://www.smartmoney.com/breaking-news/on/?story=ON-20090130-000643-1530> (last visited Feb. 17, 2009).

[12] *Id.*

[13] Salary.com, *supra* note 4.

[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] *Id.*

[18] *Id.*

[19] The Independent, Is This the End of the Mega

Bonus?, <http://www.independent.co.uk/news/business/analysis-and-features/is-this-the-end-of-the-mega-bonus-1023218.html> (last visited Feb. 17, 2009).

[20] Rick Newman, *How Wall Street Continues to Doom Itself*, U.S. News & World Report, Jan. 30,

2009, <http://www.usnews.com/blogs/flowchart/2009/1/30/how-wall-continues-to-doom-itself.html>.

[21] *Lloyds Defend Staff Bonus Plan*, BBC News, Feb. 15, 2009, <http://news.bbc.co.uk/2/hi/business/7890924.stm>.

[22] *Id.*

[23] *Id.*

[24] Holland, *supra* note 1.

[25] Salary.com, *supra* note 4.

[26] *Id.*

[27] Newman, *supra* note 20.

[28] *Id.*

[29] *Id.*

[30] *Stimulus Bill Includes Strict Limits on Wall Street Bonuses*, Feb 14, 2009, <http://www.startribune.com/nation/39621292.html>

[31] *Id.*

SAG POWER STRUGGLE SPILLS INTO COURT AMIDST TALK OF STRIKE

I. Introduction

In February 2008, when the Writers Guild of America (WGA) ended the acrimonious three-month strike that crippled American television production, a sense of relief spread throughout the entertainment industry.[1] Hollywood studios had achieved three years of labor peace with writers, television production would resume, and the Oscars could air undisturbed.[2] Any feelings of elation were short-lived, however, as the industry collectively turned its head toward the impending expiration of the Screen Actors Guild (SAG) contract that summer.[3] Despite the express desire of both parties to avoid a reprise of the writers' strike, the June 30 expiration date came and went without a new agreement between SAG and the Alliance of Motion Picture and Television Producers (AMPTP).[4] SAG members have now been working under an expired contract for over seven months, with the threat of another strike persistently looming.[5] Further complicating matters has been a power struggle between hardliners and moderates within the ranks of SAG, which has led to a legal battle over the attempted ouster of SAG's Executive Director, chief negotiator, and strike-proponent Doug Allen.[6]

II. The Contract Negotiations

With over 120,000 members, SAG is the nation's largest labor union representing actors.[7] Like its colleagues in the Writers Guild, SAG has focused its negotiation efforts on the receipt of residual payments for content distributed via

new media, such as iTunes and video streaming.[8] These growing revenue sources were not incorporated into the old contract.[9] SAG has also been determined to get a piece of the advertising income generated by product placement and increasing DVD residual rates.[10]

SAG's counterpart in the negotiations, the AMPTP, represents over 350 television and movie producers, including the production entities of major film and television studios, broadcast networks, and cable networks.[11] The AMPTP negotiates contracts with nearly all entertainment industry unions, including SAG, the WGA, the American Federation of Television and Radio Artists (AFTRA), and the Directors Guild of America (DGA).[12] Last year, the CEOs of News Corporation, Disney, and CBS all won praise for their decision to intervene and hold smaller, more informal talks with the Writers Guild after the designated negotiators had reached a stalemate.[13] This new tactic ended months of stalled negotiations, and within weeks, the contentious 100-day strike concluded with a deal that over ninety percent of the Writers Guild voted to approve.[14]

Despite the industry goodwill established toward the end of the WGA strike, AMPTP's talks with SAG have been tough. SAG rejected AMPTP's "final" offer on June 30, 2008, the day the old contract was set to expire.[15] After a five-month stare-down, the two sides agreed to sit down with a federal mediator in November.[16] Two days of meetings were unsuccessful in bridging the large gap, however, and the mediation efforts concluded with SAG's negotiation committee determined to institute a strike authorization vote in January.[17] A strike authorization would require the approval of seventy-five percent of SAG members.[18]

III. Strife Within SAG

As tensions surrounding the negotiations intensified, SAG began to splinter into competing factions. SAG Executive Director Doug Allen and President Allen Rosenberg were among the hardliners who sought to authorize a strike, though they were careful to note that such authorization would be a bargaining chip and not necessarily result in a work stoppage.[19] Conversely, over 100 Hollywood stars, including George Clooney, Tom Hanks, Alec Baldwin, and Steve Carrell signed a petition urging that the strike vote be cancelled and that SAG members work under the old contract for three more years.[20] This group wanted SAG to join forces with the other unions in three years and negotiate for unified terms.[21]

Though Rosenberg is the elected President of SAG, his Hollywood-based faction Membership First relinquished its majority control over the SAG's national board last fall.[22] The new moderate majority, composed of the New York branches and a smaller faction of west-coast members, heavily criticized Allen's negotiation tactics and successfully voted to postpone the strike authorization vote.[23] The moderate majority supports the resumption of talks with AMPTP, and after a month of sparring with the Membership First faction, succeeded in its second attempt to remove Allen from his position.[24] The board then named David White as its interim Executive Director and tapped Jeff McGuire as its chief negotiator going forward. [25]

IV. The Lawsuit

After the SAG's moderate majority wrested control from Allen, it agreed to resume negotiations with AMPTP on February 2. Those meetings had to be postponed, however, after Rosenberg filed a lawsuit to nullify Allen's removal and restrain Allen's replacements from conducting SAG

business.[26] Rosenberg's first suit was dismissed on a technicality, and after refilling, he claimed that the moderate majority violated state corporate law and guild bylaws by firing Allen without conducting a formal board meeting.[27] Rosenberg asserted that though SAG's bylaws require a two-thirds vote for the removal of individual officers, the majority employed a seldom-used procedure called a "written assent" that only forty-one (52.5%) members of board signed off on.[28]

In response to the suit, White called a national board meeting to formally fire Allen. The board created a task force to proceed with talks while dissolving the negotiation committee.[29] Subsequently, Los Angeles Superior Court Judge James Chalfant denied Rosenberg's restraining order, stating that the board acted within its rights under the bylaws.[30] A three-judge appeals court panel affirmed the decision a week later.[31] Though these rulings were based on organizational bylaws, they can also be seen as an extension of the judicial policy of showing deference to union agreements and policies enacted internally.[32]

V. Conclusion

The removal of Allen has paved the way for a new round of talks between SAG and AMPTP, which are scheduled to begin on February 17.[33] Of course, Rosenberg's attorneys may continue to seek legal redress by filing another appeal or taking the case to trial, but such avenues will not be expeditious.[34] Thus, SAG is once again in a stable enough position to resume talks. Optimistic appraisals have a deal being reached by February 23, at which time SAG is scheduled to begin negotiating a new commercials contract with advertising industry representatives.[35] Any final agreement may be difficult, though, as Rosenberg and his allies continue to insist that they will not ratify any agreement

that resembles AMPTP's current offer.[36] If SAG cannot reach an agreement with AMPTP, it would likely maintain its focus on the matter at-hand and postpone the commercials negotiation.

Additionally, further shakeups could be on the horizon, as some members of the board have circulated a petition calling for the ouster of Rosenberg.[37] Due to the tense state of relations and the slim majority of moderate board members, sparring between the two factions may continue throughout the resumption of the negotiations with AMPTP. Though Rosenberg's power has been weakened, the moderate faction's majority is tenuous, and its ability to retain control of the board may depend on how favorable the new contract is perceived to be. If SAG members do not ratify the new contract, Rosenberg's faction can argue that SAG's inability to stay united and weather a strike, as the WGA did, led to its failure.

To that end, SAG is likely to demand that a new agreement be enforced retroactive to the expiration of the last contract. By continuing to work under the expired contract, SAG members are not able to enjoy the 2.5 to 10% pay raises that AMPTP is offering.[38] Furthermore, despite the perceived successful outcome of the writers' strike, both producers and actors are likely attempting to take a more conciliatory approach in light of the acrimony that developed during the WGA negotiation. In addition to the lost revenues and income caused by the work stoppage, the industry's image was tarnished to some degree in the public mind.

A year after the conclusion of the writers strike, the country is in the throes of a financial crisis. Negotiators on both sides understand that the film industry, the market most threatened by a potential SAG strike, is more elastic than the

television market that ground to a halt one year ago. Presumably, this knowledge underlies AMPTP's decision to keep its June offer on the table, which it claims would align SAG's terms with those of the other major entertainment industry unions.[39] For the time being, SAG's reshuffling indicates a willingness to settle near AMTPT's current offer and avert a strike. Undoubtedly, the prospects for turning this dispute into a deal appear to be stronger than ever. Nevertheless, as the real-life struggle for the soul of SAG continues upon a narrative arc of its own, it is unclear whether the decisive battles have yet to be waged.

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STORM AHEAD FOR SIRIUS XM MERGER

I. Introduction

On July 25, 2008 the Federal Communications Commission (“FCC”) approved the XM Satellite Radio and Sirius Satellite Radio merger voting 3-2 to approve the deal without imposing many restrictions on the combined entity.^[1] Critics of the merger asserted that the combination of two principal satellite radio companies would result in a monopoly.^[2] The FCC recognized that the Internet age has revolutionized how individuals obtain and listen to music opening the market to a variety of competition.^[3] However, the question remains whether the Sirius XM Radio merger will survive. On July 25, 2009, the day of the announcement of the merger, Sirius shares plunged 43% and XM stock declined 40%. Recently, reports indicate that Sirius XM Radio is preparing to file bankruptcy.^[4] This article will analyze the state of Sirius XM Radio as well as give recommendations to Sirius XM radio on increasing revenue.

II. State of Sirius XM Radio since Merger

The combined entity Sirius XM radio when merged had \$5 billion U.S. in assets.^[5] However, shares from the merged entity have continued to plunge. The company is now carrying a debt of about \$3.25 billion.^[6] Sirius XM radio is attempting to refinance about \$172.5 million of debt of its outstanding 10% Convertible Senior Notes due December 2009, and the combined entity is in talks with “others” to refinance their debt.^[7] Those others include Liberty Media Corp. and also Charlie Ergen, the CEO of Dish Network Corp. and Echo Star Corp.^[8] However, Sirius XM Radio issued a statement admitting that “if these transactions are not consummated, it may be forced to file for bankruptcy protection as early as February 17, 2009.”^[9]

III. Recommendations

However, if Sirius XM Radio does receive refinancing of its debt, the combined entity needs to restructure their business model in order to remain relevant and successful during these difficult economic times.

First, Sirius XM Radio should reduce operation costs. Sirius XM Radio should renegotiate its programming agreements.^[10] For example, for the Howard Stern Show, Howard Stern is paid \$100 million per year.^[11] Also, Sirius XM Radio pays \$60 million per year to broadcast Major League Baseball until 2010.^[12] Not only should Sirius XM radio focus on renegotiating agreements but also Sirius XM Radio should concentrate more on retaining the more popular and monetary successful programs rather than having a wide variety of programming. For example, programs with a limited audience should be cut in order to pay for retaining the more appealing programs to viewers that are profitable to the company. By refocusing their programming, Sirius XM Radio could cut losses by removing the less profitable and less viewer favored programs.

Second, Sirius XM radio should change their model of being a purely subscription service. Sirius XM radio has relied on new car purchases as its source for customers.^[13] Due to the economic climate, car purchases have significantly decreased.^[14] Thus, the company should focus on other avenues of revenue. One example could be the Apple iTunes business model. Sirius XM Radio should allow for purchase of podcasts of certain talk shows or the purchase of song tracks through its website, like the iTunes model.^[15] Furthermore, instead of focusing on satellite radio service in new cars, Sirius XM Radio should allow the podcasts or song tracks to be uploaded to iPods or iPhones.^[16] By broadening the accessibility of their satellite programming, this will increase revenue for Sirius XM Radio.

IV. Conclusion

Even if Sirius XM Radio does obtain refinancing of its debt, this will only delay the inevitable – the dissolution or takeover of Sirius XM Radio. Thus, in order to prevent this occurrence, Sirius XM Radio must change its business model to remain relevant in this competitive music market.

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TICKETMASTER'S LEGAL WOES

I. Introduction

For many, Ticketmaster Entertainment Inc. (Ticketmaster) is the first place that people look when they want tickets to an event. It is the largest and most well-known broker of event tickets in the industry. Ticketmaster sells tickets for more than 80% of the major arenas and stadiums in the U.S. [1] However, it has come recently been hit with a \$500 million lawsuit in Toronto, Canada, after fans complained that Ticketmaster was deliberately directing customers into its subsidiary site, TicketsNow in violation of anti-scalping laws. [2] Not only is Ticketmaster now facing this class-action lawsuit, but it also is in danger of being hit with charges by the Canadian as well as the U.S. government.[3] Compounded with the recent backlash against its new merger with LiveNation, Ticketmaster is currently facing a host of legal problems.[4]

II. The Canadian Class-Action Lawsuit

The lawsuit began with one man, Henryk Krajewski.[5] The class-action lawsuit was filed in the Ontario Superior Court of Justice on his behalf after he was instantly redirected to higher-priced tickets on TicketsNow for a Smashing Pumpkins Concert.[6] The number of people registering for this class-action suit is growing daily.[7] Krajewski's lawyer states that "Ontario law forbids selling tickets above face value" and seeks to include anyone who has purchased tickets through Ticketmaster or TicketsNow in Ontario since February 9, 2007.[8] The

lawsuit alleges that Ticketmaster is hurting consumers and breaking Ontario's anti-scalping laws by selling tickets at higher prices in secondary markets.[9] Ticketmaster and its TicketsNow subsidiary are accused of conspiring to require customers to pay inflated prices for event tickets.[10] Ticketmaster is accused of "wrongfully, unlawfully (and) maliciously" conspiring to sell tickets at higher price and the lawsuit seeks \$500 million in damages for the conspiracy as well as \$10 million for any punitive damages.[11] Ticketmaster claims that TicketsNow helps to protect consumers against private party scalpers who may sell counterfeit or nonexistent tickets.[12] However, Canada's federal competition bureau is also looking into allegations that Ticketmaster illegally redirected consumers automatically into TicketsNow.

III. Canadian Law

In Ontario, the Ticket Speculation Act is in place, which aims to prevent ticket scalping.[13] The class-action lawsuit alleges that Ticketmaster's practices violated these anti-scalping provisions by diverting consumer traffic from the original Ticketmaster site into the TicketsNow website.[14] The Act states:

Every person who, selling (a) being the holder of a ticket, sells or disposes of the ticket at a higher price than that at which it was first issued, or endeavours or offers so to do; or purchasing as a speculation or at a higher price than advertised (b) purchases or attempts to purchase tickets with the intention of reselling them at a profit, or purchases or offers to purchase tickets at a higher price than that at which they are advertised or announced to be for sale by the owner or proprietor of any place mentioned in Section 1, is guilty of an offence..."[15]

In Canada, each of the regions including Ontario, Alberta, Saskatchewan and Manitoba have anti-scalping laws – the only region that does not is B.C.[16] Ticketmaster may be in danger of facing similar charges or lawsuits in these other regions.

IV. Implications for Ticketmaster in the U.S.

Ticketmaster has also been facing heat in the U.S.[17] Many fans became angry when they tried to buy tickets from Ticketmaster for the upcoming Bruce Springsteen concert and instead were given cryptic error messages that directed them to TicketsNow.[18] Bruce Springsteen also personally got involved and Ticketmaster has since apologized.[19] However, this is unlikely to go quietly away. Consumers have been complaining about Ticketmaster and the ticket-selling industry and lawmakers have been calling for investigations.[20] New Jersey has already launched an investigation to see whether Ticketmaster has committed consumer fraud.[21] Two New York members of Congress are also demanding an investigation.[22]

Ticketmaster launched its first resale market, TicketExchange in 2002.[23] Since then, Ticketmaster has been busy buying TicketsNow as well as Get Me In.[24] Ticketmaster seems determined to keep expanding. Recently Ticketmaster announced their new proposed merger with Live Nation Inc.[25] This proposed deal has come under intense scrutiny for fear of violations of anti-trust and monopoly law.[26] Ticketmaster will most likely be facing tough antitrust reviews in both Canada and the United States.[27] Until only a

few months, ago, Live Nation seemed on track to challenge Ticketmaster for market share on several big ticket-sales contracts.[28] Instead, this new merger would combine Ticketmaster and Live Nation into a company with a revenue of almost \$6 billion dollars, making the company into the world's largest ticket seller and reseller with more promotional clout.[29] Critics of the proposed merger argue that these plans would essentially create an entertainment monopoly, giving Ticketmaster control and influence over almost every aspect of the entertainment business including management of artists, booking concerts, selling tickets, and even selling refreshments.[30]

V. The Future?

The secondary market for tickets through sites such as TicketsNow, StubHub, and other mediums such as Ebay and Craigslist is growing. In the U.S., as many as 44 states have relaxed anti-scalping laws in order to provide a free market for resellers.[31] There are many people who are interested in seeing performances and ticket prices are not as high as their value in the open market, leading to many tickets being sold in the resale market.[32] The problem with the resale market is simply that people are forced to pay prices far above face value, especially in the cases of certain popular events in which people may buy out many tickets and then use these resale markets in order to profit.

Companies like Ticketmaster only stand to gain from the growing resale market. Ticketmaster also takes a fee from every ticket resold through TicketsNow as well as the original service charges levied when tickets are first

sold, as much as a 25% profit on all tickets sold.[33] An attorney in the class-action suit has summed up concerns well, “the mere fact that Ticketmaster has a financial interest in both retail and premium ticket sales leads to an obvious question about the process by which those tickets are sold to members of the public and how it works”.[34]

While the planned merger of Ticketmaster and Live Nation will not necessarily affect the lawsuit itself, its outcome and any other proposed charges against Ticketmaster will most likely have far-reaching consequences for the company as well as the future of ticket sales. If Ticketmaster is found guilty of this suit and any future charges, the courts will have to take a closer look at what kind of monopolization that Ticketmaster may have on the industry. Government will also have to take another look at anti-scalping laws in order to navigate the growing resale market. Until then, consumers can only hope to be treated fairly with little choice in the market.

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