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Table of Contents

2008/9 FINANCIAL CRISIS: A LOT TO LEARN ON BAILOUTS AND TOO BIG TO FAIL COMPANIES IN ORDER TO DRAFT NEW REGULATION

I. Introduction

Some basic financial concepts and the facts surrounding the 2008/9 economic crisis constitute the first stage of this article.

The analysis of certain characteristics and effects of the Bailouts and of having Too Big To Fail Companies in the market is what follows.

Finally, I will go into different opinions and strategies addressing main issues that are a challenge for the regulation to be enacted in order to prevent these kind crises and deal with the legacy of the bailouts. What to do with Too Big To Fail Companies is part of that approach.

It is a side goal of this article to make the topic in question and the issues arising from it, accessible not only to those with a background in law and finance but especially to people without it.

II. Concepts: Money, Markets, Bubbles, Government Intervention and Systemic Risk

The Economist published an article about the book "*Money (Art of Living)*" written By Eric Lonergan[1]. In a few lines that review provided the basic understanding of the following essential financial concepts: money, trade, markets, bubbles, and intervention in the markets by the authorities.

Those lines tell the following:

"*One person's saving represents another person's borrowing (which is also why it is impossible for all countries to run trade surpluses). The money that people*

deposit in their current accounts is itself a loan to the bank, which uses it to provide credit to other households and companies."

"*TOWARDS the end of Eric Lonergan's considered treatise on money, he recounts how Pokémon cards, a baffling craze from Japan, spontaneously turned into currency in his daughter's school playground. Children would swap sought-after cards for food or toys. Bubble-like behaviour soon emerged. Older pupils would fleece younger, less sophisticated ones to get hold of prized cards. Children bought more cards with credit advanced by their parents. Eventually the headmaster was forced to step in and ban trading. Whatever form it takes, the use of money as a means of exchange seems to be hardwired; so too does its capacity continually to distort human behaviour.*"

The concepts involved in this story are some of the basic ones involved in the 2008/9 financial crisis.

Additionally, it is important to understand that Systemic Risk –another main factor of the crisis– is a notion "*generally used in reference to an event that can trigger a collapse in a certain industry or economy*"[2].

III. Facts: The 2008/9 Systemic Crisis

On May 2008 Bear Stearns, one of the most relevant financial institutions in the market, was acquired by another major bank, JP Morgan Chase, and thus rescued from collapse[3].

On July and early September 2008 Freddie Mae and Fannie Mae, two government-sponsored companies in the mortgage industry, were aided by the U.S. Government to avoid failure[4].

During those days, the Dow Jones Industrial Average Index[5] moved from around 13,000 points in May, 2008 to 11,400 in early September 2008[6].

On mid September 2008 the U.S. Government decided not to provide financial aid to Lehman Brothers, a major financial entity, which eventually filed for bankruptcy protection[7].

At that point, the Dow Jones Industrial Average Index entered into a continuous fall reaching 8,400 points by October, 2008, and 6,626.94 by March 6, 2009[8]. During that time, many companies were struggling to survive.

Even though the stock markets began to recover after March 2009, the effects of the 2008 financial crisis can still be seen in the real economy, mainly in the unemployment rate which has constantly increased from 4.9 in January 2008 until reaching 10.2 in October 2009[9] (the last rate available at the time this article is written).

Because of its effects, the 2008/9 crisis has been compared to the dramatic 1930's crisis suffered by the United States[10].

The 2008/9 crisis came as a result of a systemic failure, powered by huge leverage and high volume institutions operating interconnected across the world[11]. The risk of the investments (especially the risk of granting subprime mortgages) was miscalculated –underestimated– and derivatives used for hedging were considered (or expected) to be infallible[12].

Major companies got into deep trouble. They could go bankrupt if the natural flow of the markets continued[13]. However, those companies were smart enough to convince the authorities that the cost for the economy would be much higher if they went bankrupt than if they were aided by the Government[14].

It was clear that the society already had a price to pay because of the failure of high risk investments made by profit-seeking major companies[15].

What would have happened if the markets were left alone to deal with this situation? The Government and many analysts said that the consequences were impossible to calculate, but certainly included bankruptcies of major companies and therefore of their related companies and suppliers. Consequently, massive

lay-offs in many industries should be expected. In addition, many of those consequences were expected to be cross-border given the degree of interconnection of these companies across the world –explained in detailed in Subsection III.A below– (e.g. AIG's impossibility to comply with its insurance and financial agreements would cause the failure of many other companies in different countries).

Thus, the Government decided to avoid the greater harm and consequently provided billions of dollars to the distressed companies (bailouts)[16], who became known as "*Too Big To Fail Companies*"[17]. This action prevented major bankruptcies[18] and their consequences from happening –while also created additional consequences that will be considered below–.

As will be seen in the following Sections, issues arise in regard to the accuracy of the reasoning that justified the bailouts and there are also many doubts about their costs, both in money and in new incentives for the market players.

A. A Closer Look At The Idea of Too Big To Fail Companies

The Los Angeles Times explained that, according to experts "*AIG is 'too interconnected to fail'… Its interconnectedness with other companies, markets and economies is so huge that consequences of its collapse are unforeseeable*"[19].

According to Bloomberg[20], "*American International Group, Inc. (AIG) is a holding company which, through its subsidiaries, is engaged in… General Insurance, Life Insurance & Retirement Services, Financial Services and Asset Management. …AIG provides insurance, financial and investment products and services to both businesses and individuals in more than 130 countries and jurisdictions."*

Time Magazine stated that "*AIG had become one of the world's biggest public companies, with sales of $113 billion in 2006 and 116,000 employees in 130 countries, from France to China*."[21]

Many analysts and public officers said that the cost of AIG's failure could be impossible to calculate and extremely high for the economy[22].

Time Magazine[23] gave more detail on how interconnected AIG was and how AIG's health was important to many companies in the world:

"AIG has become the banking industry's ATM, essentially passing along $52 billion… to an array of U.S. and foreign financial institutions — from Goldman Sachs to Switzerland's UBS. Those firms were counterparties to the credit-default swaps (CDSs) that AIG FP sold at least through 2005, and the companies were collecting on the insurance-like derivatives. AIG paid out an additional $43.7 billion to many of the same banks, which were also customers of the securities-lending operation run out of AIG's insurance division…"

"The reason AIG has cost taxpayers $170 billion — and the reason the Obama Administration seemed willing, at least at first, to hold its nose and accede to bonuses for the company's managers — is that it's too big to fail. It's an often heard phrase, but what does it really mean?… The idea is that in a global economy so tightly linked that problems in the U.S. real estate market can help bring down Icelandic banks and Asian manufacturers, AIG sits at some of the critical switch points. Its failure, so the fear goes, would set off chains of others, rattling around the globe in short order. Although some critics say the fear is overblown and the world economy could absorb the blow, no one seems particularly keen on testing that approach…"

"AIG says it has written more than 81 million life-insurance policies, with a face value of $1.9 trillion. It covers roughly 180,000 small businesses and other corporate entities, which employ approximately 106 million people. That makes AIG America's largest life and health insurer; second largest in property and

casualty. Through its aircraft-leasing subsidiary, AIG owns more than 950 airline jets. Just for good measure, AIG is a huge provider of insurance to U.S. municipalities, pension funds and other public and private bodies through guaranteed investment contracts and other products that protect participants in 401(k) plans. "We have no choice but to stabilize [it] or else risk enormous impact, not just in the financial system but on the whole U.S. economy," said Fed Chairman Ben Bernanke…"

"As AIG has pointed out in its own analysis, "The extent and interconnectedness of AIG's business is far-reaching and encompasses customers across the globe ranging from governmental agencies, corporations and consumers to counterparties. A failure of AIG could create a chain reaction of enormous proportion." Among other effects, it could lead to mass redemptions of insurance policies, which would theoretically destabilize the industry; the withdrawal of $12 billion to $15 billion in U.S. consumer lending in a credit-short universe; and even damage airframe maker Boeing and jet-engine maker GE, since AIG's aircraft-leasing unit buys more jets than anyone else."

AIG was saved by the U.S. Government since it was considered to be Too Big To Fail. On the contrary, Lehman Brothers' was not[24]. Many other companies shared the fate of AIG and Lehman respectively[25].

IV. Analysis of the Facts

The following analysis of certain important facts and effects of the 2008/9 crisis allow a better understanding of the main issues involved. Pointing out those issues is most relevant to later devise proper strategies for regulation.

A. Size of Companies: Market Forces and Regulation

As seen above, the concept of Too Big To Fail Companies is absolutely related to size. Size may be measured by many characteristics of a company such as

capitalization or how interconnected it is –as seen in Subsection III.A–, among others.

The idea of economies of scale reveals that as long as a company increases the quantity it produces, it will be able to distribute fixed costs among more units of product and it will also be able to get better deals in variable costs such as purchasing raw materials, thus reducing its average cost per unit[26]. However, businessmen know that this increase in the quantity produced (in the size of the company) cannot be limitless since, at some point, the company will go into diseconomies of scale where an increase in the quantity produced implies an increase in the average cost per unit[27]. Therefore, every business will try to maximize its economies of scale by growing until the point in which further growing gets the company into diseconomies of scale.

However, what would a company do if it knew that growing constantly would lead, at a certain point, to both reaching diseconomies of scale and a virtual shield against failure by being big enough to be considered for government bailouts[28]? Clearly the company would have the incentives to grow bigger each minute irrespective of the risk involved in that process since that risk will be beard by the government –not by the company–as soon as the company becomes big enough[29].

Besides incentives, regulation also plays a most relevant role in the size of financial entities.

Recent history shows that the Glass-Steagall Act was enacted in the U.S. in 1933 to separate the activity of commercial banks from that of the investment banks, "*as an emergency response to the failure of nearly 5,000 banks during the Great Depression*" of the 1930s[30].

However, in 1999 President[31] Clinton repealed that Act by enacting of the "*Financial Services Modernization Act*". Thus, banks could merge

with brokers. This new regulation was aimed helping U.S. banks to "*grow larger and better compete on the world stage.*"[32]

That was how modern regulation opened the gate to major growth of financial entities in the U.S. For sure that piece of regulation was effective and the goal was achieved.

B. The Decision Making Process: Rush and Lack of Accuracy

The 2009 economic situation is supposed to be the best possible outcome of the 2008 crisis, at least according to the rationale that if the U.S. Government (later on followed by governments around the world[33]), did not bailout major companies that were Too Big To "*let them*" Fail, the 2009 economy would be much worse. However, it is still far from being what anyone would consider a "*good*" economic situation. Exceptionally high unemployment rates are the simplest evidence of that fact[34].

Taxpayers' money was used to help Big Companies avoid their bankruptcy under the idea of avoiding a greater harm. But some other companies received no aid. Major financial companies such as AIG[35] and Bank of America[36] received governmental aid, as well as important non-financial companies such as General Motors and Chrysler –it is interesting to see that both automotive companies filed for bankruptcy some months after being bailed out[37]–.

Other companies such as Lehman Brothers or Washington Mutual Bank[38] received no aid when trying to avoid collapse, even though they asked for it[39].

And some other companies, like Ford, had the chance of asking for help but they said they did not need it[40].

Later on, important claims arose that AIG was not Too Big To Fail[41]. Further, the authorities recognized that when approving the bailout they did not know that

AIG's executives were to be paid several millions in performance bonuses irrespective of the fact that the company was almost bankrupt[42].
Hundreds of billions of taxpayers' dollars were used to bailout these Companies and still there is lack of information about the details[43].
The decision-making process was as chaotic as the crisis. Decisions were taken on a case-by-case basis, with no precise information and no pre-established parameters to follow, thus lacking of major coordination and accuracy.

C. Main Effects of The 2008/9 Crisis

The recession process that the economy is going through during 2009 is the major result of the financial crises. Outstanding economic meltdown includes people losing their homes since they are not able to repay their mortgages and unemployment rising dramatically.

D. Main Effects of the Bailouts

As mentioned in Section III above, the immediate effect of the bailouts was to calm down the markets and avoid the greater harm that would have been caused by the bankruptcy of the Too Big To Fail Companies.
However, when looking at the mid-term and long-term effects some concerns arise about the accuracy of the idea that a greater harm was avoided for the society as a whole. Some of those concerns are analyzed in the following Subsections.

i. Market Economy Incentives Seriously Affected

The bailouts were a strong hit against the basic principle of market economy: good businesses are to be rewarded with money from profit-seeking investors while bad businesses are to be punished with failure.

The bailouts came to show that management can make bad decisions, assuming excessive risk and leverage to collect big profits for a while, and when that scheme fails (as it happened with the subprime mortgages), they will still avoid bankruptcy by the grace of billions of dollars provided by the government *in order to avoid a major harm*.

Then, new incentives take over the market. They strictly say: become big enough as to make the State worry about your failure because of how interconnected your company is with other companies, and then you will avoid bankruptcy forever, making your company immortal.

That situation, which is one of the side effects of the bailouts, should sound crazy and unacceptable. However, the bailouts were destined to give us a healthier economy and markets, and we are supposed to be happy about them.

The U.S. President at the time, George W. Bush, said that he abandoned the principles of market economy "*to save*" market economy[44], when referring to the U.S. Government's intervention in the market through the bailouts[45].

About this issue, Alan Greenspan said:

"*One highly disturbing consequence of the ["too-big-to-fail"]-bailout problem is that I can see no way to convince markets henceforth that every large financial institution, should the occasion arise, would be subject to being bailed out with taxpayer funds. The implicit subsidy that such notions spawn insidiously impairs the efficiency of finance and the allocation of capital…*"[46].

It is interesting that Too Big to Fail Banks have grown even bigger after the bailouts[47], and some of them kept lobbing for more money after the bailouts were organized for their benefit[48].

ii. The Monetary Costs of the Bailouts

The U.S. Government used significant funds to bailout companies (hundreds of billions of dollars). Thus the Treasury is not as wealthy as it was before.

In that sense, it is to be noted that "*fearful investors have started to worry about how safe sovereign debt is*", in particular Greece and Ireland's sovereign debt[49], and if governments cease to be reliable they will face a severe risk of losing the capability to calm down the markets with bailouts.
In addition, the printing of money to run bailouts could lead to inflation, which would be very difficult to supersede during a period of recession.

iii. Uncertainty on When and How Bailouts Are To Be Run

No rules existed nor exist to provide parameters on basic issues such as:

– when a company is big enough as to deserve a bailout,
– how much money is the government authorized to use for a bailout
– when is the correct time to run a bailout,
– what should the government request in exchange from the rescued companies,
– when two companies in similar situations can receive different treatment in regard to a bailout[50].

This list is just an example of many important points on which there are no parameters or rules to follow when it comes to a critical decision such as running a bailout of major companies in the economy.

V. The Future

The following Sections consider certain opinions and strategies to deal with issues spotted in Section IV above.

A. Will Regulation Be Enacted to Prevent This Kind of Situations From Happening Again? If That Occurs, How Should That Regulation Be Structured?

History tells that new regulation comes out of major crises. That was the case with the 1930's crisis and the Glass-Steagall Act, Enron and the Sarbanes-Oxley

Act, among others[51]. Given the severity of the 2008/9 crisis, the same outcome should be expected.

It is clear that most policy makers, specialists and even some executives[52] agree on the idea of trying to prevent this kind of crisis from happening again[53].

The U.S. Treasury Secretary, Timothy Geithner, recently said that "*No financial system can operate efficiently if financial institutions and investors assume that government will protect them from the consequences of failure." The term "too big to fail" must be excised from our vocabulary.*"[54]

Mervyn King, the Governor of the Bank of England, said that "*Privately owned and managed institutions that are too big to fail sit oddly with a market economy*."[55]

"*No one is more sick of bailouts than I am*" said Ben Bernanke[56], chairman of the U.S. Federal Reserve. He also stated that "*As a nation, our challenge is to design a system of financial oversight that will embody the lessons of the past two years and provide a robust framework for preventing future crises and the economic damage they cause*"[57].

Former Federal Reserve Chairman Alan Greenspan said "*U.S. regulators should consider breaking up large financial institutions considered too big to fail*"[58].

U.S. Senator Christopher Dodd, chairman of the Senate Banking Committee also said that Too Big To Fail must end[59].

IMF leader Dominique Strauss-Kahn said public will not tolerate another bailout[60].

The G20 also focused in the importance of enacting new regulation, as will be seen in Subsection V.B.i below.

And most importantly, taxpayers seem to accept that the bailouts were the best available solution for a major crisis but they look convinced that the money they pay to the government is not to be used for saving private companies from failure[61].

B. Current Proposals

During the last months some technical proposals for new regulation were made, many of them in an early stage of development while. In addition, Bills have been introduced in the U.S. Congress and some measures were adopted by the U.S. Executive Branch. The main ones are considered in the following Subsections.

i. General Analysis

Among many proposals, a most relevant one is the G20's "*Global Plan for Recovery and Reform*"[62], which states that the Member Countries agreed to:

– strengthen financial regulation to rebuild trust;

– fund and reform their international financial institutions to overcome this crisis and prevent future ones;

– strengthening financial supervision and regulation;

– establish the much greater consistency and systematic cooperation between countries, and the framework of internationally agreed high standards, that a global financial system requires;

– promote propriety, integrity and transparency;

– guard against risk across the financial system;

– establish a new Financial Stability Board (FSB) with a strengthened mandate, as a successor to the Financial Stability Forum (FSF), including all G20 countries, FSF members, Spain, and the European Commission;

– extend regulation and oversight to all systemically important financial institutions, instruments and markets, including for the first time, systemically important hedge funds;

– take action against non-cooperative jurisdictions, including tax havens;

– regulation must prevent excessive leverage and require buffers of resources to be built up in good times;
– improve the quality, quantity, and international consistency of capital in the banking system;
– call on the accounting standard setters to work urgently with supervisors and regulators to improve standards on valuation and provisioning and achieve a single set of high-quality global accounting standards;
– extend regulatory oversight and registration to Credit Rating Agencies to ensure they meet the international code of good practice, particularly to prevent unacceptable conflicts of interest[63].

In addition other interesting proposal was published in the Financial Times[64], stating the following ideas:
– restore narrow banking or public utility banking;
– tax bank size;
– create effective special resolution mechanisms for all systemically important financial institutions.

Some plans[65] even call for the reinstatement of the concept behind the Glass-Steagall Act. This has lead to extensive debate, with experts in favor[66] and against[67] that measure.

ii. Bills and Executive Decisions

Some concrete actions have taken place already.

For instance, President Obama signed an executive order creating the "*Financial Fraud Enforcement Task Force*" to investigate and prosecute corporate fraud and deter wrongdoing. Its mission "*…is not just to hold accountable those who helped bring about the last financial meltdown, but to prevent another meltdown from happening*" said Eric Holder, U.S. Attorney General[68].

Senator Bill Sanders introduced the "*Too Big To Fail, Too Big to Exist*" Bill[69]. Such proposal gives the Secretary of the Treasury 90 days since the date of enactment of the Act, to submit to Congress a list of all commercial banks, investment banks, hedge funds, and insurance companies that the Secretary believes are Too Big To Fail, and "*beginning 1 year after the date of enactment of this Act, the Secretary of the Treasury shall break up entities included on the Too Big To Fail List, so that their failure would no longer cause a catastrophic effect on the United States or global economy without a taxpayer bailout*".

Such a Bill also defines Too Big To Fail Companies as any entity that has grown so large that its failure would have a catastrophic effect on the stability of either the financial system or the United States economy without substantial governmental assistance.

The Bill seems contradictory on the idea of addressing only Too Big To Fail financial entities or Too Big To Fail Companies of any industry.

Sen. Christopher Dodd, Chairman of the Senate Banking Committee, introduced a 300-page Bill, which the Wall Street Journal described by saying that "*Sen. Christopher Dodd's bill on financial regulation crystallizes the government's ability to lend to private enterprises using central bank resources.*"[70]

That Bill proposes the creation of three new agencies to look after the market's and bank's health[71], among other measures.

C. Legislative Strategy: Issues to Consider

Enacting new legislation implies giving new incentives to the market. Along that path many factors should be considered. Some of them are analyzed in the following Subsections.

i. Incentives and The Aggregate Effect of New Regulation

Systemic risk, the 2008/9 systemic crisis, and the bailouts are three different situations, with different causes and effects. That distinction must be first and foremost considered when enacting new regulation to deal with the three of them since some new rules might be effective to address one or two of them but useless in regard to the other/s. For instance, attempting to reduce the size of companies might be useful in regard to the outcomes of bailouts but might not be a solution for systemic risk.

However, since what matters is the aggregate effect of the new package of rules, no new regulation should be discarded by the mere fact that is not a *global* solution for the whole set of problems.

Obviously, we do not want new regulation to solve some of the current problems while causing new ones[72].

Moreover, since the market reacts to incentives, the new regulation should be mainly addressed towards terminating the undesired incentives that contributed to the 2008/9 crisis as well as the undesired incentives arising in the markets as a result of the bailouts.

ii. How to Address Systemic Crises (Systemic Risk)

Traditional financial regulation deals with the issue of systemic risk and, thus, systemic crises.

That involves regulation on capital, liquidity, leverage, executives' compensation and issuance of securities, as well as requirements to file reports on the companies' activities, among other rules. Some examples are the Basel rules, the Sarbanes-Oxley Act, the Financial Services Modernization Act of 1999, and public insurance for certain kind of deposits.

Fine tuning over the existing principles will help re-address the issue of systemic risk in accordance with the new situation in the market. However, excessive

increase in governmental controls of the markets and the companies to prevent failures will only bring us closer to the government being co-responsible for new systemic crises. On the contrary, drafting regulation to terminate undesired incentives and regenerate desired ones, will make the markets flow smoothly and will allow the government to remain in an objective position. Further, it should be noted that systemic risk is essential to the markets and each time new regulation is enacted or the economy shows changes, new incentives and opportunities appear for investors and then for systemic risk to occur. Miscalculations of risk are a key factor for crisis to happen and miscalculations of risk will always exist because of limited information, erroneous assumptions, etc., and mainly just because it is not possible to tell the future. Although crises will continue to occur[73], it is important to avoid falling twice in the same mistakes.

iii. How to Address Bailouts

According to the Government, bailouts were a consequence of having Too Big To Fail Companies facing failure[74]. However, as seen in Subsection IV.D above, bailouts calmed down the markets while also causing undesired incentives for the future.

Traditional regulation might not be enough to tackle this new issue. Instead, new alternatives have to be explored[75].

Bailouts like the ones seen during 2008/9 are the application of an old idea: exceptional situations require exceptional remedies. It is difficult to avoid the fact that such an idea will remain powerful irrespective of any future regulation.

It also seems strange to think that whenever the cost/benefit analysis of running a massive bailout or suffering the effects of massive major bankruptcies turns on the side of executing the rescuing plan, that analysis will be ignored –and the salvage will not be performed–.

However, some of the undesired effects that bailouts provoke can be diminished by limiting the size of companies.

The markets already know about size limits for companies in regard to antitrust matters.

The Sherman Antitrust Act, enacted in 1890, sets up the foundation and the basis for most federal antitrust regulation in the US[76]. However, this type of regulation is spread all around the world.

The courts broke up American Tobacco in 1911[77] such as they did with AT&T many years later in 1982[78].

The complexity of the AT&T break-up is one the arguments offered to tackle the idea that financial entities are too complex to be fragmented[79]. However, the international ramifications of the financial entities and other major companies that might be considered Too Big To Fail, seem to draw a scenario more complex than that of AT&T, which was mainly related to the U.S. market.

Nevertheless, the idea that business operating through subsidiaries in many countries of the world cannot be broke up seems exaggerated when the same know–how used to *aggregate* business units around the globe should be able to be used in order to *disaggregate* them, especially when there is not a specific deadline for such work.

In regard to timing it is clear that new measures to avoid the already known undesired incentives are to be taken as soon as possible, but a transition period could be worth the cost.

Further, a pay-back-period approach can be useful to deal with the idea that breaking up Too Big To Fail Companies implies a cost "*too high to be afforded*". Indeed, the costs of the undesired incentives existing in the market as a consequence of the bailouts –seen above in Subsection IV.D– should be paid continuously each day since the markets operate following those undesired incentives. On the other hand, the costs of

breaking up Too Big To Fail
companies could be distributed along a certain period of time.
Neither market theory nor Bankruptcy Law consider being "*Too Big*" as a characteristic that allows avoiding failure.
Additional perpetual wealth concentration could be a side-effect of a continuous bailout policy for Too Big To Fail Companies.
A size-limit on companies would increase the number of companies in the market. That leads to conclude *a priori* that it will be more difficult that all of them fail at the same time[80].
Anyway, it seems unreasonable to believe that such a measure could avoid systemic risk and, thereafter, systemic crises from happening, since systemic risk is intrinsic to the existence of markets. However, size regulation might help avoiding systemic risk related with Too Big To Fail Companies. In addition, in the eventual need of a bailout, the unfair situation of some few –not many– companies receiving aid from the government as well as the consequence of wealth concentration, could be both diluted if the bailout involve many companies and not only a few ones.
When the question of which companies should be reached by this size-limit regulation –or by any regulation addressing the Too Big To Fail Companies issue– arise, there seems to be no reason to distinguish among financial, insurance, automotive or any company from any other industry as long as they share the distinctive characteristic of being so big that allowing them to fail would cause a catastrophic effect on the stability of either the financial system or the economy. Nonetheless, certain industries can be considered within exceptions to the rule because of matters related to other policies (e.g. national security, health, etc.).
To that extent of deciding when a company is "*Too Big*", it should be noted that a company is dangerously big when it is large enough to transfer its risk (cost of

failure) to the government. Then, the ratio "*size of the company/size of the community where it operates*" should be considered for testing size.

The major drawback of breaking up companies would be related to the idea that operating in such a big scale is the only way to allow the existence of certain products and certain costs. Thus, consumers will suffer from an increase in the price of certain products and from the disappearance of other products. However, consumers might face a higher cost when the undesired incentives of bailouts exist in the markets, since those incentives corrupt the whole market system and not only the specific market of a product or service.

The previous comments in this Subsection refer to the idea of avoiding Too Big To Fail Companies in order to avoid bailouts and then the negative incentives they provide to the markets. Nonetheless, a different approach to the bailouts is possible: bailouts can be institutionalized. That would imply providing certainty about all the parameters mentioned in Section IV.D.iii. The consequences of that strategy would be totally different since they would create a different set of new incentives for the markets. However, that kind of approach will not be considered in this article.

VI. Conclusion

As shown below, there is a lot to consider about the 2008/9 systemic crisis, the bailouts and the Too Big To Fail Companies. It is clear that there are still many problems to be solved.

The public opinion and the policy makers agree on the idea of enacting new regulation to avoid falling twice on the same mistakes –and failures–[81].

In the past, major crises caused new regulation to be enacted, and the 2008/9 systemic crisis will also generate new important regulation on the financial markets. Indeed, in special issues such as what to do with the Too Big To Fail

Companies, such regulation could even go further than the financial markets and address other sectors as well.

When deciding what new regulation to enact, it is essential to understand that systemic risk, the 2008/9 systemic crisis, and the bailouts –used as a tool to solve large crises–, are three different situations, with different causes and effects. Improvements can be achieved separately with respect to the three of them and the aggregate effect of those improvements will put our society (and our markets) in a better position to face future systemic crises –since it is impossible to assure they will not occur–. Along that path it is most important to formulate regulation that solves current problems without creating new ones.

Systemic crises existed before but companies with secured immortality did not. The latter is the most challenging factor for the future regulation and leads to questioning if the bailouts used to "save" the economy actually performed as expected when they became a "*free pass to immortality*" for Too Big To Fail Companies. According to market reasoning, eternal companies should be the result of great and continuous business decisions through generations, and not a consequence of "great size" and government intervention.

Fine tuning over traditional financial regulation as well as exploring new ideas such as size-limits for Too Big To Fail Companies is required.

In doing so, the creation of proper incentives should be pursued as opposed to excessive government control over the markets.

There is no doubt that the opinions and strategies mentioned in this article should continue to be explored in depth, together with any other strategy available to enrich the discussion in order to achieve the best system possible.

[1]*The mystery of money – Both sides of the coin*, The Economist, Nov 26, 2009, *available at* http://www.economist.com/research/articlesBySubject/displayStory.cfm?story_id=14959703&subjectID=348918&fsrc=nwl.

[2] *What is the difference between systemic risk and systematic risk?* at Investopedia, http://www.investopedia.com/ask/answers/09/systemic-systematic-risk.asp.

[3] Press Release, JPMorgan Chase & Co. (May 31, 2008), *available at* http://www.bearstearns.com/includes/pdfs/PressRelease_BSC_31May08.pdf.

[4] Michael Lewis and David Einhorn, *The End of the Financial World as We Know It*, N.Y. Times, January 3, 2009, *availabe at* http://www.nytimes.com/2009/01/04/opinion/04lewiseinhorn.html?pagewanted=1&_r=3.

[5] "*The Dow Jones Industrial Average has persisted for a century precisely because it symbolizes not merely 30 blue-chip stocks, but the general health of the economy…" "Over the last hundred years, the average has moved from 40.94 on May 26, 1896 to a record of 5778 on May 22, 1996. The market's progress also tracks, even allowing for the vagaries of inflation, the well-being of society and people not only in the United States but throughout the world*." Editorial, *Review & Outlook: Mr. Dow's Barometer*, Wall Street Journal, May 28, 1996, *available at* http://www.djaverages.com/?view=industrial&page=editorial.

[6] Google Finance, http://www.google.com/finance?q=INDEXDJX%3A.DJI (last visited Nov. 29, 2009).

[7] Graeme Wearden, David Teather, and Jill Treanor, *Banking crisis: Lehman Brothers files for bankruptcy protection*, The Guardian, Sept. 15, 2009, *available at* http://www.guardian.co.uk/business/2008/sep/15/lehmanbrothers.creditcrunch.

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[8] Google Finance, *supra* note 6.

[9] U.S. Bureau of Labor Statistics, Labor Force Statistics from the Current Population Survey, *available at* http://data.bls.gov/PDQ/servlet/SurveyOutputServlet?request_action=wh&graph_name=LN_cpsbref3.

[10] Gerard Baker, *Banking crisis: Spectre of 1930s haunts America as financial turmoil worsens*, October 1, 2008, *available at* http://www.timesonline.co.uk/tol/news/world/us_and_americas/article4856477.ece. *See also* Alex Markels, *Comparing Today's Housing Crisis With the 1930s,* February 28, 2008, *available at* http://www.usnews.com/money/personal-finance/real-estate/articles/2008/02/28/comparing-todays-housing-crisis-with-the-1930s.html. *See also* John Waggoner, *Is today's economic crisis another Great Depression?,* April 4, 2008, *available at* http://www.usatoday.com/money/economy/2008-11-03-economy-depression-recession_N.htm.

[11] Press release, G20, The Global Plan for Recovery and Reform (April 2, 2009), *available at* http://www.g20.org/Documents/final-communique.pdf. *See also* Press release, G20, Declaration: Summit On Financial Markets and the World Economy (November 15, 2008), *available at* http://www.g20.org/Documents/g20_summit_declaration.pdf. *See also* Press release, U.S. Department of the Treasury, Treasury Outlines Framework For Regulatory Reform – Provides new Rules of the Road, focuses first on containing systemic risk (March 26, 2009), *available at* http://www.treas.gov/press/releases/tg72.htm.

[12] Federal Reserve Bank of St. Louis, The Financial Crisis – A Timeline of Events and Policy

Actions, http://timeline.stlouisfed.org/index.cfm?p=timeline (last visited Nov. 29, 2009). *See also* Steve Eder and Claudia Parsons, *TIMELINE: Action on pay comes after a year of bail outs*, Reuters, Oct 22, 2009, *available at* http://www.reuters.com/article/ousivMolt/idUSTRE59L5UF20091022. *See also Timeline: U.S. Government bail-outs*, BBC News, March 23, 2009, *available at* http://news.bbc.co.uk/2/hi/business/7748874.stm. *See also A bailout timeline*, Times Online, September 18, 2008, *available at* http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article4780330.ece.

[13] Lehman Brothers' failure generated images of several of its employees crying in the street while leaving their offices unemployed as a consequence of the company's failure. The idea of replication of this scenario in other institutions that were in jeopardy came across every mind. Many companies were in deep trouble at that time (at least the major ones that were later on saved by the Government) and no solution was expected since the figures were negative and showed no mercy. Massive sales of stock were made by investors desperately running to quality, i.e. moving their funds to U.S. Government backed assets, since those are believed to be the most secure investment possible. That made indexes fall as showed above in regard to the Dow Jones. Everything was panic about the economy and rumors in the financial markets expecting the falling of major companies. That idea was in every mind while TV screens showed important executives had last minute meetings with authorities trying to avoid bankruptcies as surgeons work in the emergency room to save lives.

[14] This situation occurred in the U.S. as well as in many other countries.

[15] It is important to note that the unfairness of this situation relies both in the idea that everyone in the society had to pay for bad profit-seeking decisions made by a small group of "*sophisticated*" people, and in the idea that such was a cross-border consequence.

[16] Among other decisions, the Treasury Announced the TARP (Troubled Asset Relief Program) Capital Purchase Program Description on October 14, 2008. Press release, U.S. Department of the Treasury, Treasury Announces TARP Capital Purchase Program Description (October 14, 2008), *available at* http://www.treas.gov/press/releases/hp1207.htm.

[17] A more accurate name would have been Too Big To "*Let Them*" Fail Companies. The name Too Big To Fail companies gives the idea that they will never fail and we already know that they would have failed if the Government decided not to aid them (as it happened with Lehman Brothers). On the other hand, the Too Big To "*Let Them*" Fail gives a more clear idea of what really occurred: the companies were about to fail, but a third party, the Government, was the one who could not "*Let Them*" fail because of the cost of such course of action.

[18] Nevertheless, companies like Chrysler and General Motors filed for bankruptcy even after receiving substantial aid from the government. *See* Chris Isidore, *GM bankruptcy: End of an era*, CNNMoney.com, June 2, 2009, *available at* http://money.cnn.com/2009/06/01/news/companies/gm_bankruptcy/index.htm. *See also* Asociated Press, *Chrysler files for bankruptcy protection*, MSNBC, April 30, 2009, *available at* http://www.msnbc.msn.com/id/30489906/.

[19] Jim Puzzanghera, *Why the world's biggest insurance company is still getting taxpayer funds*, Los Angeles Times, March 9, 2009, *available at* http://articles.latimes.com/2009/mar/09/business/fi-nofail9.

[20] American International Group, Inc. Information, http://www.reuters.com/finance/stocks/companyProfile?symbol=AIG.N (last visited Nov. 29, 2009).

[21] Bill Saporito, *How AIG Became Too Big to Fail*, Time Magazine, Mar. 19, 2009, *available at* http://www.time.com/time/business/article/0,8599,1886275,00.html.

[22] Mark Felsenthal and Theodore d'Afflisio, *Fed's Kohn: AIG too big to fail*, Reuters, Mar 5, 2009, *available at* http://www.reuters.com/article/businessNews/idUSTRE52446C20090305.

[23] Saporito, *supra* note 21.

[24] Video *AIG Too Big to Fail?*, Sept. 16, 2009, http://online.wsj.com/video/aig-too-big-to-fail/EB43660E-F0EC-4FD1-8A2E-86C5E3661C62.html (last visited Nov. 1, 2009).

[25] A detailed timeline of the crisis is provided by the Federal Reserve Bank of St. Louis. *See supra* note 12.

[26] Economies of scale, definition at Investopedia, http://www.investopedia.com/terms/e/economiesofscale.asp (last visited Nov. 29, 2009).

[27] Diseconomies of scale, definition at Investopedia, http://www.investopedia.com/terms/d/diseconomiesofscale.asp (last visited Nov. 29, 2009).

[28] Both effects may differ in time, but are the result of a growing strategy different from the traditional one, which would be growing to maximize economies of scale and stop growing when going into diseconomies of scale.

[29] "*The too-big-to-fail problem has been central to the degeneration and corruption of the financial system in the north Atlantic region over the past two decades. The too-big-to-fail category is sometimes extended to become the too-interconnected-to-fail, too-complex-to-fail and too-international-to-fail problem, but the real issue is size.*" Willem Buiter, *Too big to fail*, Financial Times, June 26 2009, available at http://www.ft.com/cms/s/0/bd93a1e6-61e9-11de-9e03-00144feabdc0.html?nclick_check=1. *See also* Eric *Dash, If It's Too Big to Fail, Is*

It Too Big to Exist?, N.Y. Times, June 20, 2009, *available at* http://www.nytimes.com/2009/06/21/weekinreview/21dash.html.

[30] *Glass-Steagall Act (1933)*, N.Y. Times, November 29, 2009, *available at* http://topics.nytimes.com/topics/reference/timestopics/subjects/g/glass_steagall_act_1933/index.html.

[31] Glass-Steagall Act description at Investopedia, http://www.investopedia.com/terms/g/glass_steagall_act.asp (last visited Nov. 29, 2009).

[32] Cyrus Sanati, *10 Years Later Looking At Repeal Of Glass-Steagall*, N.Y. Times, Nov. 12, 2009, *available at* http://dealbook.blogs.nytimes.com/2009/11/12/10-years-later-looking-at-repeal-of-glass-steagall/.

[33] *Bail-out poker*, The Economist, Nov 26th 2009, *available at* http://www.economist.com/businessfinance/displaystory.cfm?story_id=14973029.

[34] *See supra* note 9.

[35] AIG is the largest insurance company in the world. Jim Puzzanghera, *Why the world's biggest insurance company is still getting taxpayer funds*, Los Angeles Times, March 9, 2009, *available at* http://articles.latimes.com/2009/mar/09/business/fi-nofail9.

[36] Patrick Rucker and Jonathan Stempel, *Bank of America gets big government bailout*, Reuters, Jan 16, 2009, available at http://www.reuters.com/article/topNews/idUSTRE50F1Q720090116.

[37] *See supra* note 18.

[38] Robin Sidel, David Enrich and Dan Fitzpatrick, *WaMu Is Seized, Sold Off to J.P. Morgan, In Largest Failure in U.S. Banking History*, Wall Street Journal, September 26, 2009, *available at* http://online.wsj.com/article/SB122238415586576687.html.

[39] A detailed timeline of the crisis is provided by the Federal Reserve Bank of St. Louis, where it is possible to see the evolution of this complicated time. *See supra* note 12.

[40] Reuters, *Ford does not need bailout loans, CEO says*, France24, January 25, 2009, *available at http://www.france24.com/en/20090125-ford-says-it-does-not-need-bailout-loans-auto-industry-crisis*. *See also Ford Executive: Automaker Doesn't Need Bailout*, npr, Nov. 29, 2009, *available at* http://www.npr.org/templates/story/story.php?storyId=102665356. *See also Ford: We Don't Need a Bailout, But…,* U.S. News, Dec. 3, 2008, *available at* http://usnews.rankingsandreviews.com/cars-trucks/daily-news/081203-Ford-We-Don-t-Need-a-Bailout-But-/.

[41] "*Since last September, the government's case for bailing out AIG has rested on the notion that the company was too big to fail. If AIG hadn't been rescued, the argument goes, its credit default swap (CDS) obligations would have caused huge losses to its counterparties—and thus provoked a financial collapse. Last week's news that this was not in fact the motive for AIG's rescue has implications that go well beyond the Obama administration's efforts to regulate CDSs and other derivatives. It's one more example that the administration may be using the financial crisis as a pretext to extend Washington's control of the financial sector. The truth about the credit default swaps came out last week in a report by TARP Special Inspector General Neil Barofsky. It says that Treasury Secretary Tim Geithner, then president of the New York Federal Reserve Bank, did not believe that the financial condition of AIG's credit default swap counterparties was "a relevant factor" in the decision to bail out the company. This contradicts the conventional assumption, never denied by the Federal Reserve or the Treasury, that AIG's failure would have had a devastating effect. So why did the government rescue AIG? This has never been clear.*" Peter J. Wallison, *Lack of Candor and the AIG Bailout*, Wall Street Journal, Nov. 27, 2009, *available*

at http://online.wsj.com/article/SB10001424052748704779704574551861399508826.html?mod=googlenews_wsj.

[42] Saporito, *supra* note 21.

[43] Brady Dennis, *Lawmakers Rebuke Treasury Department Over TARP Spending*, Washington Post, July 21, 2009, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2009/07/21/AR2009072103561.html. *See also* Fred Lucas, *$700-Billion Bailout Lacks Transparency, Accountability, Congressional Panel Says*, CNSNews, January 14, 2009, *available at* http://www.cnsnews.com/news/article/41922.

[44] "*I've abandoned free-market principles to save the free-market system… to make sure the economy doesn't collapse.*" AFP, *Bush says sacrificed free-market principles to save economy*, Google Hosted News, http://www.google.com/hostednews/afp/article/ALeqM5jyyKrPjYt7VhpS8G8DrRkr18B0hA (last visited Nov. 29, 2009).

[45] Peter Baker, *Bush Returns to Public Spotlight*, N.Y. Times, Nov. 12, 2009, *available at* http://thecaucus.blogs.nytimes.com/2009/11/12/bush-returns-to-public-spotlight/?scp=2&sq=bush%20abandon%20market%20economy&st=Search.

[46] Alan Greenspan, *Remarks on "Systemic Risk"*, American Enterprise Institute, June 3, 2009, *available at* http://www.aei.org/docLib/Greenspan%20-%20Speech%20-final.pdf.

[47] David Cho, *Banks 'Too Big to Fail' Have Grown Even Bigger*, Washington Post, August 28, 2009, *available at* http://www.commondreams.org/headline/2009/08/28.

[48] David D. Kirkpatrick and Charlie Savage, *Firms That Got Bailout Money Keep Lobbying*, N.Y. Times, January 23, 2009, *available at* http://www.nytimes.com/2009/01/24/business/24lobby.html.

[49] Editorial, *Dubai reveals the fragility of finance*, Financial Times, Nov. 27, 2009, *available at* http://www.ft.com/cms/s/0/308e52b0-db8c-11de-9424-00144feabdc0.html.

[50] "*Not only does the "too big to fail" paradigm provide unequal advantage to big business, but when bailouts become "necessary," it can be employed unevenly among the big fish as well; allowing some to survive while others are left to fail. An example of this was demonstrated when former Treasury Secretary Hank Paulson approved Troubled Asset Relief Program (TARP) funds for AIG; Goldman Sachs biggest debtor; but not Lehman Brothers or Bear Stearns; Goldman's two major competitors."* Stan Transue, *Too big to fail: a cover for corporate welfare*, Examiner, Nov. 27, 2009, *available at* http://www.examiner.com/x-29000-Habersham-County-Conservative-Examiner~y2009m11d27-Too-big-to-fail-a-cover-for-corporate-welfare. Under this line of reasoning at least there is room to ask if the bailouts do not violate the guarantee of equal treatment under the law as established by the Fourteenth Ammendment.

[51] Even the Ponzi Scheme run by B. Madoff caused new regulation to be enacted. *See* "*The Securities and Exchange Commission Post-Madoff Reforms*" *available at* http://www.sec.gov/spotlight/secpostmadoffreforms.htm.

[52] The Chairman and chief executive of J.P. Morgan Chase wrote for the Washington Post that "*Our company, J.P. Morgan Chase, employs more than 220,000 people, serves well over 100 million customers, lends hundreds of millions of dollars each day and has operations in nearly 100 countries. And if some unforeseen circumstance should put this firm at risk of collapse, I believe we should be allowed to fail.*" Jamie Dimon, *No more 'too big to fail'*, Washington Post, Nov. 13, 2009, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2009/11/12/AR2009111209924.html.

[53] Christian Leuz, *We Need Smarter Regulation, Not More*, Forbes, Sept. 2, 2009, *available at* http://www.forbes.com/2009/02/09/dynamic-financial-regulation-opinions-contributors_0209_christian_leuz.html.

[54] Dimon, *supra* note 52.

[55] *Governor seeks more bank powers*, BBC News, June 18, 2009, *available at* http://news.bbc.co.uk/2/hi/business/8106209.stm.

[56] Edmund. L. Andrews, *Bernanke, in Nod to Critics, Suggests Board of Regulators*, N.Y. Times, Oct. 1, 2009, *available at* http://www.nytimes.com/2009/10/02/business/economy/02regulate.html.

[57] Ben Bernanke, *The right reform for the Fed*, Washington Post, Nov. 29, 2009, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2009/11/27/AR2009112702322.html.

[58] Michael McKee and Scott Lanman, *Greenspan Says U.S. Should Consider Breaking Up Large Banks*, Bloomberg, Oct. 15, 2009, *available at* http://www.bloomberg.com/apps/news?pid=20601087&sid=aJ8HPmNUfchg.

[59] *Dodd says 'Too Big to Fail' must end*, Reuters, Oct. 8, 2009, *available at* http://www.reuters.com/news/video?videoId=112806.

[60] *IMF leader Dominique Strauss-Kahn says public will not tolerate another bailout*, The Times, November 24, 2009, *availlable at* http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article6928870.ece.

[61] Paul Davidson, 78% of Americans want a bailout but most want significant changes, USA Today, Sept. 28, 2008, *available at http://www.usatoday.com/money/economy/2008-09-25-poll-results_N.htm*. See also *Poll: No more bailout for GM, Chrysler*, United Press International Inc, Feb. 26, 2009, *available at* http://www.upi.com/Top_News/2009/02/26/Poll-No-more-bailout-for-GM-Chrysler/UPI-46041235701427/.

[62] G20, *supra* note 11.

[63] "*Washington, D.C., Sept. 17, 2009 — The Securities and Exchange Commission today voted unanimously to take several rulemaking actions to bolster oversight of credit ratings agencies by enhancing disclosure and improving the quality of credit ratings*". Press release, Securities and Exchange Comission, SEC Votes on Measures to Further Strengthen Oversight of Credit Rating Agencies (Sept. 17, 2009), available at http://www.sec.gov/news/press/2009/2009-200.htm.

[64] Willem Buiter, *Too big to fail is too big*, Financial Times, June 24, 2009, *available at* http://blogs.ft.com/maverecon/2009/06/too-big-to-fail-is-too-big/.

[65] Eric K. Clemons, *How to Make U.S. Financial Regulation Work Again*, Business Week, April 6, 2009, *available at* http://www.businessweek.com/investor/content/apr2009/pi2009043_273663.htm.

[66] Lee Jones, *Turner calls for new Glass-Steagall approach*, Money Marketing, Nov. 2, 2009, *available at* http://www.moneymarketing.co.uk/regulation/news/turner-calls-for-new-glass-steagall-approach/1001475.article.

[67] Robert Pozen, *Stop Pining for Glass-Steagall*, Forbes, Sept. 16, 2009, *available at* http://www.forbes.com/forbes/2009/1005/opinions-glass-steagall-on-my-mind.html. *See also* Craig Torres and Michael McKee, *Fed's Tarullo Says Dividing Banks May Not Curb Too Big to Fail*, Bloomberg, Nov. 10, 2009, *available at* http://www.bloomberg.com/apps/news?pid=20601103&sid=asfrJ4dAXcgM.

[68] Joanna Chung in New York, *New task force to step up fight against fraud*, Nov. 18, 2009, *available at* http://www.ft.com/cms/s/0/c8226370-d3e2-11de-8caf-00144feabdc0.html.

[69] Too Big To Fail To Big To Exist Bill, *available at* http://sanders.senate.gov/files/AYO09C99.pdf. *See also* Senator Sanders Video *available at* http://sanders.senate.gov/newsroom/media/view/?id=ae60bcf0-125c-4306-b07c-d875fe48b1f5 (last visited Nov. 29, 2009).

[70] Joseph R. Mason, *Bailout Nation,* Wall Street Journal, Nov. 24, 2009, *available at* http://online.wsj.com/article/SB10001424052748704611404574556331427394554.html?mod=googlenews_wsj.

[71] Binyamin Appelbaum and Brady Dennis, *Dodd's overhaul goes well beyond other plans*, Washington Post, Nov. 11, 2009, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2009/11/09/AR2009110901935.html.

[72] As it may have been the case of the bailouts.

[73] *How the Dubai crisis unfolded*, Financial Times, Nov. 27, 2009, *available at* http://www.ft.com/cms/s/0/d9c5ef76-db84-11de-9424-00144feabdc0.html. *See also Dubai reveals the fragility of finance*, Financial Tim es, Nov. 27, 2009, *available at* http://www.ft.com/cms/s/0/308e52b0-db8c-11de-9424-00144feabdc0.html.

[74] *See* Section III of this Article.

[75] Nouriel Roubini, *'Too Big To Fail' Revisited*, Forbes, May 11, 2009, *available at* http://www.forbes.com/2009/11/04/too-big-to-fail-volcker-greenspan-mervyn-king-opinions-columnists-nouriel-roubini.html.

[76] Description of Antitrust Regulation at the Legal Information Institute of the Cornell University Law School, http://topics.law.cornell.edu/wex/Antitrust (last visited Nov. 29).

[77] Patrick Thibodeau, *History shows Microsoft dilemma is nothing new*, CNN, May 18, 1998, *available at* http://www.cnn.com/TECH/computing/9805/18/monopoly/index.html.

[78] Andrew Beattie, *Why is the 1982 AT&T breakup considered one of the most successful spinoffs in history?*, Investopedia, *available at* http://www.investopedia.com/ask/answers/09/att-breakup-spinoff.asp?viewed=1.

[79] Discussions exist about the effectiveness of the break ups on antitrust matter, even though the AT&T case seems to be pointed out as a great success. Rachel Konrad, *Is a breakup an effective solution?*, CNET News, April 28, 2000, *available at* http://news.cnet.com/Is-a-breakup-an-effective-solution/2100-1001_3-239872.html.

[80] However, certain analysis of systemic risk can be sustained to say that when the "*black swan*" phenomenon (the unexpected and underestimated event) occurs, when the systemic risk materializes, is exactly because everyone underestimated it, and the increase in the number of companies would not be an insurance against that situation since the new companies in the market would fail to properly measure the risk as the previously existing ones did.

[81] See Section V.A of this article.

COMCAST AND NBC UNIVERSAL: THE IMPLICATIONS OF BIG MEDIA MERGERS IN AN INCREASINGLY SMALLER WORLD

I.
Introduction

Comcast's proposed takeover of NBC Universal is expected to completely restructure the entertainment industry's landscape. Analysts, investors, and public interest groups alike have responded strongly to the anticipated agreement, which is expected to be finalized imminently. The merger of the largest American cable company with one of the largest entertainment enterprises in the world would give the combined entity control over approximately one out of every five viewing hours in the United States. [1] Not surprisingly, the deal will be heavily scrutinized and raise considerable questions of antitrust law, media diversity, and the future of internet usage. This article will explore the implications of big media mergers in light of the Comcast-NBC proposal.

II. Facts

Comcast Corporation (Comcast) is not only the largest cable company in the United States, but also the largest internet service provider and the third largest home phone provider. [2] Comcast has 25 million television subscribers, 15 million internet service costumers, and 6.4 million household telephone service accounts. [3] Its current assembly of cable networks includes E!, Style, Golf Channel, and G4. [4]

NBC Universal, Inc. (NBCU) is a media and entertainment company created by

the
merger of General Electric's (GE) NBC and French Media Group's Vivendi Universal Entertainment (Vivendi). The two companies own 80% and 20% of NBCU
respectively. [5] NBCU owns and operates 26 television stations, the Spanish language network Telemundo, and a dozen cable networks including USA, Barvo, Syfy, and CNBC. [6] It also has a 27% stake in the internet venture Hulu. [7]

Vivendi has an annual option to sell its stake in NBC to GE between November 15th and December 10th of each year. Vivendi has been negotiating to get the best value for its investment, as the Comcast-GE agreement hedges on Vivendi's decision to exercise this option. GE has recently reached a tentative agreement with Vivendi to buy its stake in NBCU for $5.8 billion. [8] Following a successful Vivendi buy out, GE would then sell 51% of its total ownership of NBCU to Comcast, who would merge its cable-TV channels and contribute $4 to $6
billion to the joint venture. Comcast is expected to buy the remaining 49% of NBCU from GE over the next seven years. [9]

The companies have agreed to value NBCU at about $30 billion dollars, and the Comcast-NBCU union is estimated to have an annual revenue of about $42 billion.
[10] The combination of these two entities would be, according to the public interest group The Center for Digital Democracy, "the equivalent of Godzilla swallowing the Rockefeller Center." [11]

Given the union's size, significant opposition stands in the way of the merger. The deal must pass review by the Federal Communications Commission (FCC) as

well as review of its antitrust connotations by the Justice Department or the Federal Trade Commission (FTC). [12] NBC's affiliates and competitors hold considerable sway over the federal agency approval of the deal and may chose to stand in the way of the union. [13] Additionally, public interest groups are pressuring the Obama administration to oppose the deal, citing that it would both stifle media diversity and have a negative impact on the availability of free internet information. [14] Even without the external pressures, regulatory review of the merger could take more than a year. [15]

III. The Case against Consolidation

United States antitrust law aims to eliminate transactions that threaten the competitive process. Mergers and acquisitions are regulated under the Clayton Act, which states:

> "No person shall acquire, directly or indirectly, the whole or any part of the stock or any other share capital… of the assets of one or more persons engaged in commerce or in any activity affecting commerce, where… the effect of such acquisition, of such stocks or assets, or of the use of suck stock by the voting or granting of proxies or otherwise, may be substantially to lessen competition, or to tend to create a monopoly." [16]

The merger would be a vertical integration, in which one company seeks to control

several different steps of the production and distribution of a product or service. By controlling both production and distribution of programs, Comcast could retain an unfair advantage. There are several ways in which the Comcast-NBC merger could substantially lessen competition.

The anti-competitive measures could include, but would not be limited to, Comcast blocking its competitors' access to NBC prime-time shows and local newscasts [17] or raising the distribution costs for other pay-TV providers to access NBCU networks. [18] The new Comcast-NBCU may also be dominant enough to refuse to carry cable channels owned by rivals and force its rival channels to offer lower fees. [19] Expanding beyond television, the new entity may even produce big-screen movies and then control the release dates of the movies to give itself an advantage over movie-rental businesses like Netflix. [20] Additionally, the Comcast-NBCU deal could lead to a wave of similar media mergers that would further decrease competition as Comcast's competitors struggle not to be left behind. [21]

The internet and "network neutrality" are further issues in contention. Comcast-NBCU could use its control in violation of the tenet that broadband providers should treat all internet traffic equally by favoring its own media content. [22] It could also "remove a competitive rivalry" by eliminating the availability of free television programs on the internet through its stake in Hulu. [23]

Many public interest groups are calling for a return to smaller, local media

channels and opposing the media oligopoly. They argue that a few, large media corporations would undermine the diversity of offerings and consumer choice in the industry. [24] Antitrust law, they state, is not solely about price; it is about choice, and this includes the choice of quality and editorial viewpoint that a media oligopoly lacks. [25] Since media products inevitably bear the perspective of their corporate parent, the number of firms required to ensure media diversity is larger than that required to preserve price competition. [26]

These organizations also assert that a lack of media diversity not only limits consumer choice, it harms democratic discourse and stifles minority voice as well as affects how women and people of color are portrayed in the media. Due to media giants crowding out local businesses, women and minority ownership of television stations is unacceptably low and the proportion is continually decreasing. Women, who comprise 51% of the population, own 4.97% of television
stations, and minorities, who comprise of 33% of the population, own 3.26% of all stations. [27] In addition, media diversity is believed to be an important check on
government power. [28]

IV. The Case for Consolidation

Despite widespread concern, antitrust experts find little proof that the merger would substantially lessen media competition due to people increasingly distributing leisure hours across a variety of diversions aside from television viewing [29]. Additionally, regulations are already in place to prevent Comcast from refusing to sell its programming to its competitors. [30] The merger may even increase competition in some areas, such as sports, where Comcast could become a potent rival to Disney's ESPN. [31]

The merger comes at a difficult but convenient time for both companies. Comcast has been losing hundreds of thousands of subscribers each year to its competitors, such as satellite television providers who are able to offer their channel packages at lower prices. [32] Additionally, suppliers like NBCU and Walt Disney have been charging higher prices as broadcasters like FOX and CBS have declared an intention to start charging for their programs. [33] Comcast is losing business rapidly to selective, cheaper programs on the internet. [34] NBC, too, has seen a slow and steady decline since the 1990s. [35] Ratings have steadily decreased with the number of quality, "must-see" programs [36], which are replaced by cheaper-to-produce reality television. Good television programs with intelligent, well-written scripts and capable actors are becoming progressively more costly to produce while the station's revenue are decreasing due to an increasingly lower demand in television advertising [37], the sole means by which broadcast stations bring in revenue. [38]

Comcast's move may be just what both companies need in order to bounce back. Having control of a significant amount of the content being produced would give Comcast the freedom and power to experiment with how to best deliver its programs. [39] The union would also allow for Comcast's enhanced utilization of the internet and allow both companies to benefit from Comcast's efforts to reach additional platforms. [40] The combination of the leading and third largest online video sites, Hulu and Comcast's Fancast, could boost the availability of media content on the internet. [41] The flow of money back to the studio would allow the continued and increased production of more quality television shows, benefiting the viewers. [42]

The new company would likely speed the development of new and innovative

forms
of advertisement, such as interactive television ads. [43] The merge also has the potential to revive the video on demand industry and accelerate its availability and acceptance. [44] Additionally, Comcast-NBCU can serve as a major boost for the cable industry, as big public companies tend to drive big public industries. [45]

V. Analysis

The Obama administration has vowed to encourage media diversity and to play tough on the enforcement of antitrust regulations. [46] The merger will almost indubitably pass considering the significant players' substantial size and considerable clout. While such a large-scale merger inevitably has risks, the mandated FCC and Justice Department or FTC approval serve as powerful checks on
Comcast. Comcast will have to make many concessions in order to attain such approval.

Regulators will work to ensure that competitive rivalry is maintained. The government may forbid Comcast from denying access to content to its competitors
and from discriminating against cable channels that it does not own. [47] The government may mandate binding arbitration in any disputes that arise. [48] It may go as far as to force Comcast to dissociate from local stations in fear that it will hold too much clout in negotiations. [49] It will reiterate its mandate of net neutrality. Comcast may also have to compromise on its exclusivity over its regional sports programs by granting its competitors access. [50] Additionally, Comcast may have to divest some of NBCU's assets to please the regulators. [51]

Two similar mergers in the past were America Online's (AOL) purchase of Time Warner Inc. (Time Warner) in 2001 and News Corporation's (News Corp.) acquisition of The DirecTV Group (DirecTV) in 2003. In both instances, the FCC imposed additional regulations as a check against the media giants' control. It required Time Warner to offer services additional to AOL on its cable internet network, and it prohibited News Corp.-DirecTV from discriminating against its competitors' television channels and called for mandatory arbitration for dispute resolution. [52] The FCC will likely analyze and look to these past cases while deliberating the Comcast-NBCU deal.

In both cases, the consolidations spawned similar outrage and alarm to the current Comcast-NBCU deal. Opponents of those mergers predicted rising programming prices, significant impairment to competition, decrease in media diversity, and a restructuring of the entire media landscape. [53] In both instances, the consolidated entity proved harder to maintain than expected. Whether through poor management, ill-advised business decisions, or unfortunate circumstances, both companies suffered significant losses and the apocalyptic predictions fell short. [54] Time Warner currently plans to completely divorce itself from AOL, while News Corp. successfully sold its stake in DirecTV to Liberty Media in 2008. [55]

The alarm toward the Comcast-NBCU merge may be similarly overstated. Comcast may become the most powerful player in the entertainment industry and lead its competitors by example, or it may follow in the footsteps of its predecessors and regret its sizeable decision. What the future holds for Comcast and for the

entertainment industry is unclear, but we should not fear to move forward and let the future play out.

VI. Conclusion

While the panic toward the Comcast-NBCU entity may be overstated, the significance of the merger should not be overlooked. Comcast-NBCU would not only be influenced by past mergers, it will give insight into the requirements and regulations to be imposed on furture deals. The government is not likely to treat such a merger lightly, and the resulting entity will not be an easy one to manage. The merger may very well be a large asset for Comcast, but the concessions and compromises that Comcast will be forced to make will also benefit its competitors. If Comcast manages the new entity well, the union can serve to boost the economy. Viewers can benefit in receiving more quality programming through a wider array of platforms. Technology is relentlessly changing, and business principles and administration will inevitably evolve with it. With the increasing availability of alternate platforms for media communication, Comcast may lead the entertainment industry into a more modernized future.

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MICROCREDIT – PART 1

Introduction

The Nobel Peace Prize for 2006 was awarded to Muhammad Yunus and the Grameen bank for the expansion of microcredit. [1] As the Nobel committee said, “lasting peace cannot be achieved unless large population groups find ways in which to break out of poverty.” [2] Micro-credit is a way in which development can be stimulated in a matter that also serves to advance democracy and human rights. [3]

Microcredit is a topic that has been fairly underexplored in regards to business law. In this multipart essay, I will first introduce the foundations and workings of microcredit. Then, I will explore how microcredit can be applied to the poor in present day society in the United States and the barriers that stand in its way. A big constraint to the expansion of microcredit programs is the absence of a legal framework. However, before a comprehensive legal framework can be developed, the concept of microcredit has to be understood. [4]

One of the most intractable economic problems for poor countries has been the high price, or outright unavailability, of credit in rural communities. [5] One of the few concepts that have succeeded in expanding the availability of credit has been "microfinance;" a practice that involves the provision of small loans (generally of a few hundred dollars or so) to borrowers without conventional collateral. The success of micro-lending has been especially striking because its benefits have accrued primarily to groups ignored by traditional development assistance. These groups are the poorest segments of poor countries' populations and, in particular women. [6]

As many are aware, traditional banks generally do not provide financial services or loans to individuals with little or no cash income or other forms of collateral. [7] Banks must incur substantial costs to manage a client account, regardless of how small the sums of money involved. [8] The reasoning is that banks must incur substantial costs to manage a client account, regardless of the sum of money. [9] Because of these difficulties, when poor people borrow they often rely on relatives or a local moneylender. These unregulated and unconventional lenders can have very high interest rates. [10]

Brief History of Grameen Bank and the Goals of Microcredit:

The Grameen Bank is widely considered to be the pioneer of microcredit. The goals of the microcredit system are actually ingrained in the Grameen Bank organization. The origin of Grameen Bank can be traced back to 1976 when Professor Muhammad Yunus, Head of the Rural Economics Program at the University of Chittagong, launched an action research project to examine the possibility of designing a credit delivery system to provide banking services targeted at the rural poor. [11] The Grameen Bank Project came into operation with many objectives. These included: extending banking facilities to poor men and women, eliminating the exploitation of the poor by money lenders, creating opportunities for self-employment for the vast multitude of unemployed people in rural Bangladesh, bringing the disadvantaged (mostly women) from the poorest households, within the fold of an organizational format which they can understand and manage by themselves. Fortunately, microcredit provides the good way to reverse the age-old vicious circle of "low income, low saving & low investment", into virtuous circle of "low income, injection of credit, investment, more income, more savings, more investment, more income." [12] **How Microcredit**

Works: Solidarity Lending:

In order to achieve the aforementioned goals of microcredit, one must first understand the concept of “solidarity lending,” as it is a cornerstone of how

microcredit works. [13] Essentially, the financial system of solidarity lending is the practice of bundling loans. Under this system, would-be borrowers form small groups (usually of between three and six), where each member agrees to guarantee the loans of the others in the group. [14] If any one individual member defaults on his or her loan, the other members of the group are required to cover the shortfall. [15] This involves a degree of peer pressure, social pressure, and moral pressure that can be even more effective than the threat of losing assets or collateral. This practice works well in small localized societies because generally, the respect and good name that one has is equally important as material possessions.

Successes and Hard Numbers:

Microcredit is generally considered to be a complete success in economic terms. An official announcement stated that more than 106 million of the world's people living on less than $1 per day received micro-loans, and that this goal was reached in late 2007. [16] Furthermore, the Grameen Bank, now employs more than 16,000 people, has more than seven million clients–mostly women–and has lent more than $7 billion. [17] Microcredit fueled enterprises make an important contribution to economic output and employment in developing economies. While estimates vary greatly depending on definitions, recent work by the World Bank suggests that almost 30 percent of employment in low-income countries is generated by the informal economy, while an additional 18 percent is provided by (formal) small and medium enterprises. [18] Currently, there is an immense global microfinance funding gap of at least $250 billion. Only about four per cent of the worldwide demand is being met. This problematic gap is where microcredit has the opportunity to jump in and resolve. [19] More and more large investment and pension pools are recognizing microfinance as a solid investment. Examples include the multibillion U. S. college pension fund and TIAACREF, which invested $100 million in global microfinance. [20] Aside from being implemented

in poor rural areas of Bangladesh or parts of India, recently it was announced that former Algerian prison inmates will receive small loans to ease their re-integration into society and lower their chance of becoming repeat offenders. [21]

Problems and Criticism:

Microcredit as a concept has expanded throughout the world already. Microcredit institutions operate in a variety of institutional structures. They include research projects in China, non-governmental organizations, trusts, non-bank finance corporations, banks, financial companies, and so on. [22] Since there is no official legal position for microcredit programs, they adopt an uncomfortable home just to give themselves a legal cover. [23] While it solves immediate problems, it runs into the problems of being a guest in an adopted "home." These restrictions include restraints on certain lending practices and regulations that actually impede the lending process. [24] Many programs that have reached full scale in that they have permeated the local population and wish to convert themselves into formal financial institutions are unwilling to do so because of these potential legal problems. [25] These problems are a crucial factor in the application of microcredit in the United States and will be explored in the next part of the paper.

In addition to these external legal issues regarding the position of these organizations in the course of government regulation, there are also a variety of internal problems as well. Micro enterprise faces more problems in raising finance, as the provider of financing may not find the amazing return on investment when compared to the return on investment with a large enterprise. Also investors are more skeptical about repayment due to the nature of the loans and who the money is being loaned to. [26] There have been studies which have found that in order to ensure timely repayment, the loan centers, bank workers, and borrowing peers have been known to inflict an intense pressure on women

clients. [27] In a community, many borrowers maintained their regular payment schedules through a process of loan recycling. This considerably increased the debt-liability on the individual households, increased tension and frustration among household members, and produced new forms of dominance over women and increases violence in society. [28]

Conclusion:

The concept of microcredit has tremendous potential in the world of banking. Micro-financing has a blend of social and economic characteristics which provide a strong foundation that can be used to achieve objectives of micro financing efficiently and effectively so long as one knows the pillars of micro financing. It can bring about positive change in the poverty stricken and underdeveloped parts of a country. Overall, this has been a brief introduction to the concept of microcredit and its origins. In part II, I will expand on how such a system could be implemented in the United States as well as explore the legal ramifications and possible negative consequences that such an application would have in our present day society.

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EYES WIDE OPEN: EXPANDING VIEWS ON THE ALIEN TORT CLAIMS ACT

Introduction

The Alien Tort Claim Act (ATCA) has been a source of controversy over the past years. Originally, it was used as a way to govern relations between nations, but now it is being utilized by human rights activists in order to hold corporations responsible for acts performed by their subsidiaries which infringe upon the rights of people in foreign nations in which the company resides. [1] The Act reads: "The district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States." [2]

This article will discuss the history of corporate liability under the ATCA. It will then follow by spotlighting a case that almost set precedent in terms of corporate liability under the ATCA. It will conclude with a discussion of the effects of utilizing the agency theory in corporate ATCA claims.

Corporate Liability Under the ATCA

In the past, the ATCA was developed in order to create laws that give aliens access to the federal court system in order to protect foreign merchants who are willing to do business with the U.S. [3] Another concern of the Act was to show to foreign nations that the United States would be considered a nation of laws that would not allow for torts to be avoided simply because the tortfeasors were not citizens of the United States. [4] Throughout the years, the ATCA has been increasingly used in cases against corporations in which they are accused of violations of international law in their associations with countries that are known for their violation of the human rights of employees and other third parties. [5]

So far, no corporations have been held liable under the ATCA. However, there have been corporations that have settled out of court with the plaintiffs for one reason or another. For example, Royal Dutch Shell settled with the family of Ken Saro-Wiwa, a critic of Shell who was hanged by the country's military regime in response to his protest against the company's environmental practices, and other plaintiffs, but denied any wrongdoing.[6] The company stated that it "will provide funding for the trust and a compassionate payment to the plaintiffs and the estates they represent in recognition of the tragic turn of events in Ogoni land, even though Shell had no part in the violence that took place." [7]

The first case that held promise that corporation might be held liable under the ATCA was Doe v Unocal, but this corporation also settled with the plaintiffs before it could be heard before the full en banc court that was requested by judges in the Ninth Circuit. It was also settled before the case could be heard by a jury at the state level. For these reasons, the decision that was found by the prior ruling cannot be held as precedent.

Doe v Unocal

In *Doe v Unocal*, a group of Burmese farmers from the Tenasserim region brought a claim against Unocal for atrocities that were enacted by the State Law and Order Restoration Council (SLORC), a military junta in control of Burma. [8] These atrocities occurred while carrying out the expansion of the Yadana gas pipeline in which Unocal was involved in a joint venture with the Myanmar Oil and Gas Enterprise on the Yadana pipeline project. [9]

In the District Court for the Central District of California, Judge Richard Paez found that the United States did have proper jurisdiction over this case and that this case could properly be brought against Unocal. [10] This decision opened the door for corporations to be named as defendants under ATCA violations. [11] However, Unocal was granted summary judgment on appeal because the appellate

court Judge found that there was no genuine issue of material fact and the claims were dismissed. [12] The plaintiffs then appealed at the federal level and re-filed the claims at the state level. [13]

At the federal level, the judgment was overturned by a three-judge panel and it was found that the plaintiffs did have sufficient evidence to proceed with their case against Unocal and sent it to a jury trial [14] This decision was accompanied by a concurring opinion by Judge Steven Reinhardt in support of utilizing the agency theory which will be discussed later in this article. [15] Before this case could be heard before the jury, a majority of the non-recused judges found that the case should be heard en banc by the entire bench. [16]

At the state level, there was also discussion of the liability when the case survived Unocal's motion for summary judgment. [17] Initially, the court held that Unocal did not control this subsidiary. [18] However, in the second phase of the case, the court held that a principal can be held liable for the torts committed by its agent performed in the scope of the agency, even if the agent is a distinct corporation. [19] Thus, the ruling in the first phase does not preclude a claim under the agency theory from being sought. [20]

Shortly thereafter, Unocal decided to settle the case out of court which would end both the federal and state cases against Unocal with undisclosed terms of the agreement. [21] This settlement was reached before the case could be heard en banc or before it went to jury trial at the state level. Since the Ninth Circuit ordered that the case be heard en banc, the order of the three-judge panel is vacated and can no longer be cited as precedent. [22] This case almost set precedent for corporations being held liable under the ATCA. [23]

As stated in the concurring opinion by Judge Reinhardt, this case may have claims under the agency theory [24] In Judge Reinhardt's concurring opinion, he points to the fact that the Restatement of Agency has been looked to when developing the federal common law. [25] Under the principles of the federal common law of

agency, this relationship may be express, implied or it can be found by a jury that apparent authority exists. [26] Restatement (Third) of Agency states that, "A principal who conducts an activity through an agent is subject to liability for harm to a third party caused by the agent's conduct if the harm was caused by the principal's negligence in selecting, training, retaining, supervising, or otherwise controlling the agent." [27] Reinhardt states that in order to establish plaintiff liability, it is not necessary that a contractual relationship exists if we utilize the agency theory suggested by Judge Reinhardt. [28] Should courts follows the reasoning of Justice Reinhardt and allow corporations to be held liable for its agent's behavior?

Effects of Utilizing Agency Theory in ATCA Claims

As stated in an article by University of Illinois Professor Cynthia Williams and University of North Carolina Professor John Conley, corporate boards now have a duty to consider human rights violations in regards to protecting the best interest of its shareholders. [29] With the threat that they may be subject to litigation under the ATCA, corporations are more liable now to be cautious of violations of human rights for fear that they might harm the interests of the shareholders by having to litigate or settle claims brought under the ATCA [30] This was in response to the Sosa litigation which did not follow business lobbying groups' suggestion to relinquish the power to hear human rights claims against global corporations. [31] Applying the agency theory of liability would also further this same goal.

This would also have an effect on the business judgment rule that may be used as a defense against such claims under the ATCA. [32] The business judgment rule offers corporate directors the ability to make decisions without being able to rebut such decisions using a simple negligence standard. [33] In dealing with the ATCA, the business judgment rule would subject directors to a higher standard when seeking to act in the "best interest" of the shareholders. [34] They would not

only have to consider the profit interests of its shareholders, but other stakeholders such as employees and the community in which the business thrives. [35] This approach to the business judgment rule would be highly beneficial in protecting the rights of third parties from corporate ignorance of human rights violations.

By applying the agency theory of liability, corporate firms would be more liable to its shareholders because it has to keep in mind the best interest of the shareholder when making business decisions. In turn, this would require that companies take into account all aspects of the decision that could affect the interests of the shareholders. This would include possible litigation that could be brought as a result of the decisions of the company. Successful claims under the ATCA also deny income to regimes known for violation of human rights in conducting business. [36] Furthermore, it requires businesses to take responsibility to practicing in such regimes. [37]

Conclusion

The ATCA has come a long way in its interpretation and now it could possibly hold corporations liable for the actions of its subsidiaries in committing tortious acts in the course of its business relations with its parent company. By using the agency theory discussed in Judge Reinhardt's decision, we hold the corporation to a much higher standard that would require greater transparency in their business relationships and greater scrutiny of its business decisions in areas associated with political turmoil and human rights violations. This method would increase the responsibilities that corporations have in regards to its shareholders. It would also have a few drawbacks for corporations, but those could be avoided by greater supervision over the business activities in other countries and higher scrutiny in selecting what subsidiaries to involve itself with.

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I'M ALL IN: THE ONLINE POKER INDUSTRY

Introduction

Since the first online hand was dealt on January 1st, 1998, the online poker business has exploded in popularity. [1] "Research from Christiansen Capital Advisors says online poker revenues have grown from $82.7 million in 2001 to $2.4 billion in 2005."[2] Poker Stars, Full Tilt Poker, and Titan Poker represent the three largest poker sites, and alone these three sites serve more than fifty thousand cash players a month.[3] In the past three months, the numbers of cash players on these three poker sites has increased 6-10%. [4] On these, and on the hundreds of other poker sites, U.S. players generate an estimated $85 million in revenues monthly for these sites. [5] From 2004 to 2007, the online poker industry recorded a 72% growth rate.[6]

Why Is Online Poker Becoming So Popular?

The success of the online poker industry can be attributed to a number of factors. First of all, traditional live poker in casinos and card rooms can be intimidating for a novice, and is often located hundreds of miles away from prospective players.[7] Online poker, on the other hand, can be played from the comfort of your home. Also, the opportunity costs of running a poker room in a casino are very high because poker tables take up space which can be used for slot machines, which is the true cash cow for casinos.[8] The overhead costs of online poker are dramatically cheaper because administrators can add as many tables as they want without affecting overall profits. [9] For example, a casino would never offer a poker table with stakes as low as $.01 because the costs of paying the dealers salary alone would outweigh the potential profit made on the table. Online poker, on the other hand, can offer these low stakes tables for

players to gamble on because the overhead costs are minimal, and even though the profits are small per table, they are collecting profits from hundreds of tables at a time. Also, online poker allows players to play at a number of tables at a time, which is physically impossible to do at a casino.[10] Players like this because they can increase the amount of hands they play per hour. This is an advantage for the poker sites also because the more hands being played means they make more money they make.

Finally, televised poker created an explosion in the popularity of online poker. "Thanks to the never ending broadcasts of celebrity and professional poker tournaments, poker is now the third most-watched televised sport on cable TV, behind only car racing and football."[11] A turning point in the online poker industry came in 2003 when Chris Moneymaker, who won his way into the World Series of Poker through an online poker tournament after wagering only $39, went on to win the Main Event.[12] Overnight, millions of weekend poker players realized that with a little practice, which online poker rooms could provide, they too could strike it rich. The next year, the 2004 World Series of Poker featured three times as many players as the 2003 Main Event. [13] Online poker became more than just a fad in 2004 when Greg Raymer went on to win the Main Event after winning his entry in an online tournament also. In fact, four of the top ten finishers in 2004 were players from PokerStars.com.[14]

How Do Online Pokers Sites Make Money?

One way online poker sites make money is through a rake.[15] The rake is an amount of money collected from real money pots. The amount of the rake is normally calculated as a percentage of the pot, and is normally around 3-5%.[16] This also provides online poker with an advantage over live poker in casinos because the time taken to shuffle the cards, deal the cards, count the chips, make payouts, etc., takes time away from actual game play. The average rate of

play in casinos is thirty hands per hour, compared to the ninety to one hundred hands per hour in online play.[17] By playing more hands per hour, online poker increase the rake they receive per hour.

Online sites can also make money by charging players an entry fee as opposed to a rake. Rakes are generally used in cash games where players are free to sit at a table and come and go as they please. Entry fees on the other hand are used for tournaments, where all the players enter at the beginning and play until one is left standing. Rather than take a percentage from every pot, the site takes a percentage from the tournament entry fee.[18]

Finally, poker sites invest the real money players deposit in their online accounts. Because these sites do not have to pay interest on the money players deposit in their accounts, this is considered a significant source of revenue. [19]

Legality of Online Poker

The legality of online poker has been questionable since its inception. Online poker sites try to avoid possible legal issues by offshoring. [20] They set up their main operations in places like Gibraltar or the U.K. protectorate the Isle of Man. Also, online gaming sites like Full Tilt Poker and Poker Stars can be seen advertising on TV because they only advertise the practice and learning poker aspect of free play, and allow the customer to discover the real money wagering on their own. [21] Early on in the history of online poker, the federal government claimed that online poker violated the 1961 Wire Act, but even officials at the Justice Department claimed that federal prosecutors were more interested in fighting terrorism and drugs. [22] "That makes playing or hosting poker games on the web a little like going a few miles over the speed limit. It's technically illegal, but everyone does it and you probably won't get in trouble."[23] Even large companies like Goldman Sachs, Fidelity, and Blue Ridge Capital, wanted to get into the successful online gambling industry, and represent three of the top

five institutional investors in the U.K. based sports-wagering site SportingBet.com, which trades on the London exchange.[24]

Despite this widespread acceptance and apparent legitimacy, everything changed when Congress passed the Unlawful Internet Gambling Enforcement Act (UIGEA) in 2006, with compliance required by December 1st, 2009. The bill doesn't make internet gambling itself illegal, rather, it makes certain type of financial transactions required to conduct an online gambling website illegal. [25] The reason for the ambiguity in the Act is a result of the fact that the Act does not contain a definition of "unlawful internet gambling". [26] "Also, the Act's background discussion points out that the Act itself did not determine the difference between illegal and legal gambling and that it was not intended to alter, limit, or extend any State or Federal law prohibiting or regulating gambling."[27] Rather than define illegal gambling and deal with the problems of conflicting State and Federal laws, the Act, "focuses on preventing unlawful internet gambling business from befitting from the payment system by denying them the opportunity to open bank accounts from which to receive payments." [28] Defined as "designated payment systems", the UIGEA covers any system that that facilitates money transfers that the US government determines to be used by illegal gambling sites.[29]

Despite the UIEGA , sites like PokerStars have publically announced that it will ignore the Act and continue operations as usual, claiming that the law applies to games of chance, and that poker is a game of skill and therefore not regulated.[30] Recently, the U.S. Attorney for the Southern District of New York seized $34 million belonging to 27,000 online poker players, but because of the ambiguity of the UIGEA and the feeling among many that online gambling should be regulated and taxed, it is possible that the seizing of these assets will backfire and a court decision will actually support internet poker. [31]

In response to the passing of the UIGEA, Rep. Barney Franks, Chairman of the Financial Services Committee, unveiled The Internet Gambling Regulation, Consumer Protection, and Enforcement Act of 2009. [32] "This Act would establish a federal regulatory and enforcement framework under which Internet gambling operators could obtain licenses authorizing them to accept bets and wagers from individuals in the United States."[33]
The confusing aspects of the UIEGA, due to conflicting State and Federal law, and the proposed legislation which would permit internet poker, mean that the legal battle over internet gambling has yet to play out.

Conclusion

The popularity of online poker exploded in the US in response to seemingly average people winning millions of dollars on national TV. These people were not card sharks playing in casinos, they were regular people playing poker in their free time. But as the exposure and popularity of online poker increased, it became a target of the federal government. Although legislation has been proposed that would allow online gambling, and large sites like PokerStars claim they will continue to offer their services, the December 1st deadline by which these sites must comply with the UIEGA is approaching, and the history of online poker remains to be seen.

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LEVEL THE PLAYING FIELD: CONSIDER STATE TAXES WHEN DEVELOPING SALARY CAPS IN THE MAJOR SPORTS

I. Introduction

States and cities tax professional athletes in multiple ways. A traditional method, which applies to athletes and non-athletes alike, is income taxation by the state in which an individual resides. A second method, utilized by twenty states, is to tax athletes when they participate in games other than in the state they reside. [1] This second method is commonly referred to as the "jock tax." Since the inception of the jock tax, inequality from state to state has been a prevalent issue. The combination of the jock tax and differences between how states tax its residents may make some cities in the United States and in Canada more attractive than others. "Although a player may have contract offers from different teams for the same dollar amount he will receive drastically different amounts based upon where those teams play and how often the team plays there." [2] At the same time, but for a few adjustments that are made to a team's salary cap, the teams in the major sports are limited to the same payroll as the other teams in the sport. Given the salary cap, teams in hockey, football, baseball, and basketball may find it difficult to compete with teams with more attractive tax situations. To further increase parity in the major sports, changes should be made to salary caps in the major sports based on the different tax situations created by different states.

II. Background

The salary cap used in the major sports, is a rule that states a team's payroll cannot exceed a certain level. [3] As the only competition for an athlete is from the other teams in the league, the salary cap assists to minimize the advantage

wealthier or bigger market teams have. [4] However, a team's payroll does not take into account the individual taxes previously mentioned.

Philadelphia was the first city to actively collect the jock tax from the income professional athletes earned in the city. [5] Since Philadelphia announced their intention to actively pursue the collection of taxes on the income earned by professional athletes in April 1992, [6], many other cities and states have enacted statutes to tax the income earned by nonresident professional athletes. [7] Although Philadelphia may have been the first to target professional athletes, Philadelphia used a statute that had been in effect since the 1930s. [8]. Philadelphia has used this statute to collect taxes from entertainers, doctors, attorneys, and other professionals. [9] The practice has spread to the extent that as of 2007, twenty of the twenty-four states that host a major professional sports team impose a jock tax. [10]. It is easy to see why taxing nonresidents might be an attractive option for states as in 1992, California collected $365 million in state taxes from nonresidents alone. [11]

There is also a lack of consistency between states with regards to how professional athletes are taxed in the state they reside. Nine states do not have an income tax, which include Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, or Wyoming. [12] Where as California's individual income tax rate for 2008 was 9.3%. [13] This may not seem like a lot, but when athletes earn salaries in the millions, the amounts states collect and athletes pay adds up. For example, the salary cap for the NBA for the 2007-2008 season was $55.63 million per team. [14] 9.3% of $55.63 million is $5.17 million. While there are other considerations to take into account, this high level calculation shows that two teams in different states, that plan to use all of the salary cap space allotted to them, could have significantly different bargaining powers. Teams in California would have to consider that up to $5.17 million of their salary cap could eventually be paid to the state of California rather than its

athletes. A team in Florida, where individuals are not subject to an income tax, would be able to utilize this amount as incentive for athletes to sign with their team, as it would not be used to pay taxes.

III. State Taxes Make Some Teams More Attractive Than Others

Florida has no individual income tax and if an athlete played all of their games in Florida, the athlete would not have to pay an income tax to the state of Florida. However, professional athletes who reside in Florida will still have to pay income taxes if they play in a state with a jock tax. Thus, "[w]hen athletes travel to states that do not impose the jock tax, the only players who can escape without having to pay any income taxes to either the nonresident state or their home state are those who reside in states without a state income tax." [15] An athlete who resides in Texas and does not pay an income tax will still have to pay at a high rate when they play in California. [16] This makes cities like Miami or Houston a much more attractive cities to play, rather than playing in Los Angeles, New York City, whose 2008 tax rate was 6.85% for earnings over $40,000, [17], or Chicago whose 2008 state tax rate was 3%. [18] It is not a secret that the free agent class of the NBA for 2010 has many big names who will be seeking large contracts. However, in order to lure a player like Dwyane Wade away from Miami, the Chicago Bulls or another team in the aforementioned higher taxing jurisdictions would have to offer players a higher salary to provide a salary with equivalent after tax value. [19] Even though teams like the Bulls or Knicks may have an advantage by being located in markets that consistently attract more fans and sponsors, players in these markets will earn less after taxes. Therefore teams will have to offer a player more to give them equivalent value, which utilizes more of the team's salary cap and will put teams in those higher taxing markets at a significant disadvantage.

Different states have different methods to calculate the jock tax. [20] Even though states usually grant a tax credit for taxes paid to another jurisdiction, [21],

double taxation is not always eliminated. [22] The problem is that while the majority of states use the "game-day" approach to calculate the tax owed, what is considered a game day may be different from state to state. Therefore, there is a risk that allocated earnings for one game day or travel day may be allocated to multiple states. [23] This could lead to that particular income being taxed twice, which is known as double taxation. [24] Therefore, while this may not create the same magnitude of disparity between the tax situations in two states that the income tax creates, it is a consideration that accountants and lawyers should account for to maximize an athlete's after tax contract value.

A third difference between states is that a small number of states will not tax certain athletes if they have a less than a certain number of contacts or time spent within a state or earn small enough compensation. [25] These are called "de minimis visit exceptions" and are utilized in states like Massachusetts, Minnesota, Missouri, and Wisconsin. [26] This could further differentiate team tax disparities. For example, the Detroit Lions who play two games against the Minnesota Vikings and two games against the Green Bay Packers every season could potentially avoid the jock tax for a quarter of their games, while athletes who play no games in those states would have to pay jock tax on all of their games. Again this is a consideration to maximizing an athlete's after tax contract value. While two teams may use the same amount of their salary cap room in an offer to an athlete, the athlete will not receive the same after tax value from both teams.

Additional differences arise in the matter in which a state treats another state's taxes charged to athletes. Illinois only taxes athletes whose state of residence taxes Illinois teams. [27]. Therefore, Illinois taxes those athletes from the nineteen other states that impose a jock tax, but will not levy a jock tax on those athletes in state without a jock tax. Illinois double taxes its own athletes by

levying the jock tax on the income the athletes earn within Illinois and also in the nineteen other states that tax Illinois athletes. [28]

IV. Recommendation

As a diehard sports fan, it may seem odd to make a recommendation that could lead to higher ticket prices for me. However, the major sports should allow teams in cities or states with unfavorable tax environments for athletes, to exceed the salary cap. "[W]hile a league may wish to impose a salary cap on its member teams in order to promote parity, an $80 million cap on gross pay in California will not be the same as an $80 million cap on gross pay in Texas." [29] Player agents, lawyers, and accountants will take this into account when negotiating contracts for their clients, but "it can put its teams at a competitive disadvantage when trying to recruit players with a team from a state with no income tax (like Texas or Florida)." [30] When the salary cap does not equate to the same bargaining power from one state to the next, the efforts of a salary cap to level the playing field on the free agent market, falls short.

V. Conclusion

No one wants to pay taxes and there are arguments that the jock tax should be eliminated, [31], however as it is a source of income for many states, this may be a tough battle to win. Until that happens, the major sports should take into account the competitive disadvantage teams in high tax jurisdictions have. To remedy this disadvantage, salary caps should be adjusted.

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WHY LAWYERS SHOULD KNOW MORE ABOUT ANTITRUST REGULATIONS

I. Introduction

Antitrust law is usually understood as applying to companies and their products. The incentives for assuring competition among companies have not limited the function of antitrust law. Antitrust law has developed its application to beyond those players in the market. Now, lawyers and bar associations also have to watch out for antitrust regulation. The American Bar Association has been under pressure to lighten up several of its rules in order to allow multidisciplinary firms to evolve.[1]

The application of antitrust law to lawyers will be discussed in this article. Part I discusses if the definition of "*trade*" applies to professional services for the purpose of antitrust regulation. Is the discussion of regulation related to horizontal agreements or legislation? If it is legislation (for example, laws establishing bar associations), it is out of the scope of antitrust law. Part II brings the European and also an economic approach to this matter giving more light to the discussion of what are the consequences of the direct application of antitrust law to lawyers. Part III recommends that lawyers should not be exempt from antitrust regulation. The formation of collusion and price fixing exists among this profession as well as in other areas and should be regulated. However, the existence of an exam to evaluate the quality of lawyers is not an anticompetitive behavior limiting entrance on the market, but it is a correction of the market that should exist to inform prospective clients. Part IV provides concluding thoughts on the regulation of attorneys.

II. The Concept of Professionals for Antitrust Purposes

The status of "*professionals*" raises uncertainty in the antitrust context, but the implied antitrust exemption for professional's collective behavior has come under increasing analysis.[2] For example, in most European countries the legal system does not have a general definition of professionals, but rather there are multiple distinct concepts.[3] The reality is that many of these professionals engage in concerning behavior that would otherwise be unlawful under antitrust laws[4] like fixing price and boycotts.[5]

American courts have three periods that can be identified for the professional antitrust exemption debate.[6] At first, early judicial inquiries rigidly differentiated the learned professionals from "trade" or "commerce."[7] Then, Courts analyzed whether the professionals enjoyed an exemption from antitrust law and the Supreme Court explicitly held that professionals are subject to antitrust law in *Goldfarb v. Virginia State Bar* ("Goldfarb"). [8]The issue presented in *Goldfarb* was whether a minimum fee schedule for lawyers published by a county bar association violates the Sherman Act. [9]The bar association affirmed that the activities of lawyers belong to a "learned profession," which indicates that competition is inconsistent with their practice.[10] Antitrust, therefore could not reach their activities.[11] However, the Supreme Court rejected this argument, stating that in the present market it cannot be denied that the activities of lawyers play an important role in commercial interaction and that anticompetitive activities by lawyers may exert a restraint on commerce within the meaning of antitrust laws.[12]Nonetheless, the Supreme Court mitigated the impact of the above statement, alleging in the same case that it would not be realistic to understand the practice of professions as interchangeable with any other business activities and to automatically apply to the professions anti-trust concepts that were created in other areas.[13]A final understanding regarding this issue, therefore, was not reach by the Court.

Currently, *California Dental Association v. Federal Trade Commission* ("California Dental Association") is the precedent for the treatment of professionals under antitrust law. In *California Dental Association* the Court deals with advertisements regarding quality and price of professionals. The Federal Trade Commission asked for a *per se* treatment of such behavior.[14] The Supreme Court, however, held the advertisement as pro competitive.[15] The Court also elaborated on the difference between professionals and other typical market participants and affirmed the existence of important challenges to informed decision-making by customers for professional services.[16] The Supreme Court brought an important economic issue behind the discussion, the lack of information among consumers regarding legal services available in the market.

As stated above, the definition and characteristics of the term *professional* for professional services matter for the treatment and for the application of the antitrust rules. According to supporters of applying antitrust law onto this category, professionals have values and attitudes, which distinguish them from the persons in other occupations, and this justifies self regulation, freedom of government intervention and application of the antitrust laws.[17]Despite the fact that self regulation ensures that poorly informed consumers will be able to maximize their welfare by purchasing professional services of satisfactory quality at a reasonable cost, these professionals believe in the existence of their goals in addition to the maximization of individual gain.[18] At the same time, an additional discussion concerns the bar associations and the instrument for its creation.

III. The Economic Implications of This Analysis: Differences from an European Approach

Apart from a legal point of view, an economic examination of this subject points out a strong asymmetry of information. For example, the function of the

bar association is to provide information.[19] Since most people do not have the appropriate skills to assess the services of a lawyer, passing the bar exam can evaluate the quality of the attorney and correct this market failure for the prospective clients. However, it should be pointed out that professionals are not immune from making use of typical antitrust concerns, such as price fixing, boycotts and joint ventures that can be employed by these professionals and other industries.[20]

The antitrust interpretation of the legal market has changed since the 1940s when the law firms tended to be too small to alert the antitrust authorities.[21] Even so the application of the antitrust laws should be under a *rule of reason,* and never under a *per se rule.* Under the rule of reason analysis, courts look at the full context to determine whether the anticompetitive effects pose an "unreasonable" restraint on trade[22]. On the other hand, in a *per se* analysis, courts are to presume the illegality of activities[23]. The courts should move away from this rigid application because lawyers are not easily exchangeable merchandise (but rather a true "*learned profession*"). The facts and circumstances of the case presented to Courts must then be carefully analyzed.

The European Commission has adopted two reports and commissioned two independent studies on the competitiveness of some particular professions, including the market and activities of lawyers.[24] The report aimed to clarify why antitrust action was needed but also acted pro – actively to set out a plan of action to promote the abolition of unjustified restrictions.[25] This discussion was brought in front of the Court of Justice in the European Union in *Wouter et Cie.**[26]*** The main issue in *Wouter et Cie* was the extent to which the Netherlands Bar Association is a horizontal agreement that violates the Articles 101(1) or (3) of the European Union Regulation.[27] If a regulation limits the lawyers ability to

price their services, publicize their services, etc, there is a clear restrain in competition, and thus antitrust/competition law should be applied.

Also in Europe, the examples of Sweden and Finland bring interesting insights. In these countries, lawyers do not have to be certified by the bar association to provide legal services, but instead the quality of this profession is reflected by the market.[28] For example, hiring someone with a law degree is more expensive than hiring a young person without a law degree for legal advice. The market, in this case, is said to control the problem of asymmetry, in which you pay more for getting a better quality service. However, such a system does not work in all the countries, and in most of them there is a bar association exercising the main function of controlling the quality of the lawyers in the market.

In contrast, a certifying body that does not have a clearly articulated relevant criteria applied on a consistent basis runs the risks of being accused of boycott, even though the practical impact of antitrust exposure in the law market has been low.[29] Also, the idea of the exemption of professionals is also related to the fact that there is less potential for actual agreement among professionals to knowingly engage in anticompetitive activity.[30] The bar association may consequently serve in this case as a potential instrument for anticompetitive behavior.

IV. Conclusion

The fact that legal services involve the sale of personal services, rather than commodities[31] does not take it out of the category of "*trade*" and lawyers can certainly give cause to anticompetitive behavior. However, the antitrust rules if applied shall be cautiously used, especially when the analysis is properly based on a *rule of reason* approach rather than a *per se* approach. Standards which are useful to individual decision-making in markets should be protected under the rule of reason.[32] The second problem, the asymmetry of information, should be carefully analyzed and legislators and courts should always look to the welfare of consumers. A special and specific approach should be developed for professional

services. Otherwise, because of the above stressed points, the traditional antitrust law would not be suitable for these special markets of "*intellectual trade*".

The Courts nonetheless tend to get away from this problem and there are a number of reasons of why they do so. On the one hand, the Court may not think it is appropriate to set up rules governing this issue because it can bring unexpected consequences. On the other hand, the Courts may just have some notion of the specificity of the professions such as lawyers but are unable to articulate the difference. Despite the prejudices and the peculiarity of the discussion, an answer should be articulated either by the courts or the legislative bodies. Otherwise, silence may give incentives for anticompetitive behavior

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[2] *See* Christopher J. Gawley, *Protecting Professionals from Competition: the Necessity of a Limited Antitrust Exemption for Professionals,* 47 S.D. L. REV. 233 (2002)

[3] *See* Daniel Vazquez Albert, *Competition Law and Professional Practice,* 11 ILSA J. INT'L & COMP. L. 555 (2005)

[4] *Id.*

[5] *Id.* According to the author, collective price fixing and the prohibition of certain forms of advertising by a professional association may constitute a restriction of competition under the meaning of Article 81(1) of the European Community Treaty.

[6] See *supra* note 2

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] *Id*.

[11] *Id.*

[12] *See* David Shapiro, *Cost Containment In The Health Care Field And The Antitrust Laws*, 7 AM. J. L. & MED. 425 (1982)

[13] *Id*.

[14] *See* Gawley, *supra* note 2

[15] *Id.*

[16] *See* American Antitrust Institute, *supra* note 1.

[17] *See* Philip C. Kissam, *Antitrust Law and Professional Behavior*, 62 TEX. L. REV. 1(1983)

[18] *Id.*

[19] *See* Michelle Behnke, *In this Issue: A Fresh Look at an Old Friend: The American Bar Association: Partnership with the Alabama Legal Community*, 70 ALA. L. 63 (2009)

[20] *Id*.

[21]*See* Thomas D. Morgan, *The Impact of Antitrust Law on the Legal Profession*, 67 FORDHAM L. REV. 415 (1998)

[22] *See* Meghan K. Woodsome and Katherine S. Dumouchel, *Antitrust Violations,* 46 AM. CRIM. L. REV. 275 (2009)

[23] *Id.*

[24] *See* Mary Catherine Lucey, *European Union Antitrust Law and Professional Associations: the Strategic Choices of "Soft" Weapons by the European Commission,* 16 TULSA J. COMP. & INT'L L. 87 (2008)

[25] *Id.* In Spain, for instance, mandatory fee schedules have been prohibited and advertising and marketing activities by professionals are now permitted as well as geographical restrictions to the practice of professionals have also been repealed. *See* Francisco Marcos, *A New Age In Spanish Antitrust Law: Fighting Against Restrictions To Competition In The Professional Services Market* (Nov. 6, 2001), (unpublished article, http://ssrn.com/abstract=282491.)

[26] *See* ELEANOR M. FOX, THE COMPETITION LAW OF THE EUROPEAN UNION IN COMPARATIVE PERSPECTIVE (2009)

[27] *Id.*

[28] *Id.*

[29] *Id.*

[30] *See* Albert, *supra* note 3

[31] *See* Geoffrey C. Hazard, *Why Lawyers Should be Allowed to Advertise: A Market Analysis of Legal Services*, 58 N.Y. U. L. REV. 1084 (1983)

[32] *See* Gawley, *supra* note 2

JURISDICTIONAL COMPETITION IN A DEVELOPING ECONOMY: LAW AND POLICY ISSUES OF THE OFFSHORE STRUCTURE USE IN RUSSIA

I. Introduction

Someone might view the economic crisis times as the best period to broaden one's business horizons and invest into a new market. The fast growing markets such as China, Brazil, India and to some extent Russia are waiting for new investors. Russia, having more than 140 million inhabitants, i.e. potential consumers, and abundant natural resources remains mostly neglected by investors in many business fields. For decades Russian market was viewed as not a place for those faint-of-heart. Now the growth of political stability and positive developments in legislation make the investment less risky and more attractive. Nevertheless, the still existing differences between local and internationally recognized legislative frameworks and court practices make investors wonder if there is any possibility to opt out of the Russian legal rules.

This article will explore the reasons behind Russian corporate norms that explain the inflexibility of current legislation and court practice and discuss views on future development of the corporate law system of the country. Part II introduces an overview of the policy issues behind the corporate law created specifically for Russia as a developing economy. Part III analyzes the legislation and its drawbacks, provides advice for investors who for various reasons want to opt out of Russian law. Part IV discusses the reasons for the government amending the corporate law, gives a forecast of future developments and provides a general conclusion.

II. Why Russian Corporate Law is Different?

Russian Corporate Law created after the collapse of the Soviet Union was specifically fit to satisfy the needs of a country with a developing newly privatized economy and aimed at raising confidence in the capitalist model of society. [1] Professor Bernard Black, who devoted his scholarship inter alia to corporate law governance in emerging markets and participated in the creation of what is the basis of the current Russian corporate legislation, proposed a "self-enforcing" model of law that was supposed to trigger foreign and national investment and minimize transactional costs. [2] However, it was impossible to directly "plant" a western legal tree into the Russian soil. While such countries as the U.S. had a long history of courts regulating the issues of reasonableness of defensive actions in takeovers, fiduciary duties, conflicts of interest, Russian lawyers and judges had virtually no practical experience in corporate disputes as private business did not exist as a notion during the Soviet era. [3] The main idea of the "self-enforcing model" was to make it function through the actions of the first-hand participants (shareholders and managers) and not judges or government authorities. [4] As the court practice in the corporate field was undeveloped and cumbersome the legislators came up with the idea of simplicity and clarity of the statutory language; possible elimination of "vague" concepts, such as fiduciary duties, that are supposed to be evaluated by courts; a prevalent number of mandatory norms and strong legal sanctions as a counterbalance to the low probability of their real application. [5] The legislators tried to minimize agency costs by giving a single shareholder rights to protest "majority transactions" and "transactions with interest", by establishing cumulative voting for election of members of the board of directors; a one (common) share – one vote rule; special rules for approval of transactions in which managers or large shareholders have a conflict of interest; requirements that a company issues and acquires its own shares only at market value; redemption and appraisal rights for shareholders who do not approve of reorganizations, and takeout rights that allow investors to sell

their shares to a shareholder who acquires a controlling block of a company's shares). [6] On the other hand creditors were not always well protected, especially in limited liability companies (LLCs) where until recently an LLC participant had the unrestricted right to exit the company anytime with the market value of her stock paid to her. [7]

III. Why You Might *Not* Need Russian Law in Russia?

It has been almost 15 years since the adoption of Russian corporate regulation. The market is open, relatively stable and corporate law has experienced serious changes, but the core concepts of the law have mainly stayed untouched as the abundance of mandatory provisions remained. A foreign investor coming today to the market and seeking an equity investment into a Russian company has mainly two options: a contractual joint venture based on a co-operation contract (not the best choice because of an unfavorable taxation regime) and an incorporated joint-venture. [8] There is always a possibility, for instance, in sales-purchase transactions to sign a contract with a Russian company under foreign law and include an arbitration clause containing choice of law and forum provisions. However, this makes sense if a foreign investor is not interested in controlling the company that has assets in Russia; otherwise joint-venture is the most suitable option. The two commonly used forms of joint-ventures are an LLC and a closed joint-stock company (CJSC – a private company where participants own shares that are not publicly traded); however, the choice of form mainly depends on the economic considerations and specific circumstances. [9] Some investors prefer LLC as they are subject to a lighter regulatory regime, while others choose CJSC as it offers higher protection to shareholders, although is more burdensome as it implies issuance and registration of shares. [10]

The main problem is that international joint-venture terms such as, inter alia, shareholders' agreements and share retention agreements, options and certain governance standards and are not applicable to Russian incorporated LLCs and

CJSCs. [11] Let's imagine a courageous investor who comes to the market. He will be probably eager to enter into a share purchase agreement containing warranties protecting him from liabilities or inaccuracy of the financial statement. [12] However, under Russian law enforceability of such warranties is doubtful, as these warranties cover the company and other business issues not directly related to the shares. [13] Shareholders' agreement, in its turn, for a long time did not exit in Russia. Traditionally in developed economies this type of agreement between shareholders has been used as a powerful tool of control over exercise of voting rights, election of company bodies, and distribution of profits. [14] However, under Russian law shareholders (and members of LLCs) did not have explicit right to enter into such agreements to add voting rights, change quorum requirements and rights to appoint managers. [15] Investors were also discouraged from using foreign law for shareholders' agreements even if one of the shareholders was a foreign company; although theoretically it complied with Russian choice of law rules, courts did not share this point of view. [16] In a number of notorious cases shareholders' agreements constructed under foreign law were viewed by Russian courts as founding documents of the company which cannot be governed by foreign law; as an unlawful restriction of civil-law rights (because shareholders were obliged to act in a certain way in accordance with the agreement) and as violation of public policy. [17]

Option agreements, under which one party has the right to demand purchase of its shares by another party and the other party assumes an obligation to sell the relevant shares, are strictly limited under Russian law, as it is not clear whether such a transaction may be at all conditional on the actions of one party. [18] Share retention agreement (in which parties agree not to dispose of their shares in a joint venture unless special circumstances occur) is in its sense a negative covenant and, thus, its enforceability is questionable. [19] Moreover, Russian law does not contain an event on default provision when breach of one party would make it sell

the shares in the joint-venture to the other member of the company at a specified price. [20]

Thus, investors, not satisfied with the rules of Russian corporate law, started searching for a new market for law which eventually resulted in jurisdictional competition between Russia and, not surprisingly, offshore zones. The concept of the corporate market for law is a relatively new one and implies that with free trade, faster communication and transportation shopping for legal regulation of corporations (business entities in many jurisdictions are regulated by the laws of the place of incorporation) is like shopping for other goods. [21] Incorporating offshore is, basically, killing two birds with one stone: minimizing tax burden by incorporating in a jurisdiction that has a favorable double taxation treaty with Russia, a favorable domestic tax regime and a flexible corporate law regulation. [22] The most popular offshores are Cyprus and Netherlands (popularity of Cyprus is explained both by its favorable tax treaty and by its common law legislation and, thus, flexibility in administration and corporate governance). [23] While the simplest structure of this joint-venture is a company incorporated in an offshore zone which wholly owns a Russian subsidiary, the most sophisticated one might represent a three tier structure including several investment vehicles, intermediaries, a treasury company located offshore and Russian subsidiaries owning assets in Russia. [24] This might be achieved by the transfer of the title in all shares in a Russian incorporated joint-venture to an offshore holding company. [25] The advantages of this incorporation are legally binding and enforceable shareholder agreements and other internationally recognized methods of shareholder protection (limited only by the legislation of the offshore jurisdiction).

IV. Will Russia Ever Win the Jurisdictional Competition Battle? Prognosis and Conclusion

So far Russia was constantly losing its jurisdictional ‘battle’ to offshore zones. One of the main reasons why offshores have not become even more popular was their dubious reputation as tax evasion vehicles. However, their reasonable use by investors as a means of creating a more stable company has significantly changed this belief in the Russian market.

Nevertheless, there have always been investors who feel ‘uncomfortable’ if not hostile to dealing with offshores, and until recently Russian law had practically nothing to offer them. The revolution in corporate regulation was a long awaited one and happened in the winter and summer of 2009. Amendments to the Laws on Joint-Stock and Limited Liability Companies finally introduced shareholders’ agreement into Russian Law (in addition to a number of other important provisions); and amendments to Law on Pledges made pledges over Russian shares a more attractive proposition to a lender. [26] These substantial improvements of the legislation seem to be the response of the government dissatisfied with the offshore fashion that furthers residual non-repatriation of profits through offshore structures to Russian beneficial ownership. [27] The question arises: have these amendments really changed anything? In the short term perspective the answer is: “No”. Unless and until investors see a significant amount of shareholders’ agreements being enforced in Russian courts, they will still prefer to incorporate offshore rather than in Russia.

Now under Russian law shareholders are permitted to coordinate exercise of their voting rights; refrain from transfer of shares until certain circumstances occur; perform coordinated actions in connection with managing of the company; acquire shares at a pre-determined price (or) when certain circumstances occur. [28] However, it is still not clear whether the agreement can be governed by foreign law, or whether the use of tag-along and drag-along provisions contradicts the Russian Civil Code stating that contracts may be conditional only on circumstances which are not under control of the parties to the contract. [29]

Furthermore, breach of the agreement does not invalidate the decision made by the general meeting of shareholders in violation of the agreement and only provides to the non-breaching parties recourse to contractual remedies stipulated in the agreement. [30] Consequently, the listed amendments will unlikely lure investors into incorporating in Russia.

Moreover, Russia proving the theory that jurisdictional competition is supposed to discipline the government at the same time refutes it in another respect. [31] The recent Decree of the Federal Financial Market Service imposes 5% of the company's stock limit on the amount of a Russian company's shares offered in an overseas IPO. [32] This amount is generally considered inadequate for an IPO and, consequently, the amendment "could spell the end of Russian IPOs on international securities markets" (31 of 48 Russian companies trading on foreign and domestic stock exchanges placed their shares on foreign exchanges in 2006-2007). [33] While this amendment might have the aim to increase liquidity of the domestic securities market by forcing investors to purchase shares of Russian companies in Russia, it will likely cause a new wave of offshore incorporations, as Russian issuers can transfer assets to an offshore holding which in its turn can freely trade them on international stock exchanges. [34] Thus, Russia will lose its jurisdictional competition 'battle' again.

Russian corporate law was created as a "self-enforcing" model but with a clear idea that the development of the market should be joined by the development of the legal system. Evolution of law is impossible without the evolution of the judiciary, which in its turn in Russia should be supported by strong anti-corruption program that is already being implemented at least on a partial scale. [35] It is certain that offshore structure will be used in the future, unless a law is adopted prohibiting operations of offshore owned subsidiaries on the Russian territory, which is unlikely. The analysis provided in this paper suggests that until the government and the judiciary clearly decide whether they are adopting a

strongly pro-investor policy, such issues as the one of the IPO regulation will be turning investors towards a better market for law which is offshore havens. It might be that the government with the existence of a better anti-corruption control and promotion of corporate governance culture will be more willing to abandon self-enforcing model of corporate law, to give Russian courts more leeway in deciding corporate cases and provide companies with a more flexible regulation.

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BE CAREFUL, THEY'RE UNPAID INTERNS: IS THE NCAA AND ITS MEMBER SCHOOLS UNFAIRLY PROFITING FROM THE LIKENESSES OF ITS ATHLETES?

I. Introduction

We hear the debate all the time. Some sports writer will call for college athletes to be paid.[1] Another will rebut that they are given hundreds of thousands of dollars in college tuition, books and housing.[2] This debate is surely to drag out as long as there are intercollegiate sports, no matter what the rule on the NCAA's books is either way. As it stands, the NCAA and its member schools profits by selling the publicity rights of its athletes to video gaming companies, as well as market their likenesses themselves even long after the player has graduated or moved on from intercollegiate sports. This article focuses on the recent athlete initiated cases regarding this problem, as well as a potential solution.

II. The Issue of the Use of Player Likenesses and Publicity is Finally Being Brought to the Attention of the Juridical System

However, more recently, former athletes have taken a different route in explaining how the NCAA and its universities are profiting from the exploitation without compensation of student-athletes. Ed O'Bannon, former UCLA Bruin and National Champion in 1995, has raised the issue with a federal district court in San Francisco by alleging that the NCAA improperly forces students to sign away their likeness rights with a form entitled "Form 08-3a."[3] This form is more aptly named the "Student-Athlete Statement."[4] O'Bannon has alleged, along with the former athletes that have joined him in this class action suit, that his has been depicted to sell DVD box sets, photographs, and other items in which he is not compensated for.[5] In that same vein, Sam Keller, former Nebraska quarterback via Arizona State, focuses his filing in the Northern District of

California on Electronic Arts' use of his and other athletes' likenesses in their hugely popular NCAA Football titles.[6] In these games actual university names and colors are used. However, with respect to the players and their amateurism individual names are not used. That being said, the statistics, jersey number and physical characteristics of the player are identical to the player being depicted.[7] That is arguably how Electronic Arts and the NCAA 2K franchise markets their games, by placing a former NCAA player on its cover, and stressing that consumers are playing as their favorite team and players. There are independent third party distributors that sell a "patch" that will add in the players real names, and in many cases, the broadcasting crew will say the name of the new players.[8] ESPN/EA Sports announcer Brad Nessler even admitted that he and the crew recorded the names, even though technically that practice is not allowed.[9]

III. Athletes Have a Right to their Own Likeness and Publicity that Should not be Disturbed without Compensation

NCAA has a bylaw from profiting from a player's likeness or image.[10] However, the NCAA itself, along with its member institutions, has been doing exactly this. The NCAA garnered $614 million from marketing and television deals in 2008.[11] Included in this number is the NCAA's compensation from Electronic Arts and other video game companies. For comparison as to what the true number of player licensing compensation the NCAA receives, over the same period the NFL's Players Union received $35 million for the rights to use player names and likenesses.[12] Additionally, the NCAA athlete's plight is similar to the use of NFL retired players likenesses, for which until recently, have gone uncompensated. Recently, the Northern District of California found damages of $28.1 million dollars in favor of a certified class action pool of retired players against the NFL Players Union for unauthorized use of retired player likenesses.[13]

The 9th Circuit has recognized the right to publicity of celebrities in*White v. Samsung*. In this case, a portrayal of a robotic figure intending to humorously depict Vanna White was deemed in violation of Ms. White's publicity rights because the appearance was "substantially similar" to the real life Vanna White.[14] The cases presented by O'Bannon and Keller are substantially similar. Without doubt, the goal of the NCAA in designing the players is to make them as similar to the real athlete as possible. This is reflected in the physical characteristics, jersey number and statistics being the same between the "fictitious" player and the student-athlete. In Sam Keller's case, former Nebraska Cornhusker's quarterback, the player represented as the quarterback of the Cornhusker's offense in the game has exactly the same statistics as Sam Keller had the previous year.[15] Isaiah "Juice" Williams, is the quarterback for the Fighting Illini of the University of Illinois and wears #7.[16] On the roster, he is listed as 6'2 and 235 pounds.[17] In NCAA Football 2010, Illinois' quarterback, #7, is listed as 6'2 and 223 pounds.[18] The players in games like EA Sports' NCAA Football franchise are so recognizable, that third party websites offer roster downloads/memory cards for purchase that automatically edit the name from, for example, "WR #9" on the Fighting Illini to Arrelious Benn.[19] Without a doubt, the NCAA and its member institutions are profiting from selling the rights of athletes, and with the undisputedly similar attributes of the players on the game to the real college player, the NCAA and EA Sports cannot decline that they are trying to replicate actual athletes as much as possible.

IV. A Workable Solution

Understandably, some college purists gasp at the idea of having a pool of money available for individual athletes upon the exhausting of the athletes eligibility. Even more troubling for these purists would be to have athletes being compensated for games, DVDs and other products bearing the athletes likeness while the athlete is still in school. Paying college athletes, even for publicity

rights, jabs at the idea of amateurism. However, some mechanism must be agreed upon that would leave former NCAA athletes in a better position by signing away their publicity rights. The O'Bannon complaint starts to draw out a solution that would benefit both the NCAA by allowing the continued use of player likenesses, and NCAA athletes by providing a pool of benefits that they can draw from. [20]

While the O'Bannon complaint provides a starting point, with the millions upon millions of dollars flowing into the NCAA and its member institutions off the rights of its athletes, the NCAA could do much more for its athletes. What the NCAA and its member institutions could do is provide benefits to student-athletes after they have exhausted their eligibility. Most student-athletes do not go on to play professionally and many end up unemployed and without basic benefits such as health insurance. The NCAA should use a portion of the money it gets from its contracts with Electronic Arts and other video game companies, as well as from sales of DVD box sets, magazines, etc. bearing the likenesses of former players, and distribute it to the individual schools for the purposes of the schools setting up group health insurance, a pension program for former athletes and a continuing education fund. Much like the ongoing debate regarding former NFL players and disabilities, it is imperative to have a well-funded resource for former athletes to have continuing medical coverage for present and future injuries/conditions associated with their participation in college athletics. This would ensure that athletes who generate millions of dollars for the NCAA and their respective schools would not be unfairly forced to sign away their publicity rights. This plan would also allow for the college athlete to focus on not only his craft, but schoolwork while being assured that his interests are being protected.

V. Conclusion

The NCAA has an obligation to protect amateurism and not let its practices bleed into a more professional-style system. However, the NCAA cannot continue to

profit unfairly off the backs of its athletes by forcing these athletes to sign away their rights. An NCAA regulated and partly funded system charging member institutions to provide a pool of benefits to its athletes is one method of protecting the interests of college athletes, but still protecting the amateur aspect of college athletics that has made the NCAA so successful.

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[13] *Parrish, Adderley, Roberts III et al. v. NFL Players Inc*., C 07-00943 (N.D. Cal., post-trial motions order Jan. 13, 2009).

[14] *White v. Samsung*, 971 F.2d 1395 (9th Cir. 1991).

[15] Kevin Goldberg, *A Hail Mary for Athletes' Right of Publicity?*, CommLawBlog, May 11, 2009,http://www.commlawblog.com/2009/05/articles/intellectual-property/a-hail-mary-for-athletes-right-of-publicity/.

[16] University of Illinois Fighting Illini Football Roster, http://espn.go.com/ncf/teams/roster?teamId=356 (last visited Oct. 29, 2009).

[17] *Id.*

[18] NCAA Football 2010

[19] NCAA Football 10 Rosters, http://www.footballrosters.net/ (last visited Oct. 29, 2009).

[20]Dinzeo, *supra* note 3.

ASTROTURF LOBBYING ORGANIZATIONS: DO FAKE GRASSROOTS NEED REAL REGULATION

I. Introduction

Mail carts are pushed down the halls of Congress passing offices with televisions showing images of protestors at a rally. Phones in those congressional offices ring steadily from calls of individuals voicing their opinions over the issue du jour. But are the authors of the letters, the protestors on the televisions or the people on the other end of the telephone conversations concerned citizens or are they paid by an Astroturf organization – pawns of big business trying to pull the covers over the eyes of Congress?

An Astroturf organization is a "group that lends a veneer of moral legitimacy to a cause" which "allows a group to present its position as a grass roots campaign, regardless of the actual degree of public concern." These organizations are often "Washington-based campaigns that simulate grassroots support but are in fact coordinate by ideological interest groups seeking particular legislative outcomes." The purpose of creating such fake grassroots is to create a façade of widespread support by acting as grassroots organizations to hide their underlying motivation. Frequently Astroturf organizations have large bank accounts but small membership rolls. The term "Astroturf," has been attributed to Democratic Senator and 1988 Vice-Presidential candidate Lloyd Bentsen who, in

1985, said "[a] fellow from Texas can tell the difference between grassroots and Astroturf."

Lobbying is big business inside the beltway, but it is the effects lobbying can have on businesses across the country that make lobbying so important.

How Important? If the money spent by business on lobbying is any indication of how important lobbying is one can conlude it is staggeringly important. This year more than 275 million dollars have been spent on lobbying on health care reform alone! From June until September 2009 nearly one million dollars a day was spent on health care reform television advertising. With so much money being spent influencing Congress, the question of whether and how to regulate organizations that peddle such influence is a pressing one.

II. The Possible Downside of Astroturf Organizations

Exaggerating the number of people who support or oppose a policy is, of course, not new. But the line between exaggeration and fraud is, unfortunately, a narrowing one. For example, the coal lobby was caught essentially "sending bogus letters to member of congress." Such activities crossed the line from showing ones ideas in the best possible light to using smoke and mirrors to lie to elected representatives.

Existing campaign finance laws require some disclosure but

> [i]ndividual firms may mask their activity by acting through a trade association, and that

> association's members, objectives, and financial structure may be only
> partially transparent . . . they need not quantify the in-house dollars expended on lobbying, nor are the disclosure requirements sufficiently detailed
> as to subject matter. Firms also need not disclose their efforts to generate
> grassroots lobbying support.

In sum, existing laws are inadequate.

III. Should we Regulate Astroturf Lobbying Organizations? If so, How?

A. To Regulate or Not to Regulation?

The right of freedom of expression is one held closely by Americans and it is one that has extended to spending money. In fact, limiting the amount of money people and business can spend to support candidates or causes received backlash from Americans who thought such limitations unconstitutionally limited speech. Even if one believes spending limits are good, it is indisputable that such limits do not essentially limit liberty and thus regulation should not be taken lightly.

On the other hand, Astroturf organizations can distort the truth and make it more difficult for Congress to respond to the real demands of the people. Such speech can be seen as a hindrance to democracy. However, as opponents of regulation have

pointed out, our "political tradition is that voters judge the truthfulness and relevance of campaign arguments."

B. How to Regulate

Though Astroturf organizations are different from political campaigns, there is a lesson to learn from limiting political fundraising: unintended consequences can make regulation moot and can, in some cases, provoke innovation that is contrary to the regulations original purpose. For example, the Bipartisan Campaign Reform act of 2002 (BCRA), which limited the amount of money which could be donated to political candidates led to the emergence of 527 political organizations. These organizations could raise unlimited funds from citizens, corporations, or unions and have therefore played an increasingly important role in our electoral system since 2002. The BCRA, which was intended to make money less important in the electoral process, simply changed how money was raised and spent. Arguably the BCRA led to "less transparency, less accountability in who's financing what or whom than ever before." Clearly, if regulation is a route worth pursuing it is worth pursuing with caution.

Just because past regulations of a similar kind were unsuccessful or not as successful as supporters hoped they would be, does not mean that no regulation is worth pursuing. If one learns the lessons of the past one might create more effective solutions in the future.

C. Solutions that Work and Minimize Unintended Consequences

Lobbyists influence is not solely financial. "Control of information is as central to lobbyists' power as control of money." That is to say, only focusing on the financial aspect of lobby will not stop lobbyists from affecting legislative outcomes. Congress relies on lobbyists for expertise. One solution which aims to decrease the importance of lobbyists generally is "increasing the funding for the Congressional Research Service and Government Accountability Office." This funding increase would give Congress more information free of lobbyist influence.

A second option is simply to increase the transparency of Astroturf organizations. If Congress defines Astroturf organizations as those with a funding to donor ratio of over a certain number, it could effectively require greater disclosure of organizations that practice Astroturf lobbying. Congress could then require Astroturf organizations to give more detailed and more frequent disclosures. New disclosure requirements create disincentives to use Astroturf lobbying strategies and create transparency that would help voters and politicians assess arguments and biases. This solution avoids the mistakes of the BCRA and will not catalyze a new set of organizations that insulate politicians or causes from the mudslinging of the political process.

IV. Conclusion

Astroturf lobbying organizations pose a real threat to our democracy because they can distort the amount of popular support behind a public policy. These organizations make it more difficult for our Congress to truly act as the people's branch. However, past attempts at regulating donations to political campaigns suggest that, in some circumstances, the cure can be worse than the disease. Thus, any regulation of lobbying organizations should be limited to increasing Congress's access to unbiased information and full and frequent disclosure of the sources of funding for such organizations. Smart regulation can help the political process without compromising people's and business' opportunities to voice their opinion – regardless of popularity.

[1] Paul Dickson, *Fresh Legs and Idiot Sheets*, WASHINGTONIAN, Oct. 2005.

[2] David A. Hyman, *Consumer Protection in a Managed Care World: Should Consumer Call 911* 43 VILL. L. REV. 409, 422 n.49.

[3] ALAN WOLFE, DOES DEMOCRACY STILL WORK? (Yale University Press 2007).

[4] Ryan Sager, *Keep Off the Astroturf*, N.Y. TIMES, Aug. 19, 2009, *available at*http://www.nytimes.com/2009/08/19/opinion/19sager.html.

[5] Jennifer Liberto, *Health Care Lobbying: Political Power Machine*, CNNMONEY.COM, September 13, 2009, http://money.cnn.com/2009/09/08/news/economy/health_care_lobbying/index.htm.

[6] *Id*.

[7] Jill E. Fisch, *How Do Corporations Play Politics?: The FedEx Story* 58 VAND L. REV. 1495, 1564 (2005).

[8] *Id*.

[9] *Id*.

[10] See, Robert Samuelson, *So Much for Free Speech*, WASHINGTON POST, Aug. 25, 2004, *available at* http://www.washingtonpost.com/wp-dyn/articles/A30280-2004Aug24.html.

[11] *Id*.

[12] Bipartisan Campaign Reform Act of 2002, PUB. L. NO. 107-55, hereinafter Bipartisan Campaign Reform Act.

[13] These organizations are called "527s" because they are taxed under section 527 of the Internal Revenue Code. Eliza Newlin Carney, *Heavy Bickering, Light Reforms*, NATIONAL JOURNAL, May 13, 2006.

[14] Jeffrey P. Geiger, *Preparing for 2006: A Constitutional Argument for Closing the 527 Soft Money Loophole* 47 WM AND MARY L. REV. 309, 311 (2005).

[15] *Id*.

[16] Bipartisan Campaign Reform Act, *supra* note 12.

[17] Steve Forbes, *Fact and Comment: Bursting the Bubble*, FORBES, Sept. 20, 2004.

[18] Lee Drutman, *Three Fixes for Our Lobbyist Problem*, AMERICAN PROSPECT, June 5, 2008, http://www.prospect.org/cs/articles?article=three_fixes_for_our__lobbyist_problem.

[19] *Id*.

[20] *Id*.

IMPLICATIONS OF THE GENETIC INFORMATION NONDISCRIMINATION ACT (GINA) ON PROFESSIONAL SPORTS

I. Introduction

The sports business industry is one of the largest and fastest growing industries in the United States. In fact, the Sports Business Journal estimates the size of the sports business industry to be $213 billion in the United States alone. [1] Furthermore, sports business law is a dynamic field of law with new issues arising on an almost daily basis due to courts decisions, new legislation, and regulation. [2] One piece of new legislation, the Genetic Information Nondiscrimination Act (GINA), [3] will have a profound impact on employment decisions in professional sports. This article discusses the implications of GINA on professional sports: specifically, part II of the articles discusses GINA in detail, part III discusses GINA's impact on professional sports, part IV discusses GINA's economic impact on professional sports, and part V provides some concluding remarks.

II. The Genetic Information Nondiscrimination Act (GINA)

The Genetic Information Nondiscrimination Act (GINA) is designed to prohibit the improper use of genetic information in health insurance and employment decisions. [4] The Act, *inter alia*, bars employers from using individuals' genetic information when making employment decisions (*i.e.*, hiring, firing, or promotion decisions, and for any decisions concerning terms of employment). [5]

The statute defines 'genetic information', *inter alia*, as information about (1) an individual's genetic tests; (2) the genetic tests of the individual's family members; and (3) the manifestation of a disease or disorder in family members (family history). [6] Genetic information, however, does not include information about the sex or age of any individual. [7] Moreover, the statute defines 'genetic test' as

an analysis of human DNA, RNA, chromosomes, proteins, or metabolites that detects genotypes, mutations, or chromosomal changes. [8] Nonetheless, the results of routine tests that do not measure DNA, RNA, or chromosomal changes, such as complete blood counts, cholesterol tests, and liver-function tests, are not protected under GINA. [9]

While the Equal Employment Opportunity Commission (EEOC) is responsible for promulgating regulations concerning GINA, it has not yet done so. [10] The Act, however, will only take effect on November 21, 2009. [11] Accordingly, the full scope of GINA will only be seen when regulations are promulgated and court decisions are made.

III. Impact on Professional Sports [12]

A. Major League Baseball (MLB)

A common occurrence among Latin American baseball players is to lie about their age in order to appear younger and attract Major League Baseball (MLB) teams. [13] Accordingly, the MLB, currently collects DNA samples from prospective players whose identity it is questioning in order to prevent age fraud. [14] For instance, in July, the Yankees voided the contract of a shortstop they thought was Damian Arredondo after a DNA test conducted by the league's Department of Investigations established that he was older than the 16 years he claimed to be. [15] As was discussed above, GINA, however, explicitly bars employers from using genetic results in hiring and workplace decisions. [16] It is possible that the EEOC could determine that neither age nor identity represent "genotypes, mutations, or chromosomal changes" which might be enough to exclude the testing from GINA's definition. [17] Moreover, the EEOC could reach the same result by deciding that the exclusion of "information about the sex or age of any individual" from the definition of "genetic information" encompasses genetic tests designed to ascertain an individual's age. [18]. According to one commentator, however, that does not appear to be the intent of

the statute's exclusion. [19] According to Dan Vorhaus, an attorney who advises genomics and biotechnology researchers, entrepreneurs, companies and investors on legal compliance issues,

Neither of these outcomes seem particularly likely based on the plain language of GINA: the test at issue in the MLB matter is an "analysis of human DNA" and its results may be used, in some cases, to refuse to hire or otherwise discriminate against potential employees; seemingly the precise behavior that that GINA is intended to prevent. Still, there is sufficient ambiguity in the statutory language that the final analysis will depend in large part on how the EEOC, and courts, choose to interpret GINA. [20]

Nonetheless, Robert Plummer, a MLB agent with extensive experience in recruiting Latin American prospects, thinks that GINA will be a non-issue for MLB because it will be impossible to prove anyone is being forced to submit their DNA. [21] He likens MLB's DNA testing to off-season workouts in the National Football League (NFL): "Sure they're called voluntary," he says. "But do you want to be the one guy who doesn't show up?" [22]. Moreover, GINA may be unenforceable on practical terms. Plummer recently stated that "I have so many teams back out of deals for so many reasons, how could I ever prove that DNA testing was one of them?" he asks. "If I even tried to make the case, a GM would just turn around and say, 'Oh, I just don't like your guy for all these other reasons.'" [23]

B. Other Professional Sports

Moreover, GINA will have increased significance in regards to the National Basketball Association and the National Football league and their current players. To illustrate, recall the 2005 case of Eddy Curry: in that instance the Chicago Bulls refused to extend the contract of Curry unless he took a genetic test. [24] The Chicago Bulls were concerned that Curry might have a rare mutation that

increased the chance of him suffering a fatal heart attack while playing for the team. [25] Ultimately, Curry signed with the New York Knicks without ever having to take a genetic test. [26] GINA is designed to stop situations like the one described above. GINA prevents an employer (in the above instance, the Chicago Bulls) from requiring a genetic test. According to Eddy Curry's former agent Alan Milstein, GINA is designed to prevent similar situations from arising again. [27] "It goes hand-in-hand with all the laws that say your medical history is your own and no one can have access to it," he says. [28] Should a similar situation come up again, it would seem to be clearly prohibited under GINA, and the team's best option would likely be to simply assume the worst and not take the risk. [29]

IV. Economic Impact of GINA on Professional Sports

The economic impacts of GINA on professional sports leagues, teams, and players may prove to be of significant consequence. As indicated above, if a situation similar to the one of Eddy Curry arises again, teams would likely assume the worst and not take the risk. [30] In essence, the team would not sign the particular player. Although this may not cause a considerable impact on professional sports leagues and teams if the player is a substitute who does not play, consider if the situation arose in the case of a marquee player. Consider, for instance, if Lebron James or Kobe Bryant were suspected of having a genetic disorder and not signed. Their respective teams would lose revenues, *inter alia*, from attendance, merchandise sales, and general team goodwill. Moreover, from an economic perspective, other teams would be harmed as their fans often go to games to watch these "superstars." Lastly, the National Basketball Association would lose revenue from the loss of fans as they would no longer be able to produce as high quality a product (quality of play would diminish).

Furthermore, teams may not want to commit large amounts of money into players that may be older then they say they are or having a genetic condition which will

not allow them to play. Accordingly, players may lose money as are forced to sign deals for lesser salaries or shorter number of years. In essence, an appropriate salary will be difficult to determine due to an asymmetry of information: the teams will not know if they are receiving a healthy or not healthy player and thus the teams will only be willing to pay for a player of average health. This asymmetry of information is inefficient from an economic viewpoint and may ultimately lead to market failure. In the case of professional sports, players, particularly basketball players, may decide to play in other professional sports league around the world. This should not be a serious problem, however, as an athlete can affirmatively disclose his genetic information to a sports team. [31] In fact, Robert Plummer encourages his clients to submit DNA samples to prove their identity. [32] Plummer claims that a DNA sample helped his client, 16-year-old Miguel Angel Sano, secure a $3.15 million signing bonus from the Twins. [33]

V. Final Thoughts

Players may feel obligated to provide their genetic information even if they are not explicitly being asked for it. [34] According to Palmer, players are being forced to give up a DNA sample as MLB assumes that if you don't, "you're guilty, if you're clean, you should want to do it." [35] Whether other professional sports leagues will adopt a guilty-until-proven-innocent approach, remains to be seen. [36] Moreover, the implications of GINA on professional sports will only be seen when the EEOC promulgates regulations and court decisions are made.

End Notes:

[1] The Sports Industry, *SportsBusiness Journal* (Street & Smith's), 2008, *available at* http://www.sportsbusinessjournal.com/index.cfm?fuseaction=page.feature&featureId=1492.

[2] Shropshire, Kenneth L, Introduction: Sports Law, 35 Am. Bus. L.J. 181, 182 (1998).

[3] 42 USCA. § 2000ff et seq. (2009).

[4] Assael, Shaun, Genetic Property: A New Law Protecting Genetic Information Could Butt Heads with MLB Policy, October 7, 2009, *available at insider.espn.go.com/espn/insider/news/story?id=4537203.*

[5] Statement of Administration policy, Executive Office of the President, Office of Management and Budget, April 27, 2007.

[6] 42 USCA § 2000ff (2009).

[7] *Id*.

[8] *Id*.

[9] *Id*.

[10] *Id*.

[11] Vorhaus, Dan, MLB Meet GINA, July 22, 2009, *available at* http://www.genomicslawreport.com/index.php/2009/07/22/mlb-meets-gina/

[12] *See* Assael, *supra* note 4 (No impact of college sports according to Chris Kuczynski, a policy-making attorney with the agency, because "College athletes are not employees…and if there's no employment, GINA does not apply").

[13] *Id*.

[14] *Id*.

[15] *Id*.

[16] *Id*.

[17] Vorhaus, Dan, MLB Genetic Testing Program at the Plate Again, July 28, 2009, *available at* http://www.genomicslawreport.com/index.php/2009/07/28/mlbs-genetic-testing-program-at-the-plate-again/

[18] *Id*.

[19] *Id.*

[20] *Id*.

[21] Assael, *supra* note 4.

[22] *Id*.

[23] *Id*.

[24] Vorhaus, *supra* note 11.

[25] *Id*.

[26] *Id*.

[27] Assael, *supra* note 4.

[28] *Id.*

[29] Vorhaus, *supra* note 17.

[30] *Id*.

[31] *Id*.

[32] Assael, *supra* note 4.

[33] *Id*.

[34] Vorhaus, *supra* note 17.

[35] Schwartz, Alan, A Future in Baseball, Hinging on DNA, July 22, 2009, *available at* http://www.nytimes.com/2009/07/23/sports/baseball/23dna.html?_r=2&scp=1&sq=baseball%20genetic%20test&st=cse.

[36] Vorhaus, *supra* note 17.

DEFICIENT IN DEFICIENCIES: THE POTENTIAL EFFECTS OF THE REFUSAL TO UPHOLD FULL-RECOURSE, RESIDENTIAL REAL ESTATE LOANS

I. Introduction

Foreclosures have taken on a new significance in the last few years as a result of the financial crisis. This has the led the finer points of the foreclosure proceedings to become extremely important for many lenders, and for many borrowers in default. One potentially important practice is the oft-rumored, but rarely documented routine of certain judges to simply refuse to grant any deficiency judgments in personal foreclosures. Cases have been brought before higher courts across the country, leading to judges being rebuked for ill-advised activism in refusing to properly entertain requests for deficiency judgments. [1] In light of the record number of foreclosures taking place in the last two years [2], a lack of deficiency judgments may prove to have a significant effect on banks and may lead to a change in the practices of many banks. The purpose of this article is to question what effects such a practice is having, and could further have on the residential real estate loan market.

II. Background

Traditional real-estate loans, also known as recourse loans or full-recourse loans, have allowed the lender and mortgagee to seek the enforcement of a deficiency judgment against the borrower. This would be the case where the foreclosure sale was not sufficient to cover the debt. [3] These types of loans afforded the banks a strong probability that the full debt would eventually be collected even if foreclosure were to take place.

Recourse loans exist alongside non-recourse loans which, as the name implies, offer the lender no recourse against the borrower beyond foreclosure of the

mortgage instrument. [4] Typically, non-recourse loans offer a higher degree of risk, and therefore carry a higher interest rate to match. [5] The banks run the risk that owners will abandon properties which they can no longer afford in a poor state of upkeep, reducing the value of the home, and therefore the amount the bank will receive out of a foreclosure sale.

III. Analysis

A. How prevalent is the practice of refusing deficiency judgments?

It is unclear how many of judges and courts have been routinely and categorically refusing to grant deficiency judgments, though rumors of such are often heard from those attorneys working in the foreclosure industry. [6] In the past, the need to know and understand the residential foreclosure and deficiency realms was limited due to the relatively low importance of deficiency judgments. This lowered importance was not only due to a smaller number of overall foreclosures. It was also in part because the expenses involved, the insolvent nature of the average defendant, and the low chance of success combine to make seeking deficiency judgments less than cost-effective for the banks. [7] As such, they were low importance considerations. Even more importantly, deficiency judgments are left within the discretion of the judges; this means that the appellate standard would be an abuse of discretion standard. [8] This is a difficult to burden to meet. Due to this burden, it is possible that such cases have never been brought to light in an appellate forum.

In addition to judge activism, there are some compelling legal reasons for why a judge may choose not to grant deficiency judgments in the great majority of cases. [9] Such reasons include the fact that lay persons interpret mortgage loans as being non-recourse and that the lay approach should be the one accepted by the courts. [10] Furthermore, some argue that a mortgage and loan transaction constitutes a contract, which should be interpreted against the drafter, ergo the lender; as such, even the slightest ambiguity with regard to recourse should create

a non-recourse loan. [11] Such a result is therefore not necessarily judicial activism, but it is nevertheless counter to the expectations and intuitions of the lenders who loaned money to borrowers under full-recourse conditions. At this time, it is unclear to what extent these practices exist, but the effects can nevertheless be considered.

B. What are the potential effects of this practice?

If a lender believes that a loan once considered to be full recourse is not going to be recoverable beyond foreclosure, they may choose not to offer the loan product anymore. They may also offer an interest rate closer to that of non-recourse loans, since interest rates are determined largely by risk. [12] As such, if the risks of full-recourse and non-recourse loans become near equal, so will their interest rates. This would practically limit the borrower's selection when considering loan products even if full-recourse loan products are not eliminated.

Another alternative that the banks may choose to exercise is to extend non-recourse, “carved-out” loans, often found in the commercial sphere, to the residential real estate world. In recent years, the non-recourse concept has changed significantly from its first iteration, especially in the commercial sector. Specifically, commercial real estate loans now have a growing number of exceptions, often known as “carve outs,” created by the loan documents, giving rise to deficiency judgments. [13] The carve outs therefore allow the lender to minimize the risk it accrues through moral hazard. [14]

For example, in a traditional non-recourse loan, the lender runs the risk that the borrower will abandon or undermaintain an unprofitable property. [15] This would serve to reduce its value and the lender would therefore stand to recover less of the debt. Carve outs solve this problem by delineating situations that render a loan partial- or full-recourse. [16] Such situations include subsequent encumbrances, bankruptcy, or certain types of waste. [17]

This same concept, typically reserved for commercial loans, may well soon be applied to residential loans. If full-recourse loans never lead to deficiency judgments, they amount to little more than non-recourse loans. Non-recourse loans with carve-outs may allow lenders to more easily recover deficiency judgments because they all require a showing of borrower bad behavior. This may lead reluctant judges to become more likely to rule against borrowers who have willingly and intentionally interfered with the lender's ability to recover on the note.

The practice of applying carve-outs to non-recourse, or partial-recourse residential loans is not new per se. Carve-outs have existed in many residential loans for some time but are generally very rare. [18] If full-recourse loans have lost their teeth, it may very well be that these carved loans will become much more common in the coming years.

Not all carve-outs currently used for commercial properties would necessarily be applicable to, or useful for, residential purchase-money mortgages. Of the typical carve-outs identified by authors Portia Morrison and Mark Senn, environmental risk is the particular stand out in this category. [19] Whereas commercial lenders need to be protected from any costs associated with environmental contamination, this need is nearly nonexistant with residential owners because they are not taking part in industrial activities. On the other hand, many other identified carve-outs, such as fraud and sale are very relevant to residential properties. [20] Several questions arise as to some of the carve-outs that would still be possible, but arise out of situations that are not typically default conditions on a residential loan. For example, commercial loans often have a carve-out creating a loss of exculpation for subsequent encumbrances, which can be a default on a commercial loan but is typically not so on a residential loan. [21] Another typical commercial carve-out is bankruptcy. [22] It seems questionable that individuals should be 'punished' in this way for a bankruptcy the way a corporation would be.

This leads to the question as to whether this approach is desirable. Given the recent economic situation, many feel that deficiency judgments against individuals on foreclosures are neither necessary nor desirable but it becomes questionable as to whether a world where recourse is no longer widely available to lenders would be beneficial to homeowners present and future. The availability of certain types of loans could decrease. Furthermore, the interest rates could generally increase on full-recourse loans. Therefore, the needs of today's foreclosed homeowners and the needs of tomorrow's borrowers will need to be balanced carefully.

C. Will the effects necessarily come about?

Many lenders do not pursue deficiency judgments because the borrower is simply unlikely to have any funds from which judgment could be recovered. [23][24] As such, it seems possible that the interest rates and general costs of full-recourse fully encompass this fact. It is possible that, despite the growing importance of foreclosure in loan considerations, deficiency judgments will not have any effect on the behavior of lenders because they have already sufficiently covered for these potential losses by the interest rate schemes present in their current loan products.

IV. Recommendation

The number of mortgage loans in default and of residential foreclosures is increasing significantly as a result of the subprime crisis; for example, 342,038 residential properties were in default or in a foreclosure proceeding in April 2009, for an overall rate of 1 in 374 households, showing a significant increase over 2005 rates. [25] The results are twofold. First, some judges may prove themselves more reluctant to impose deficiency judgments, either through pity or through activism against the banks, thereby increasing the prevalence of this practice. Second, the great amount of foreclosures as a percentage of all home loans means that the amounts lost by lack of deficiency judgments is much more significant to

the lenders' bottom line than it used to be. As such, the lenders's practices and product offerings may prove much more sensitive. These factors combine to mean that now is the time to both seek to understand whether this practice is a significant part of the foreclosure world or simply a real estate lawyer's myth, and whether this is having any effect on lending practices. The lack of deficiency judgments may serve to increase interest rates and reduce the variety of loan products available to future borrowers. This fact must be balanced against the interests of homeowners in foreclosure due to subprime loans. The data at this time is simply insufficient to fully understand the situation, and therefore makes it impossible to determine what the exact effects may be. As such, we must study this problem further in order to ascertain the effects of this practice on the residential lending market. We must further question whether these effects are desired or not, and whether it is wise to leave such a practice to the discretion of the individual judges and courts rather than fully deciding the issue through legislation.

V. Conclusion

Given the presence of foreclosures at the forefront of the banking and real estate landscapes, the potential declawing of full-recourse loans is an important consideration. Any systematic refusal to grant deficiency judgments against residential borrowers could have a significant effect on lenders and their practices. In order to proper regulate residential lending practices, it is critical to gain a clear understanding of the extent to which this practice exists. It would also be important to more fully question to what extent lender behavior would be modified by the prevalence of such a practice, and whether this change in lending practices is one that should be welcomed or rebuffed.

[1] *See e.g.* Am. Gen. Fin. Servs. v. Brown, 658 S.E.2d 99 (S.C. 2008) (confronting a lower court judge who refused to grant any deficiency judgments).

[2] *See e.g.* Les Christie, *August foreclosures hit another high*, CNN, http://money.cnn.com/2008/09/12/real_estate/foreclosures/ (last visited Oct. 27, 2009).

[3] Portia Owen Morrison and Mark A. Senn, *Carving up the 'Carve-Outs' in Non-Recourse Loans*, 9 PROBATE & PROPERTY 8, 9 (1995).

[4] *Id.*

[5] STEVEN W. BENDER, CELESTE M. HAMMOND, MICHAEL T. MADISON & ROBERT M. ZINMAN, MODERN REAL ESATE FINANCE AND LAND TRANSFER, 252 (2008).

[6] Ilyce Glink, *Foreclosure Affects Credit But Homeowner May Avoid Deficiency Judgment*, http://www.thinkglink.com/article/2009/07/02/foreclosure-affects-credit-but-homeowner-may-avoid-deficiency-judgment (last visited Nov 2, 2009).

[7] Ron Lieber, *Thoughts on Walking Away From Your Home Loan*, N.Y. TIMES, Mar. 13 2009, *available at* http://www.nytimes.com/2009/03/14/your-money/mortgages/14money.html?_r=1 .

[8] *See e.g.* FDIC v. Hy Kom Dev. Co., 603 So. 2d 59, 59-60 (Fla. Dist. Ct. App. 2nd Dist. 1992).

[9] John Mixon, *Fannie Mae/Freddie Mac Home Mortgage Documents Interpreted as Nonrecourse Debt*, 45 CAL. W. L. REV. 35 (2008).

[10] *Id.* at 51.

[11] *Id.*

[12] Morrison, s*upra* note 3, at 9.

[13] *Id.*

[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] *Id.*

[18] HARRIS OMINSKY, REAL ESTATE LORE: MODERN TECHNIQUES AND EVERYDAY TIPS FOR THE PRACTITIONER, 93 (2006).

[19] Morrison, s*upra* note 3, at 10-11.

[20] *Id.*

[21] *Id.*

[22] *Id.*

[23] Ilyce R. Glink , *Failure to Repay Home-Equity Lines Can Result in Foreclosure*, WALL ST. J., Oct 17, 2009 *available at* http://www.washingtonpost.com/wp-dyn/content/article/2009/10/15/AR2009101504566.html .

[24] Mixon, *supra* note 8, at fn 21 (quoting Texas attorneys Michael C. Barrett and Tommy Bastian).

[25] Dan Levy, *U.S. Foreclosure Filings Hit Record for Second Month*, BLOOMBERG, http://www.bloomberg.com/apps/news?pid=20603037&sid=aYokz_rb3kbw (Updated May 13, 2009).

SHOULD SECTION 10(B) RULE 10B-5 OF THE SECURITIES ACTS BE AMENDED TO ALLOW PRIVATE RIGHT OF ACTION FOR AIDING AND ABETTING?

I. Introduction

The Securities Act of 1933 and the Securities Exchange Act of 1934 were enacted in response to the Stock Market Crash of 1929 that ushered in the Great Depression. [1] In passing the Acts, Congress' intention was to implement regulations that would govern the ways securities were bought and sold in the United States and to protect individual consumers from securities fraud. Specifically, Section 10(b) of the 1933 Act and Rule 10b-5 of the 1934 Act regulate fraud in connection with the purchase or sale of a security. [2] To obtain a conviction under these provisions, it must be proved that:

(1) (a) the defendant engaged in a fraudulent scheme, or

(b) made a material misstatement, or

(c) omitted material information to one to whom the defendant owed a duty;

(2) the scheme, misstatement, or omission occurred in connection with the purchase or sale of a security; and

(3) the defendant acted "willfully."

[3] From the time Congress passed the laws in the early 1930's, there has been debate over exactly who could be held liable for securities fraud under Section 10(b) and Rule 10b-5. For the most part, courts have understood the antifraud provisions to extend liability to "primary violators," those who actually make material misstatements or omissions or commit a manipulative act or acts. In *Central Bank of Denver v. First Interstate Bank of Denver* [4] and again in *Stoneridge Investment Partners, LLC v. Scientific Atlanta*, Inc. [5] the United

States Supreme Court considered the issue of whether to adopt a theory of "scheme" or "aider and abettor" liability. According to the holdings in those cases, shareholders can only sue parties directly involved in a fraud, and not third parties who indirectly aid or abet the fraud. [6] As the Court put it, the issue before it was "whether private civil liability under Section 10(b) extends as well to those who do not engage in the manipulative or deceptive practice, but who aid and abet the violation." [7] In both cases, the Court held that "because the text of Section 10(b) does not prohibit aiding and abetting … a private plaintiff may not maintain an aiding and abetting suit under 10(b)." [8] In Central, the court explained that its decision was guided by statutory interpretation, noting that "[i]f … Congress intended to impose aiding and abetting liability, we presume it would have used the words 'aid' and 'abet' in the statutory text. But it did not." [9]

II. New Legislation: S.1551, the Liability for Aiding and Abetting Securities Violations Act of 2009

A year after the Court defended this interpretation of Section 10b in Stoneridge, as if responding to its "Congressional intent" argument posed by the majority in that case, Senator Arlen Specter (D-PA) introduced S.1551, the Liability for Aiding and Abetting Securities Violations Act of 2009. [10] The bill, introduced in July 2009 and co-sponsored by Senators Edward E. Kaufman (D-DE), Jack Reed (D-RI) and Sheldon Whitehouse (D-RI), would repeal the Supreme Court's decisions in Central and Stoneridge by amending the securities laws to allow private litigation against a person that provides "substantial assistance" in a violation of the securities laws. The language of the proposed bill states:

For purposes of any private civil action implied under this title, any person that knowingly or recklessly provides substantial assistance to another person in violation of this title, or of any rule or regulation issued under this title, shall be deemed to be in violation of this title to the same extent as the person to whom such assistance is provided.

[11] In effect, the bill would permit private civil actions against aiders and abettors, including accountants and attorneys. The aider and abettor liability proposed by Sen. Specter reflects the "substantial participation approach" advocated by the plaintiffs in *Wright v. Ernst & Young LLP*. [12] There, plaintiffs claimed that Ernst & Young violated the antifraud provisions of the 1933 and '34 Acts by orally approving materially false and misleading financial statements made by the company which it was auditing. [13] In turn, that company disseminated that information to the public in a press release. [14] As a basis for liability, the plaintiffs argued that the Court of Appeals for the Second Circuit should adopt a "substantial participation approach," under which third-party defendants, like Ernst & Young, would be held primarily liable for statements made by others in which the defendant had significant participation. [15] The Court in that case declined to adopt such a rule and refused to extend liability to those who did not actually make fraudulent or misleading statements to the public. [16] Instead, the Court utilized a "bright-line approach," under which a third party's review and approval of documents containing fraudulent statements is not actionable under Section 10(b) because one must make the material misstatement or omission in order to be a primary violator. [17] In other words, the Court refused to extend liability to a defendant who did not actually make the misleading statement or omission. If Sen. Specter's bill is passed, the "substantial participation approach" would essentially replace the "bright line approach" used by the Supreme Court in Central and Stoneridge. The question remains, should this bill be adopted?

III. The Debate: Should the Bill Be Passed?

On September 17, 2009, the bill had its first committee hearing at a session of the Subcommittee on Crime and Drugs of the United States Senate Committee on the Judiciary ("Subcommittee"). During that hearing, the Subcommittee heard testimony from University of Michigan Law Professor Adam Pritchard, who

outwardly opposes the bill. Among Professor Pritchard's many concerns over the bill, he states that its enactment would essentially "tear down the safeguards instituted in Central and Stoneridge and create the potential for the securities laws to be injected in a wide range of ordinary commercial transactions." [18] Pritchard is most concerned over the prospect of increased "strike suits" filed against deep-pocket, third-party defendants. [19] The professor suggests that litigation aimed at "aiders and abettors" will be detrimental to the economic strength of the United States and significantly raise the cost of capital. [20] In his testimony before the Subcommittee on September 17, Professor Pritchard articulated the potential negative effects of the proposed legislation:

Giving the plaintiffs' bar aiding-and-abetting authority would offer class action lawyers one more weapon with which to shake down settlements. Here the obvious targets would be available deep pockets with some contractual connection to the corporation, such as accountants, lawyers, and banks … Aside from the threat of bankruptcy, shifting liability from the corporation to these third parties only puts an additional link in the chain of the pocket shifting problem. Professionals providing services to public corporations will demand compensation for bearing the risks of liability. Moreover, these advisors will begin more aggressively monitoring statements in order to protect themselves from litigation risk. The additional time spent on monitoring will not only duplicate the corporation's efforts to ensure accuracy; it will also be redundant across the multiple advisors working on a common document. Shareholders will bear those costs; securities class actions are not a free lunch.

[21] In essence, Pritchard believes that the bill will hurt the competitiveness of U.S. capital markets and financial centers and expand the potential liability and litigation expense for innocent third parties. Professor Pritchard is not the only one having trouble seeing the potential benefits of this bill. Professor William Jacobson, director of the securities law clinic at Cornell University Law School,

has reservations about extending liability for securities fraud to a third-party defendant who did not make a fraudulent statement. “The person who assists in the sham transaction isn’t the person making the public statement or the public filing,” said Jacobson. [22] Along with Pritchard and other experts in the field of securities law, Professor Jacobson is worried that the bill will benefit plaintiffs’ attorneys more than shareholders. “Whether it actually helps investors, it’s hard to say,” he said. “But it's certainly going to help investors’ lawyers – there’s no question about that.” [23]

On the other hand, there are many who believe that the bill is necessary to provide relief for investors who have fallen victim to securities fraud aided by third-party actors. Columbia Law Professor John Coffee testified before the Subcommittee in support of the bill, stating that civil aiding and abetting liability is necessary to provide compensation for defrauded investors and to deter third-party actors, like accountants and lawyers, from intentionally or recklessly assisting a corporation in defrauding shareholders. [24] Sitting before the Subcommittee on September 17, Coffee rebuked claims by opponents of Specter’s proposed legislation that, if passed, the bill would have a negative effect on capital markets:

[P]rivate liability for aiding and abetting violations makes sense because (1) the critical gatekeepers of the capital markets – accountants, investment banks, securities analysts, credit rating agencies, and sometimes law firms – will not otherwise face liability and will remain underdeterred in most instances, and (2) these gatekeepers can be more easily deterred than the primary violator because they do not stand to receive the same gain as the primary violator. In contrast, the primary violator may be essentially undeterrable by civil penalties.
[25] Coffee’s support for the bill, it seems, rests on an assumption that by threatening the gatekeepers with aider and abettor liability, securities fraud will be

prevented more frequently. However, Coffee does not assess the risk of increased "strike suits" against third-party defendants. Even assuming that the bill will have the deterring effect cited by its proponents, it is unclear whether the benefit of decreased fraud will outweigh the costs of increased strike-suits against deep-pocketed gatekeeper companies.

IV. Conclusion

While it appears that the bill has an equal amount of support and opposition within Congress, it is becoming increasingly clear that it will probably not reach the Senate floor for debate by the end of the year, as the legislative calendar is quite full with issues concerning health care reform. While the time-line for this bill is not certain, shareholders can rest assured that this debate will not go away indefinitely. As the United States remains in the midst of a serious recession, voices for stricture regulation in regard to the purchase and sale of securities are growing louder and more insistent.

[1] Donna M. Nagy, Richard W. Painter, Margaret v. Saches, *Securities Litigation and Enforcement: Cases and Materials*, 2nd ed., 2003.

[2] *Id.*

[3] J. Kelly Strader, Sandra D. Jordan, W*hite Collar Crime: Cases, Materials, and Problems*, 2nd ed., 2009.

[4] 511 U.S. 164 (1994).

[5] 128 U.S. 761 (2008).

[6] *Supra* Note 4.

[7] *Id.* at 167.

[8] *Id.* at 191.

[9] *Id.* at 177.

[10] S.1551 (2009)

[11] *Id.*

[12] 152 F.3d 169 (2nd Cir. 1998).

[13] *Id.*

[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] *Id.*

[18] Adam C. Pritchard, Evaluating S. 1551: *The Liability for Aiding and Abetting Securities Violations Act of 2009, Before the United States Senate Committee on the Judiciary, Subcommittee on Crime and Drugs, Sept. 17, 2009.*

[19] Leslie A. Platt, Kimberly M. Melvin, *Senate Subcommittee Takes up Repeal of Stoneridge, Central Bank,* September 18, 2009, http://www.wileyrein.com/publications.cfm?sp=articles&newsletter=1&id=5530.

[20] *Id.*

[21] Pritchard, *Supra* Note 19.

[22] Suzanne Barlyn, U*pdate: Compliance Watch: Bill Would Fuel More Investor Fraud Suits, Wall Street Journal,* Aug. 5, 2009, http://online.wsj.com/article/BT-CO-20090805-715386.html.

[23] *Id.*

[24] Kevin M. LaCroix, S*pecter's "Aiding and Abetting" Bill: Why it Could Pass and Why it Matters,* September 21, 2009, http://www.dandodiary.com/2009/09/articles/securities-litigation/specters-aiding-and-abetting-bill-why-it-could-pass-and-why-it-matters/.

[25] John C. Coffee, Jr., Evaluating S. 1551: T*he Liability for Aiding and Abetting Securities Violations Act of 2009, Before the United States Senate Committee on the Judiciary, Subcommittee on Crime and Drugs, Sept. 17, 2009.*

WHO SHUT OFF THE A/C?: TURNING UP THE HEAT ON CORPORATE ATTORNEYS AND THE ATTORNEY CLIENT PRIVILEGE

I. Introduction

The decision of Judge Jed Rakoff in the settlement agreement between Bank of America ("BofA") and the Securities and Exchange Commission ("SEC") is one that could strike fear in the hearts of corporate attorneys everywhere. On August 3, 2009, the SEC filed charges against the Bank of America Corporation for its lack of disclosure to its shareholders about bonuses paid to Merrill Lynch executives in the merger. [1]

The Bank of America/Merrill Lynch merger is a complicated web of litigation and investigation that has become multifaceted as time goes on. As stated by Pennsylvania law professor David Skeel, "It's like a multiplayer chess game where each party is making different moves from a different strategic position and each party has a huge amount at stake." [2]

While the SEC is investigating the lack of disclosure to BofA shareholders regarding the bonuses paid out to Merrill Lynch executives, Congress' Committee on Oversight and Government Reform ("COGR") and New York attorney general Andrew Cuomo are also investigating the surprise losses incurred by Merrill Lynch in regards to receiving bailout money from the federal government. [3] It has been noted by Edolphus Towns, chairman of the COGR that BofA is not allowed to rely on the attorney client privilege in dealing with Congress' investigation. [4] The legal principle of attorney client privilege is only protected to the extent that the information stays between client and attorney. As stated in *In re Grand Jury*, even though the attorney client privilege has been on utmost importance, it must be guarded cautiously or else the privilege would be waived.

[5] Would this mean that there would be a forced waiver of the attorney client privilege in regards to concurrent litigation and investigation by the SEC? If so, what does this mean for corporate lawyers?

This article will discuss the history of the merger between BofA and Merrill Lynch, the dismissal of a settlement offer between BofA and the SEC and the effect this will have on corporate attorneys and their communication and representation of their clients in the future.

II. Background on BofA/Merrill Lynch Merger

When forming the contract in a hasty manner, BofA and Merrill Lynch executives developed a joint proxy statement in order to obtain votes from shareholders regarding the merger. [6] In this statement, BofA stated that Merrill Lynch executives would not receive year-end bonuses or other incentives without the consent of BofA and its shareholders. [7] However, the two companies' Board of Directors had already come to an agreement that Merrill executives would receive up to $5.8 billion in discretionary bonuses. [8] These bonuses were going to be paid regardless of the fact that Merrill Lynch had lost $27.6 billion that year. [9] The schedule appended to the merger agreement stated that Merrill Lynch executives would be paid bonuses, but those bonuses could not exceed a total of $5.8 billion. [10] This was obviously contrary to the provision within the merger agreement that Merrill Lynch would not pay its executives bonuses without the permission of BofA and its shareholders. [10] However, this appended Schedule was not disclosed to the shareholders for consideration before voting on the merger. [11]

III. The Settlement and its Downfall

On September 14, 2009, the SEC and BofA proposed a settlement agreement for $33 million which was subject to court approval. [12] However, court approval of this settlement was denied. [13] In a decision by Judge Jed Rakoff, the settlement was rejected and set to move to trial in February 2010. [14] The judge stated that

this settlement was, “a contrivance designed to provide the SEC with the facade of enforcement and the management of the bank with a quick resolution to an embarrassing inquiry — all at the expense of the sole alleged victims, the shareholders.” [15] Judge Rakoff scolded the SEC and Bank of America because its settlement would not impose liability upon those at fault for the lack of disclosure itself. [16] The SEC, which usually does go after the executives who were responsible, stated that it was not able to do so in this case because the lawyers for BofA and Merrill were the drafters of the merger documents and made the decisions about disclosure and this information would be protected by the attorney client privilege. [17]

Judge Rakoff, in his order, made a statement that perked up the ears of corporate attorneys everywhere. He stated that, “…if that is the case, why are the penalties not then sought from the lawyers?” [18] The rejection of this settlement could greatly influence the decisions of corporate attorneys when dealing with corporations.

IV. The Effect of the BofA/Merrill Lynch Merger on the Attorney Client Privilege

The purpose of the attorney client privilege is to provide full, frank communication between attorney and client for complete and adequate legal representation for the client. [19] By forcing BofA to disregard the attorney client privilege, corporate lawyers could become defendants in this case or be investigated further to seek claims based on their professional ethics. [20] According to the Associations for Corporate Counsel, this would be an absurd precedent for other companies if BofA was forced to give up information regarding private legal advice. [21]

By setting such a precedent, corporate attorneys might be reluctant to have full, frank communication with their clients for fear that they will no longer be protected by the attorney client privilege if their company comes under

investigation by Congress where the attorney client privilege will not hold up. In this case, BofA's disclosure of such information to Congress is based on the amount of losses incurred by Merrill Lynch during the past year with regards to the acceptance of federal bailout money, while the SEC's investigation is focused on whether shareholders were wronged by BofA's lack of disclosure of executive compensation. [22] As stated before, in dealing with Congress, BofA's employees are not able to invoke the attorney client privilege and would be forced to share information regarding the legal advice given by its corporate counsel. [23] In response, BofA would be forced to supply information that would normally be sheltered by the attorney client privilege in investigations by the SEC and New York attorney general Andrew Cuomo. This is due to its disclosure of such information to Congress in its investigation. [24]

In his order, Judge Rakoff states that the persons who really suffer from the settlement deal between the SEC and BofA would be the investors. [25] However, if allowed this precedent of forcing the company to disclose its private legal communications would also harm the shareholders. If corporate lawyers are not able to discuss private legal matters with its corporate clients for fear that they will be held liable for wrongdoing, the costs of corporate counsel will begin to skyrocket to account for the potential cost of litigation and settlements stemming from such conduct. This cost would be indirectly borne by the shareholders.

This would also cause corporate counsel to be fearful of providing legal assistance to a corporation regarding certain matters. Attorneys will fear that they will be held liable and would not be protected by the attorney client privilege. This would also be detrimental to the corporation and shareholders in that there would not be adequate legal representation based on full and accurate disclosure of all legal possibilities due to the lawyer's fear of liability. As stated by Susan Hackett, senior vice president and general counsel for the Association of Corporate

Counsel, corporate lawyers would be unable to do their job effectively if they did not trust that the company will protect materials covered by the attorney client privilege. [26] This policy is one that we should adhere to the fullest in order to protect the investors, corporation and the field of corporate law itself.

V. Conclusion

While expanding liability to more individuals may seem to be in the spirit of the SEC, such an expansion would greatly hinder the ability of corporate lawyers to best defend their clients. By forcing a corporation to waive its attorney client privilege, shareholders and the corporation itself suffers as a result. While initially, it may be in the best interest of the shareholders of the specific corporation in general, this breakdown in the attorney client privilege would set bad precedent and lead to a slippery slope of corporate attorney liability which would, in effect, deny the corporation sufficient legal counsel. The shareholders would also bear the effects of this policy in the rising rates of corporate attorneys due to fear of liability if the attorney client privilege does not stand. The attorney client privilege has, in the past, been balanced with competing interests, however, the interests in adequate legal counsel and protecting the field of corporate law greatly trump the policies set forth by forced waiver of this privilege. [27]

[1] Press Release, Securities and Exchange Commission, SEC Charges Bank of America for Failing to Disclose Merrill Lynch Bonus Payments, http://sec.gov/news/press/2009/2009-177.htm (August 3, 2009).

[2] Louise Story, *Congress Aims to Force Bank of America to Give Details on Merrill*, N.Y. TIMES, Sept. 21, 2009, *available at*http://www.nytimes.com/2009/09/21/business/21bank.html.

[3] *Id.*

[4] *Id.*

[5] *In re* Grand Jury, 475 F.3d 1299 (D.C. Cir. 2007).

[6] Plaintiff Compl., Sec. Exch. Comm'n v. Bank of America, No. Civ. 6829 (S.D.N.Y. August 23, 2009), *available at*http://www.sec.gov/litigation/complaints/2009/comp21164.pdf.

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

[8] *Id.*

[9] Marcy Gordon, *Bank of America Trial With SEC Coming*,HUFFINGTON POST, Sept. 22, 2009, *available at*http://www.huffingtonpost.com/2009/09/22/bank-of-america-trial-wit_n_294437.html.

[10] Plaintiff Compl., Sec. Exch. Comm'n v. Bank of America, No. Civ. 6829 (S.D.N.Y. August 23, 2009), *available at*http://www.sec.gov/litigation/complaints/2009/comp21164.pdf.

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

[12] Sec. Exch. Comm'n v. Bank of America, No. Civ. 6829 (S.D.N.Y. Sept. 14, 2009), *available at*http://online.wsj.com/public/resources/documents/bofaorder914.pdf.

[13] Zachary A. Goldfarb, *Judge Says SEC Failed Investors*,WASHINGTON POST, Sept. 15, 2009, *available at*http://www.washingtonpost.com/wpdyn/content/article/2009/09/14/AR2009091401671.html.

[14] *Id.*

[15] Loren Steffy, *Judge Speaks Justice to Wall Street*, HOUSTON CHRONICLE, Sept. 18, 2009, *available at*http://www.chron.com/disp/story.mpl/business/steffy/6626409.html.

[16] Sec. Exch. Comm'n v. Bank of America, No. Civ. 6829 (S.D.N.Y. Sept. 14, 2009), *available at*http://online.wsj.com/public/resources/documents/bofaorder914.pdf.

[17] *Id.*

[18] *Id.*

[19] ABA Task Force Mission Statement, http://www.abanet.org/buslaw/attorneyclient/home.shtml (last visited Oct. 8, 2009).

[20] Nathan Koppel, *Ashby Jones, and Amir Efrati, Law Firms Put in an Unfamiliar Spot*, WALL ST. J., Sept. 16, 2009.

[21] Story, *supra* note 2.

[22] *Id.*

[23] Letter from Edolpus Towns, Chairman, House Committee on Oversight and Government Reform, to Kenneth Lewis, Chief Executive Officer and President, Bank of America Corporation (September 18, 2009)http://www.huffingtonpost.com/2009/09/20/congress-aims-to-force-bo_n_292931.html.

[24] Story, *supra* note 2

[25] Sec. Exch. Comm'n v. Bank of America, No. Civ. 6829 (S.D.N.Y. Sept. 14, 2009), *available at*http://online.wsj.com/public/resources/documents/bofaorder914.pdf .

[26] Kimberly Atkins, *AG Michael Mukasey: Attorney-client privilege policy may change*, LAWYERS USA, Feb. 25, 2008,http://www.allbusiness.com/government/government-bodies-offices/8896391-1.html.

[27] ABA Task Force Mission Statement, *supra* note 19.

FREE TRADE VERSUS PROTECTIONISM: A TAXING DEBATE

I. Introduction

President Obama's September 11th decision to restrict imports of Chinese tires has sparked a taxing debate both domestically and abroad. On top of the preexisting four percent tariff on all tire imports, the president determined to impose additional *ad valorem* duties upon certain passenger vehicle and light truck tires from China, designed to taper down from 35 to 30 to 25 percent over three years. [1] China responded within days by raising a World Trade Organization ("WTO") challenge to the safeguard, alleging that Obama's actions are inconsistent with existing international laws. [2] Meanwhile, the proclamation has incited both criticism and praise from a variety of domestic and foreign interests. This article will assess the legality, consequences, and judiciousness of implementing such a tariff and conclude with a word on the free trade versus protectionism debate.

II. Background

The tire tariffs are in response to a United Steelworkers complaint about the impact of cheap Chinese tire imports on the U.S. economy. The union brought the action to the International Trade Commission ("ITC") in April, citing that from 2004 to 2008, imports of cheap consumer tires from China increased 215 percent, boosting Chinese market shares of tires in the U.S. from 4.7 percent to 17.3 percent while domestic production declined by roughly 25 percent. [3] As a result, United Steelworkers allege that over 5,000 American tire workers have lost their jobs and four tire plants have closed about the nation, with three more to close this year. [4]

The ITC, a bi-partisan, quasi-judicial agency created by the United States to provide guidance to Congress and to the president on trade matters, returned a recommendation of stepped tariffs over three years in amounts of 55 percent, 45 percent, and 35 percent, respectively. [5] President Obama heeded the recommendation, but enforced the tariffs at somewhat lower rates in order to reduce but not to prohibit Chinese tires in the U.S. market. [6]

III. Legality

China's WTO challenge is based on the premise that the U.S. tire tariff is inconsistent with Article I:1 of the General Agreement on Tariffs and Trade ("GATT") of 1994. [7] The GATT, the treaty that is the predecessor to the WTO and the foundation from which the WTO was born, was created to facilitate the reduction of barriers to international trade. [8] Article I establishes one of the GATT's most fundamental rules, the "most favored nation" principal, a non-discrimination regulation which states that conditions pertaining to the most favored trading nation must apply to all member-states of the WTO. [9] Although China's assertion that the tire tariffs violate the GATT because they apply solely to China is sound, there are several exceptions to Article I that the WTO will take into account.

The first relevant exception is the *Agreement on Safeguards* of Article XIX of the GATT 1994 and Section 201 of the Trade Act of 1974. Article XIX allows a nation to implement temporary safeguard measures when imports are found to cause or to threaten serious injury to a domestic industry. [10] However, as the *Agreement on Safeguards* requires adherence to strict substantive and procedural regulations, including that safeguards be applied on a non-selective basis [11], the exception is not likely to apply in the present case.

The exception in contention is contained in the Protocol on the Accession of the People's Republic of China and in section 421 of the Trade Act of 1974. [12] When China joined the WTO in 2001, it signed an Accession Protocol whereby it agreed to allow other WTO members the right to impose safeguard relief on goods from China when imports of the goods are in such increased quantities as to cause market disruption to the acting country's domestic industries. [13] Under section 421, safeguard relief can be granted on a lower standard than in section 201 – a standard of "material injury" instead of "serious injury" to the competing domestic industry. [14] As the objective of the Accession Protocol is to allow the other WTO members a period of adjustment, the China-specific protocol was determined to last for twelve years and is to terminate in 2013. [15] The United Steelworkers filed their complaint pursuant to section 421 of the Trade Act, and upon investigation the ITC found the required material disruption to the U.S. domestic tire industry. [16] The president responded by implementing the ITC's recommendation, effectively exercising his option to utilize the existing trade laws. As a result, China is unlikely to succeed on its WTO challenge.

IV. Debate

The benefits of the tire tariffs are contentious. Obama's decision drew a fair amount of praise, but more commonly criticism both from within the nation and abroad. Both sides are adamant in their positions.

Acclaim for Obama's actions rang loudly from The United Steelworkers. Although the union had originally sought quotas from the ITC, it was receptive to the idea that the tariffs will provide effective economic relief domestically. [17] The United Steelworkers remain optimistic despite analyst opinions that should the price of Chinese-made tires increase, domestic businesses will simply shift to other low-cost producers to obtain cheap tires [18]. The union states that

alternative low-cost sources are few and have limited capacity to supply the U.S. market. [19]

Advocates of the tariff cite that China itself is in violation of international trade law through its labor and business policies. [20] Proponents of protectionism cite moral grounds for enforcing trade barriers against China, including the Chinese government's own questionable business practices and its brutal labor policies in violation of safety conditions and of its own national minimum wage. [21]

Free trade advocates maintain several arguments against the tariffs. First, they state that the tariffs will not benefit American domestic industry and are even harmful to advancing domestic and global interests – the comparatively higher cost to produce the tires in the U.S. renders the business uncompetitive, and raising tariffs will do little to remedy this in the long run. [22] As a protectionist policy can only impede growth, the focus should not be on protecting businesses that will inevitably be phased out, but on otherwise regenerating growth at home and abroad. [23]

Critics are also afraid that the tire tariff can set a dangerous precedent that may spark a trade war between the U.S. and China. [24] Riding on the victory of the tire tariffs, United Steelworkers, in conjunction with three paper manufacturers, have filed a new trade case against Chinese imports of coated paper. [25] Many fear that protectionist tariffs will heighten bilateral tensions and cause a China-U.S. trade war as textile and steel producers start to follow suit. [26] Within 24 hours of Obama's proclamation, China announced antidumping trade investigations into U.S. poultry and automobile parts [27], an action that observers were quick to label as retaliation. [28]

A trade war would be disastrous for both parties as bilateral trade accounted for more than $400 billion dollars in 2008, and China-U.S. trade accounts for around 12 percent of the total U.S. trade and 13 percent of total Chinese trade. [29] A trade war between the U.S. and China could lead to severe ramifications for already contracting global trade. [30] With China at the forefront of the battle for global economic recovery [31], a deterioration of the Chinese economy would be disastrous for all international actors.

Finally, some fear that China could pressure the U.S. by refusing to purchase U.S. Treasuries. [32] In September of this year, China became the largest holder of U.S. government debt, holding over $585 billion dollars. [33] Volatile China-U.S. relations could affect U.S. interest rates and lead to unnecessary volatility in the domestic money market, cascading yet again into injurious consequences for global economic recovery. [34]

V. Analysis

While the China tire tariffs may be legally sound, its principle and application are in conflict with the very purpose of the WTO, which was created to promote and advance the prospect of free trade. China has been a member of the WTO for eight years, and China-U.S. trade relations existed long prior to China’s accession into the WTO [35]. The current action seems to arise not out of a need for an "adjustment period" but rather out of the standard consequences of free trade. Absent the Accession Doctrine, the China-specific safeguard falls short legally as it directly contradicts the most favored nation principal as well as the key tenant of the WTO that safeguard measures must be applied on a nondiscriminatory basis. Despite falling within the word of the law, the tire safeguard is at odds with the spirit of progressing international law.

However, while economics agree that a policy of free trade is preferable to a policy of protectionism by margins of up to 100 to 1 [36], no industrialized

country has ever adhered strictly and indefinitely to a policy of free trade. [37] In a free trade system, there are always losers as well as winners, but the net gain is said to offset the loss. [38] What happens when one nation is continuously the loser? One can say that a government has a duty to its own people over those not within its constituency, and therefore one cannot expect any government to ignore the immediate welfare and morale of its people. Consequently, the occasional protectionist policies will and should occur despite not being the most beneficial ones on a global economic scale.

While balance in a system of interdependent states is often seen as precarious, the economics of self-interest will demand that each state looks out for itself by carefully heeding its relationships with each other state. As a result, the framework that ties each actor together may be stronger than observers believe.

Many analysts believe that the tire tariffs will in reality have minimal impact. [39] Chinese tire exports constitute less than 1 percent of China's total exports to the U.S., an amount that is insignificant in view of China's total export volume. [40] The Automotive Trade Policy Council calculated that at the tariff rates implemented by Obama, the additional cost per tire would amount to less than $3.50. [41]

Because of heavily intertwined economic interest between both nations, a major escalation is unlikely. [42] President Obama announced on September 15th that the tire tariffs will not spark a trade war and is in fact a step toward expanding trade in the long run [43], alluding to the notion that he recognizes that open markets are a fundamental catalyst of economic recovery. [44] His imposition of a lesser tariff than originally recommended by the ITC also lends to this recognition as well as to his desire not to grievously injure China-U.S. relations. He is

unlikely to entertain further protectionist demands in light of the severe detriments a trade war can cause, and likewise, while China must act tough to quell resentment and to promote public image, the Chinese government will tolerate much to avoid social discontent in the form of lost jobs. [45] It is also unlikely that China will respond by halting its purchase of U.S. Treasuries, as doing so would slash the value of its own foreign reserves. [46]

While many fear China's announcement of antidumping investigations as a retaliatory response to the tire tariffs, there is a substantial argument that it is a coincidence or a setup; a large bureaucracy such as China is unlikely to be able to announce such investigations in less than twenty-four hours response time, and the poultry dispute had previously existed between China and the U.S. [47] Dr. Elliot J. Feldman proposes that instead of viewing China's actions through a lens of retaliatory fear, China's actions actually signify its maturation as a major world power willing to accept the legitimacy of international institutions and their disciplines. [48] China's increasing acceptance of international law further promotes the notion that China will not retaliate illegitimately without the approval of the WTO.

VI. Conclusion

Normally an avid advocate of free trade, the U.S. employs selective protectionism that is contrary to the spirit of progressive globalization and to the goals of the WTO. Nonetheless, occasional protectionist policies employed by member-states are natural and to be expected; in light of the legality of the tire tariffs and their low economic impact, major consequences are unlikely.

The tariffs can be seen as a wise move, as domestically they aim to effectively please labor unions, to raise industry morale, and to give the president political

clout. Internationally, there remains much to be considered outside of economics; the president must be careful not to injure foreign relations and to upset the balance that the global economy rests upon, a contention that he is undoubtedly aware of. While the occasional tariff like this one will ultimately pass without dire consequence, continued protectionist policies may trigger the very trade wars that critics fear. However, as long as each state looks out for itself by regarding the reactions of each other, entwined economic interests will ensure that the occasional exclusively self-serving measure will not destroy the equilibrium.

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RENEWABLE ENERGY: LOOKING TOWARD THE FUTURE

I. Introduction

Rising gas prices and an increasing awareness of the environmental consequences associated with the use of fossil fuels have spurred the development of the biofuel industry. "From being merely an interest of marginal innovators, it has become a multi-million dollar business – transforming economies – thanks to rising attention and support from governments and the public."[1] With the US consuming nearly 20.8 billion barrels of oil per day, and with OPEC officials claiming they will not be able to meet the projected western oil demands in 10 to 15 years, the prospect of meeting our energy needs through homegrown and renewable resources is becoming more appealing.[2],[3] But this seemingly cut and dry solution to the US dependency on fossil fuels is not as simple as it appears. The actual economic and environmental benefits realized by relying more heavily on biofuels is hotly debated, and due to the fluid nature and unpredictability of the world market, concrete answers are hard to come by. Before considering the impact of a switch to biofuels, it is important to understand the true costs of our current oil dependency.

II. The True Costs of Oil Dependency

Through 1970 to 2005, US dependence on foreign oil has cost the US economy nearly $8 trillion.[4] The costs associated with oil dependency are not limited to the price of a gallon of gas, "they are the transfer of wealth from the United States to oil producing countries, the loss of economic potential due to oil prices elevated above competitive market levels, and disruption costs caused by sudden and large oil price movements."[5]. "Recent studies estimate that every $1 billion of trade deficit costs America 27,000 jobs.[6] "Oil imports account for almost one-third of the total U.S. deficit and, hence, are a major contributor to

unemployment."[7] Furthermore, it is estimated that $50 billion is spent each year securing our access to oil in the Middle East.[8] The cost of oil dependence is not limited to imports versus exports, oil dependency seeps into a wide swath of the U.S. economy. Also, the environmental costs associated with the production and use of oil, including the damage done by oil spills, drilling and extraction, and the emissions produced from the burning of fossil fuels, needs to be taken into consideration.

As you can see, the cost of oil dependence is not merely limited to the amount the average American pays per gallon at the pump. With demand for oil on rise, and the crude oil production expected to peak in 2037, a in-depth analysis of the pros and cons of biofuels is needed.[9]

III. The Switch to Biofuels and its Economic Impact

A study done on the U.S. Renewable Fuel Standard, which provides for the amount of renewable fuels which must be blended with gasoline starting in 2006 and going through 2022, concluded that "direct job creation from advanced biofuel production could reach 29,000 jobs by 2012, rising to 94,000 jobs by 2016, and 190,000 jobs by 2022.[10] Total job creation, accounting for economic multiplier effects,could reach 123,000 jobs in 2012, 383,000 in 2016, and 807,000 by 2022."[11] Also, economic output from the biofuels industry, including capital investment and research and development "is estimated to rise to $5.5 billion in 2012, reaching $17.4 billion in 2016, and $37 billion by 2022."[12] "Taking into consideration the indirect and induced economic effects resulting from direct expenditures in advanced biofuels production, the total economic output effect for the U.S. economy is estimated to be $20.2 billion in 2012, $64.2 billion in 2016, and $148.7 billion in 2022."[13]The production and use of biofuels not only reduces the costs associated with our dependence on foreign oil, it further stimulates the economy by introducing a new domestic

energy industry, by providing jobs to people, and by providing lower production costs to businesses.

IV. Problems with the Use of Biofuels

The production of biofuels itself requires energy, from the use farm machinery, to producing fertilizer, to transportation of the finished product. "To be a viable substitute for a fossil fuel, an alternative fuel should not only have superior environmental benefits over the fossil fuel it displaces, be economically competitive with it, and be producible in sufficient quantities to make a meaningful impact on energy demands, but it should also provide a net energy gain over the energy sources used to produce it." [14] A positive net energy benefit is achieved when biofuel energy content exceeds fossil energy input. [15] While the net energy benefit of corn based ethanol is 25% over gasoline, wholesale costs of gasoline in 2005 were $0.44/liter, the production costs alone of the energy equivalent liter of ethanol (EEL) were $0.46/EEL. Also, the production cost of soybean diesel is $0.55 per diesel EEL, while the wholesale price of diesel is $0.46/liter.[16] These numbers prove that without government subsidies, steadily increasing petroleum costs, and environmental concerns, biofuels would simply not be economically viable or competitive in the global energy market. Also, increased demand and production of biofuels around the world has lead to deforestation, negating possible environmental benefits from the use of biofuels.[17] "A 2006 study done by the research group LMC International found that increasing biofuel production to a point where it provided 5% of global fuel needs by 2015 would require expanding the acreage of all cultivated land worldwide by 15%.[18] Dedicating all U.S. corn and soybean production to biofuels will meet only 12% of gasoline demand and 6% of diesel demand.[19] Deforestation accounts for 20% of all current carbon emissions, and the destruction of forests, wetlands, and grasslands, for the purpose of growing

crops to produce biofuel, is destroying the environmental benefits of using biofuels in the first place.[20]

Finally, switching land from food production to fuel production has increased food prices around the world. A study done by the IMF in 2007 found that, "One country's policy to promote biofuels while protecting its farmers could increase another (likely poorer) country's import bills for food and pose additional risks to inflation or growth."[21] The expansion of biofuel production could affect food security though four major dimension: availability, access, stability, utilization.[22] Availability and access to food will be effected because food production will suffer with producers favoring biofuel production.[23] Stability may be affected because a switch to biofuel production may make food prices more volatile.[24] And utilization refers to the health concerns associated with diverting time and resources away from having cheap and healthy food.[25] On the other hand, technology is advancing constantly, and research on non-food based biofuels, such as cellulosic ethanol, can be produced with far less inputs and on marginally efficient land.[26] Research in the area of advanced biofuel is creating hope for new sources of biofuel that will reduce the drag on food supplies, while at the same time produce a less costly and more efficient source of energy.

V. Important Biofuel Legislation

In 2005, Congress passed the Energy Policy Act of 2005. The Act provided $14 billion to the Department of Energy, and authorized the Department to partner with industrial and academic institutions in order to conduct research and develop advanced biofuels that are cost competitive with gasoline and diesel.[27] Because it was aimed at combating one of the major problems associated with biofuels, its cost competiveness, it was an important piece of biofuel legislation.

The Energy Independence and Security Act of 2007 was also a milestone in the history of the biofuel industry because it created a more aggressive Renewable Fuel Standard, calling for the production of 36 billion gallons of renewable fuel, 21 of which from advanced biofuels, by the year 2022.[28] Also, it requires automakers to increase the average mileage of new vehicles to 35 miles per gallon by 2020.[29] Finally, the Act created incentives for research and development in the area of advanced biofuels by allocating $500 million for awards for grant programs that propose biofuels and technology that have the greatest reduction in life cycle emissions as compared to comparable motor vehicle lifecycle emissions.[30] This Act was important because it set goals for the future and took an active part in directing and funding vital research.

More current legislation, like the American Recovery and Reinvestment Act of 2009, appropriated $786.5 million to the U.S. Department of Energy's Biomass Program.[31] Most of the funding will be aimed at the production of new biorefineries, with awards incentivizing the refineries that can be built and operational in the shortest amount of time. Most of the remaining funds are to be spent accelerating and expediting the construction of refineries already in the initial construction stages.[32] One of the most recent pieces of biofuel related legislation is no more than an amendments to a Senate appropriations bill for Interior Department funding, and is still currently under consideration.[33] One of the proposed measure would direct the Environmental Protection Agency (EPA) to allow gasoline to contain up to 15% ethanol blend, 5% more than the maximum of 10% currently allowed by law.[34] Another measure in this amendment calls for the delay of the adoption of a rule proposed by the EPA that would penalize biofuel producers for environmentally-damaging land use.[35] It is still unclear if vehicles can run efficiently on 15% blends, or if the penalty rule is necessary to curb deforestation and land clearing activities.[36]

VI. Conclusion

While our dependency on oil has cost the U.S. trillions of dollars and has done immeasurable damage to the environment, renewable sources of energy are also riddled with drawbacks. Even though the benefits of biofuels may be exaggerated and their costs downplayed by some, there is no doubt that biofuels are the lesser of two evils when compared with oil. It does not matter whether new technology will make hidden oil reserves available or more cost efficient to extract, oil is simply a finite resource. Even if oil can still be extracted for years to come, the rise in demand and the fall in supply of oil will make it increasingly expensive and inefficient. Thankfully, government agencies have recognized this and have passed legislation aimed at the research and development of biofuels, building biofuel refineries, and increasing the consumption of biofuels across the country and the world. The science of renewable energy is developing all the time, and even though many questions still need to be answered with regards to the feasibility and sustainability of biofuels, it is safe to say that biofuels will be one, if not the main source of energy for the future.

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HAVE HOMEOWNERS ASSOCIATIONS CROSSED THE LINE? HOMEOWNERS ASSOCIATIONS ARE QUICK TO PURSUE FORECLOSURE FOR UNPAID ASSESSMENTS

I. Introduction

Common Interest Communities have become a way of life for the American people. Millions of Americans reside in gated communities governed by homeowners associations. [1] These communities are growing in popularity for numerous reasons. One such reason is that families want to live and raise their children in an environment that fits their needs and desires. [2] Another reason is that people feel a sense of security and stability in a gated community. [3] However, these communities have not escaped strong criticism for their burdensome restrictions, excessive regulation and aggressive enforcement. Critics argue that the disadvantage of living in such a community is that homeowners have to comply with a myriad of restrictions and covenants and failure to do so can result in fines. [4] Critics also allege that the zealous homeowners associations often times abuse their powers when enforcing the rules and penalties. [5]

With the current economic crisis homeowners associations are faced with difficult choices of how to keep the community alive but also keep members in their homes. As the economy is getting worse homeowners are not only falling behind in their mortgage payments but they are also struggling to pay their monthly assessment fees. [6] As more homeowners leave the area, those remaining have to take the burden of paying additional fees to maintain their communities. [7] This is raising a myriad of issues concerning what should be done to keep

these communities alive. In many states, associations are pursuing non-judicial foreclosure against homeowners who have not paid their assessment fees. [8] Many homeowners are outraged because they may be on the verge of losing their primary residence and their largest investment. [9] What can homeowners associations do to collect their unpaid fees? Should resorting to foreclosure be an option or is that an abuse of power? Should homeowners associations have to pursue other remedies to collect their debt before resorting to foreclosure? What are the limits on the power of homeowners associations? What can homeowners do to prevent foreclosures? What is the role of the courts and the legislature to put limits on the power of homeowners associations?

This article considers and criticizes the current laws that have been enacted in several states and proposes solutions to address these questions. Specifically, this article will focus on non-judicial foreclosures which accord less protection to the homeowners. [10] Part II discusses the general structure and law governing common interest communities. Part III analyzes how various states have responded to the issue of homeowners associations pursuing non-judicial foreclosure on members who fail to pay their assessments. Finally, Part IV combines the various state approaches and creates a solution that attempts to address the concerns of the homeowners associations and the members.

II. The Structure of Common Interest Communities

Common interest communities consist of properties that are burdened with restrictions controlling the use of the property, requiring homeowners to pay assessments for maintenance of the community property, and assessing fines for violations. [11] The restrictions are imposed in the community's declaration of covenants, conditions, and restrictions, the bylaws, and the rules adopted by the board or the owners. [12]

Common interest communities are managed by a board of directors elected by the owners. [13] The declaration outlines the power of the board of directors to collect assessments from individual homeowners for the maintenance of common areas and to take actions against owners that fail to pay their assessments, such as placing a lien on the property or pursuing foreclosure if the assessments are not paid. [14] Furthermore, the board of directors can charge a late fee with interest for delinquent assessments. [15]

Common interest communities are typically incorporated as non-for-profit corporations and governed by a board of directors. [16] Therefore, the principles of corporate law apply to the decisions of the board of directors. [17] For instance, courts apply the business judgment rule when assessing the board's actions. [18] Consequently, the court will not interfere with the board's decision unless it appears that there fraud, self-dealing, or unconscionable conduct. [19] This gives the board of director substantial discretion to decide what type of method to use when collecting unpaid assessments. [20] With the current economic conditions, this is becoming a growing concern because there has been a substantial increase in the amount of homeowners being unable to pay their assessments. [21] As a result, homeowners associations are increasingly foreclosing on property owners for minor unpaid dues. [22] Do homeowners associations have the power to foreclose on a member's property for failing to pay assessments?

In most states homeowners associations have the power to foreclose on property for unpaid assessments. The courts in various states have reasoned that the homeowner's association's lien on the property for unpaid assessments constitutes an interest in real estate to secure debt and therefore can be foreclosed upon. [23] Furthermore, most state statutes contain a provision allowing foreclosure for unpaid assessments. [24] With the current economic conditions, the homeowner's

association's unregulated power to pursue foreclosure is becoming a growing concern because there has been a substantial increase in the amount of homeowners that are unable to pay their assessments. This article will focus on whether the homeowners associations are abusing their power and resorting to foreclosure for low amounts of debt without exhausting other remedies. Many states have responded to this growing concern by enacting legislation restricting the association's power to foreclose on property.

III. Proposed Legislation

The following is a brief survey and critique of three states that have enacted or attempted to enact legislation to deal with homeowners associations foreclosing on properties for unpaid assessments.

A. Texas Legislation

The Texas legislature has been consistently fighting over the past several years to restrict the powers of homeowner associations, especially with regards to foreclosure. Republican Senator Burt Solomons, who has been the lead proponent of the bills, stated that "things have gotten out of control with homeowners associations … it's amazing that the courts have allowed them to foreclose on homesteads for something as minor as getting behind on association dues…we have to restore some balance." [25] Senator Solomons, along with several other Texas state senators, proposed four bills significantly restricting homeowners' associations' rights to foreclose on property but only one has been enacted into law. [26]

The first proposed bill was designed to limit the homeowners' associations' powers to foreclose on properties by requiring them to take preliminary steps before resorting to foreclosure. [27] For instance, the bill would require a homeowners association to "visit a board member before any foreclosure, stopping a foreclosure if a homeowner paid back dues or agreed to a payment

plan, and extending the time a foreclosure owner could buy a home back." [28] This bill was never signed into law. [29]

The second bill called for homeowners associations to reimburse a property owner if their home was sold for less than the most recent appraisal of the property. [30] The homeowners association would have to reimburse the owner the difference between the sale price and the appraisal value. [31] This bill was also not passed into law. [32]

The third bill which has been passed into law restricted the power of homeowners associations to pursue foreclosure for unpaid attorney's fees or overdue fines. [33] The bill also allows home owners to redeem their property 180 days after the foreclosure sale. [34]

Finally, there has been another recently proposed bill that would drastically limit the power of homeowners associations. The proposal is to submit a "constitutional amendment to Texas voters that would prohibit foreclosures by associations on homesteads within their jurisdiction." [35] The bill would still allow the association to place a lien on the property for which they can receive payment once the owner decided to sell the house voluntarily. [36] This is expected to receive strong opposition and probably will not be passed into law. [37]

Despite the active role of the Texas legislature in trying to reform the rights of homeowners little has actually been done. The most recent proposal, taking away the power of homeowners associations to foreclose, is an extreme solution and will not work for several reasons. First, this type of solution does not effectively deal with the problem of homeowners not paying their dues. Rather it gives homeowners a chance to take advantage of the system and avoid their obligations to the community. Second, this would nullify the power and authority of the board and threaten the existence of the association because the association will

have no recourse against delinquent homeowners. [38] The current law gives homeowners more time to redeem their property but does not address the issue of foreclosing for unpaid assessments.

B. California Legislation

Similarly, in California homeowners associations were accused of abusing their powers and pursuing non-judicial foreclosures to collect relatively small debts. For instance, people were losing their homes in California for failing to pay a couple hundred in dues. [39] While these may be extreme examples the legislature in California noticed and decided to take action. Senator Denise Moreno Ducheny sponsored a bill that would require homeowners associations to use small claims court to collect unpaid assessment sums below $2,500. [40] Ducheny told the Senate Committee hearing for the bill that "often for less than $200 people are losing their homes and being evicted without the due process rights given to tenants…we understand the need for everyone to pay their agreed-upon debts, but we also want to protect the equity of homeowners and their due process rights." [41]

The proposed bill was amended several times and became effective January 1, 2006. [42] Known as Chapter 452, the new law would greatly limit the power of homeowners associations to foreclose on properties. Under Chapter 452, homeowners association can pursue judicial and non-judicial foreclosure only if the assessment debt is $1,800 or more and the debt must also be more than 12 months delinquent. [43] If these requirements are not met the homeowners association can file a civil action in small claims court to collect the debt. [44] Alternatively, the homeowners association can file a lien on the property upon which it can foreclose later after the $1,800 or 12 month delinquency thresholds are met. [45]

Chapter 452 also toughens foreclosures notices and provides procedures that the board of directors must follow when deciding whether to pursue foreclosure. For instance, the homeowners association's board of directors "must make a formal decision to foreclose upon a lien at an executive meeting of the board, by a majority vote, and at least 30 days prior to any foreclosure auction to sell the property." [46] The association must also send legal notification to the homeowner regarding the foreclosure and provide an itemized list of the delinquent assessments. [47] Finally, the law also provides that homeowners associations should participate in alternative dispute resolution to settle the disputes before resorting to litigation or foreclosure.[48] For instance, a homeowner has the right to seek a meeting to discuss the delinquent debts and try to figure out a way to pay back the assessments. [49] There are also options for a formal arbitration process where a neutral third party mediates the dispute. [50] California's law is the best approach to dealing with the foreclosure issue but it also has its drawbacks. First, the law significantly restricts the homeowners' associations' power to foreclose on properties for unpaid assessments. This addresses the possibility of the board of directors abusing their power and makes them take preliminary steps before resorting to such a drastic measure. This approach strongly encourages alternative dispute resolution which is in the best interest of the property owners and the association because it saves costs and time. However, the law does not effectively address the issue of transparency in the board's decision making process or the lack of communication between the board and the members.

C. Nevada

Finally, Nevada, among several other states, has proposed solutions focusing on alternative dispute resolution and increased transparency of the board's decision making. For instance, Nevada's legislature passed a law in 1991 that was designed to increase the rights of homeowners in common interest

communities. Specifically, the bill provides that members may attend and speak at all of the association's meetings. [51] In addition, the bill provides homeowners with greater access to financial statements of the association. [52] For instance, the homeowners associations are required to send the members an annual statement of the association's budget. [53] Members shall have open access to all financial documents except those dealing with the individual owner's unit. [54] Furthermore, before any litigation the association must send a statement to the owners describing the potential costs of the litigation and an explanation of the benefits and risks. [55] In addition, the law restricts the power of homeowners associations to pursue foreclosure for unpaid fines and places a cap on fines which may not exceed $100 per violation or a total of $500, whichever is less. [56] Finally, an Office of the Ombudsman for Owners in Common Interest Communities was created which was designed to provide education to homeowners and board members to help them better understand their rights and obligations under the governing documents and state laws. [57]

Even though Nevada's law may not be as comprehensive as the measures taken in California it provides a good idea of possible ways to increase the transparency of the board's decision making process. Providing greater access to financial statements and allowing members to attend and speak at board meeting provides members with the ability to get involved in the decision making process. It also gives homeowners a chance to evaluate the financial condition of the community and determine whether foreclosure is necessary. Foreclosures have the tendency to bring down the value of homes in the neighborhood and also increase the assessment fees for other members. [58] Therefore, giving members a chance to participate in the decision making process the rate of foreclosure may decrease. Also, creating an office which provides information to the board members and homeowners is a great way to ensure that the decisions are as a

result of an informed board and homeowners are aware of the risks and disadvantages of the their actions.

While this bill increases transparency and communication among board members and property owners it does not address the issue of foreclosing on property owners for unpaid assessments. More limits are necessary on homeowners' associations' power to pursue foreclosure because there is a possibility of abuse. [59]

IV. Solution

An effective solution to this problem is going to take a balanced approach to the issue. There needs to be a balance between the individual homeowner's interest in preserving their equity and the association's interests in preserving the community.

A. Minimum Threshold Required Before Pursuing Foreclosure

The California approach has put reasonable limits on the homeowners association but can still use improvement. First, creating a minimum debt that the homeowner must accumulate before foreclosure is pursued is a good way to approach the problem. Homeowners associations should not be foreclosing on people for owing just a couple hundred in debt when their house has greater. [60] Therefore, placing a limit will prevent the abuse of power and will give the homeowner a chance to remedy the problem before foreclosure is pursued. [61] The legislature should consider increasing the limit from $1,800 to provide greater protection for homeowners. The reason greater protection is necessary is because "a home is one of the most valuable assets a person may ever own." [62] In addition to the minimum threshold, requiring the homeowners associations to take the delinquent property owner to small claims court to recover the unpaid assessments is a good

way to make the associations pursue other remedies before resorting to foreclosure.

B. More Transparency in the Board's Decision Making

Creating transparency in the board's decision making process will prevent the abuse of power and will make it easier to hold the board accountable when there has been wrongdoing. Transparency makes the decision making process look legitimate and makes it easier for the homeowners and the court to evaluate whether there has been wrongdoing. Some possible ways to accomplish transparency is by making the board members provide written financial statements of the homeowners' delinquent fees, providing notice when there are delinquencies, and meeting with the homeowners to discuss a possible solution to the problem. [63] Furthermore, providing the time and place of all the board's meetings and making all the information available to all parties is necessary to increase transparency.

C. Increased Communication between Members and Homeowners Associations

Increasing communication between the members and the homeowners association will help solve this problem. Many homeowners do not have a positive opinion of the board of directors. [64] While this may be a natural reaction because the board is required to enforce the restrictions, impose fines, and take other unfavorable measures against members this does not have to be a cruel and hostile process. By increasing communication this can increase the feeling of community and understanding among the members and the homeowners association. First, the homeowners association should let the members express their opinions and provide insight into what is happening in the community. [65] For instance, when a member is facing foreclosure the homeowners association should let all the members provide insight at the meeting and try to propose solutions. This will help the members feel that they also have a say in what is happening in their

community and will encourage creative solutions to solve the financial difficulties. After all, the attraction of common interest communities is that they are environments where people work together not against each other to live comfortably.

D. Flexibility of Homeowners Associations

Homeowners associations need to be flexible, especially in this struggling economy. Flexibility allows for good relations between the board and the members. That can be accomplished by providing a grace period for owners that cannot afford to pay their fees for a couple months and stopping the accumulation of fees until the homeowners have caught up in making payments. Another possibility is creating a payment plan that can help delinquent homeowners pay back their debts in smaller monthly payments rather than one large sum. [66] This will increase the likelihood that homeowners facing financial difficulties will be able to pay back their debts.

V. Conclusion

The legislature needs to balance the interests of the homeowners associations and the individual members. The new law needs to ensure mechanisms so that homeowners do not take advantage of the system and avoid paying their fees. The law also needs to ensure that homeowners associations are not abusing their powers and pursuing foreclosures when other steps can be taken to cure the debt. These communities constitute a large part of the housing market and truly provide a value to many peoples' lifestyles. Therefore, the solution is not to abolish these communities completely or to enact laws that effectively get rid of their power to function but rather to create a greater sense of community and support by stressing transparency, communication, and flexibility. This type of solution will foster good relations which will improve the value that homeowners place on their community and will give them a desire to remain there in the future.

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[1] Paula A. Franzese, *Privatization and Its Discontents: Common Interest Communities and the rise of Government for the Nice*, 37 URB. LAW 335, 335 (2005).

[2] *Id*.

[3] *Id*.

[4] *Id*. at 340.

[5] *Id*.

[6] Jeff Collins, *Homeowner Association Delinquencies on the Rise*, THE ORANGE COUNTY REGISTER, September 28, 2008.

[7] *Id*.

[8] Jim Wasserman, *For Want of $120, House was lost more Homeowners Association using Foreclosure as Tool to collect dues*, MILWAUKEE JOURNAL SENTINEL, February 22, 2004.

[9] *Id*.

[10] BLACK'S LAW DICTIONARY 674 (8th ed. 2004) (defining "nonjudicial foreclosure", also called "power-of-sale", as "a foreclosure process by which … property is sold at a nonjudicial public sale by a public official, the mortgagee, or a trustee, without the stringent notice requirements, procedural burdens, or delays of a judicial foreclosure").

[11] RESTATEMENT (THIRD) OF PROPERTY (SERVITUDES) § 6.5 (Council Draft No. 8, 1997) [hereinafter RESTATEMENT].

[12] Susan F. French, *Making Common Interest Communities Work: The Next Step*, 37 URB. LAW. 359, 362 (2005).

[13] *Id*.

[14] *Id*.

[15] Gemma Giantomasi, *A Balancing Act: The Foreclosure Power of Homeowners Associations*, 72 FORDHAM L. REV. 2503, 2515 (2004). (focusing on the law in various states regarding homeowners associations this article does not address the issue from the current economic and legal perspective and the solutions proposed are outdated).

[16] Wayne S. Hyatt, Common Interest Communities: Evolution and Reinvention, 31 J. MARSHALL L. REV. 303, 342-343 (1998).

[17] *Id*. at 343-344.

[18] *Id*.

[19] Paula A. Franzese, *Common Interest Communities: Standards of Review and Review of Standards*, 3 WASH. U. J.L. & POL'Y 663, 667 (2000).

[20] Giantomasi, *supra* note 15, at 2515.

[21] Wasserman, *supra* note 8.

[22] *Id*.

[23] *Board of Directors of Olde Salem Homeowners Ass'n v. Secretary of Veterans Affairs*, 226 Ill. App.3d 281, 288 (1992);*Inwood North Homeowners Ass'n Inc. v. Harris*, 736 S.W. 2d 632 (Tex. App. 1987).

[24] DONALD KUPERMAN, ASSESSMENT COLLECTION, IN CONDOMINIUM AND HOMEOWNERS ASSOCIATION LITIGATION: COMMUNITY ASSOCIATION LAW 259 (Wayne S. Hyatt & Phillip S. Downer eds., 1987).

[25] Eric Berger, *Homeowners Association Bill Gets OK/ Some More Stringent Requirements Unlikely to Survive Law Making Process*, HOUSTON CHRONICLE, May 16, 2001.

[26] Giantomasi, *supra* note 15, at 2532.

[27] *Id*.

[28] S.B. 699, 1999 Leg., 76th Reg. Sess., § 207.125(b) (Tex. 1999) at http://www.capitol.state.tx.us/tlo/76R/billtext/SB00699H.HTM.

[29] *Id*.

[30] S.B. 1834, 2001 Leg., 77th Reg. Sess., § 51.008(c) (Tex. 2001), at http://www.capitol.state.tx.us/tlo/77R/billtext/SB01834I.HTM.

[31] *Id*.

[32] *Id*.

[33] TEX. PROP. CODE. § 209.009(1)(2) (West 2009).

[34] *Id*. at § 209.011(b).

[35] Terrence Stutz, *Texas Amendment Would Prohibit HOA Foreclosures*, DALLAS MORNING NEWS, February 28, 2009.

[36] *Id*.

[37] *Id*.

[38] Niki Zupanic, *Keeping Homes off the Auction Block: California Limits Foreclosures by Homeowners Associations*, 37 MCGEORGE L. REV. 199, 200 (2006).

[39] *Id*.

[40] Daniel Yi, *Homeowner Groups' Power to Foreclose Is Under Attack Lawmakers say boards have gone too far by seizing and selling units over minor disputes*, LOS ANGELES TIMES, June 7, 2004.

[41] Jim Wasserman, *Bill Advances to Limit Power of Homeowner Groups to Take Houses*, DAILEY BREEZE, March 30, 2005.

[42] Zupanic, *supra* note 36, at 202.

[43] CAL. CIV. CODE. § 1367.4 (b) (West 2009) (hereinafter referred to as Chapter 452).

[44] *Id*.

[45] *Id*.

[46] *Id*.

[47] *Id*.

[48] *Id*. at § 1367.4(c)(2).

[49] *Id*. at § 1367.1(c)(1).

[50] *Id*.

[51] Frankie Sue Del Papa, *Rules for Homeowners Associations*, 9-MAY NEV. LAW. 10 (2001).

[52] *Id*.

[53] *Id*. at 11.

[54] *Id*.

[55] *Id*.

[56] *Id*. *See also* Michelle Crouch, *New Law to Limit Power of Neighbors: Rules would make foreclosure more difficult, limit some fees*, CHARLOTTE OBSERVER, August 22, 2005. North Carolina legislature passed a similar bill that would reduce the maximum fines assessed by association from $150 to $100 a day and will cap late fees for association dues unless the rules state otherwise. *Id*.

[57] *Id*. at 11-12.

[58] Collins, *supra* note 6.

[59] Giantomasi, *supra* note 15, at 2540.

[60] Zupanic, *supra* note 34, at 204.

[61] *Id*.

[62] *Id*.

[63] Giantomasi, *supra* note 15, at 2537.

[64] Franzese, *supra* note 1, at 336.

[65] Frankie Sue Del Papa, supra note 49, at 10.

[66] Chapter 452, *supra* note 43, at § 1367.1(c)(1).

FROM THE 2016 OLYMPICS GAMES TO ANTITRUST LAW: BRAZIL STEPS TOWARDS GLOBALIZATION

I. Introduction

Rio de Janeiro will be the first Olympic location in the history of South America. This is the result of Brazil gaining status internationally and integrating to the global market. Apart from sports, globalization has had a great impact on the business transactions and also in the rules enacted in Brazil. An increasing number of international merger companies and nations had switched a red light on the antitrust law regime for merger control that coexists in the many jurisdictions.[1] The different views of antitrust law in each country are important to determine the approach and practical implications of the review systems application.[2] In the merger context, there are significant burdens in international business operations when companies are required to comply with a diversity of procedural requirements in domestic regimes regulations. Over sixty nations have merger notification requirements. Transactional costs are elevated when the merging parties have to report and produce detailed information for each jurisdiction to assess the transaction.[3]

This article discusses the challenges and benefits of the harmonization of merger reviews procedures among different countries. Part II identifies the importance of the suggested modifications in the Brazilian antitrust law while seeking the internationalization of the merger review process. Part III describes the likely coming new rules for the Brazilian antitrust organization. Part IV concludes by pointing out the increased convergence to the procedures in effect by the Unites States antitrust authorities.

II. The Marathon for Harmonization in Merger Review Systems

One of the benefits of a merger review process is the identification of prejudicial mergers and the complications of having to piece apart the merger of a previously concluded transaction.[4] There are advantages for consumers and markets to identify and remedy problematic mergers. The detection protects the market against transactions that could lessen competition and increase prices.[5] Also prior notice of mergers reduces post acquisition litigations.[6] According to an estimate of the Department Of Justice, from 1998 to 2008, merger efforts have saved consumers about 20 billion dollars.[7]

Nevertheless, the obligation of merger reviews has its burdens and imposes costs to the companies interested in merging, especially if the merger triggers thresholds in different jurisdictions with diverse merger review system. Those burdens can be divided broadly in two categories: **(a)** high fees and onerous requirements and **(b)**uncertainties in procedural and substantive standards.[8] When companies have to confront nations with premerger and post merger reviews, while the authorities in a nation that adopts a premerger review would be closing its own review of the merger, the authority in the second merger review model will be just getting started with their own analysis.[9] As a result, we have increased uncertainties and delays in the outcome of the transaction.

A harmonization of merger review rules may resolve part of the issues raised above. Despite the obstacles to enforce a harmonization process[10], the movement towards a congruent system certainly diminishes transactional costs in the international business. The dissimilar arrangement of antitrust law reduces efficiency gains in the operations, and can deter companies from the outcome of the business deal. For this matter, the convergence of nations' rules and the cooperation between jurisdictions to a more common approach of merger reviews can bring many advantages for companies and enhance efficiency gains. Likewise, consumers benefit when productive mergers are not discouraged by the excessive costs of numerous compliances.

III. A 5K to a Pre-Merger Review System in Brazil: Bill 3.937/04

Under U.S. antitrust law, authorities analyze mergers to identify potentially anticompetitive transactions and prevent market concentration[11]. The existence of a premerger review system means that U.S. antitrust authorities will analyze the transaction before its consummation, and during this verification period the companies are prohibited to conclude the transaction. As a result, the authorities have the opportunity to challenge a problematic merger and reduce a post-acquisition litigation scenario.[12]

Under Brazilian antitrust law[13], any act that may limit or otherwise restrain open competition or any form of economic concentration (including mergers), or that result in the control of relevant markets for certain products or services, shall be submitted to the antitrust authorities for review.[14] The Brazilian antitrust law currently does not required a pre-merger notification, but only imposes a mandatory post-merger notification to be submitted to the antitrust authorities[15]in no longer than 15 days after the occurrence of the transaction[16].

However, Bill nr. 3.937/04 providing a structural reformulation of the Brazilian antitrust system is currently under analysis. It has already been approved by the House of Representatives and is at present being discussed in the Brazilian Congress to be approved probably by the end of this year[17]. The Bill includes, among other important modifications, the introduction of a premerger review notification system in Brazil[18].

A. A Bilateral Agreement: Warming the Big Muscles

Extraterritorial jurisdiction in antitrust issues can bring a set of difficulties for the implementation of the competition law in a globalized context[19]. Bilateral agreements are one of the means available to negotiate cooperation, mutual assistance for enforcement and also accomplish a movement towards a merger control convergence that strengthens assistance between antitrust authorities.

These agreements functions as a binding positive instrument, which allows a setting of a minimum antitrust rules and also an efficient dispute settlement instrument[20]. Also agreements avoid conflicts in the application of domestic antitrust law, especially in international transactions.

In 1999 Brazil and Unites States signed a bilateral agreement to promote cooperation between their antitrust authorities, including technical cooperation, in the enforcement of their antitrust laws. Both countries agree that the cooperation and coordination in antitrust law may result in a more effective resolution of the country's concerns in identifying anticompetitive practices. The cooperation agreement reflects an important connection between the two countries, through the consideration of the other country's objectives in the application of antitrust law.

As a result of improving communication between the antitrust authorities, both countries are frequently coordinating investigations and working towards a more extensive international collaboration. In the last year, for instance, the representatives of the American antitrust authority traveled to Brazil to lecture on the premerger review system employed in the U.S. since the Hart-Scott-Rodino Antitrust Improvements Act of 1976.

B. Unambiguous Thresholds: the Trigger to Run

One way of eliminating unnecessary obstacles to merger parties is the establishment of objective notification thresholds.[21] Asset or revenue bases thresholds are examples of tests that can be easily calculated. These tests will reduce transactions costs and uncertainty.[22]

The United States authorities require a premerger notification procedure when certain thresholds are achieved in certain transactions. The Section 7A of the Clayton Act[23], requires the merging parties to notify the Department of Justice (DOJ) when the acquisition will result in an "acquired person" holding **(i)** more than $200 million in voting securities and assets of the acquired person

or**(ii)** more than 50 million where one of the parties to the transaction has annual net sales, or revenues, or total assets exceeding $100 million and the other party has annual net sales, or revenues, or total assets exceeding 10 million.[24]
Under current Brazilian law, notification is required when the resulting company or group of companies accounts for twenty percent (20%) of a relevant market, or in which any of the participants has posted in its latest balance sheets an annual gross revenue equivalent to R$ 400,000,000 (about 200 hundred million dollars). The Brazilian Bill under analysis proposes to change such requirement, establishing a more objective notification threshold, based only in the company's revenue, and not its market share in the relevant market. The relevant market definition is in most of the times a subjective exam of the market, which is in the long run is defined by the antitrust authority. Therefore, in many situations the companies might not have this information *ex ante*. This result in uncertainty: whether the firm's product is or is not a portion of the relevant market for notification purposes. Furthermore, the trigger to thresholds will be limited to the satisfaction of an objective nexus to Brazilian jurisdiction.[25]
Nevertheless, the Bill also proposes discretion to the antitrustauthority and requires the notification of a transaction that does not match the thresholds specified above in a period of one year after the consummation of the transaction. Under this Bill, the antitrust authorities in Brazil have no restrictions to implement such a provision. This mechanism functions as a safeguard for the antitrust authorities, making a notification feasible when it appears to have anticompetitive effects in the market. Even if such a stipulation might be used as an exemption and not as a frequent applied rule by the authorities, it can undermine the safety of merger transactions sought through objective revenue thresholds. A minimum set of requirements might be advantageous in limiting the discretion of the authorities, assuring then a more reasonable application of antitrust law.

1. Waiting Periods: Keep the Pace

The HSR Act requires the parties to the transactions to observe a 30 calendar days waiting period after the completion of the pre merger filing before consummating the merger[26]. This thirty day period is subject to another extension of 30 calendar days by the issuance of a Second Request. The Second Request counts from the day the parties have substantially complied with this request.[27] Once both of the periods mentioned expire, the parties are free to complete the transaction, unless the authority had obtained an injunction relief.[28]

Once the revision of the Brazilian antitrust law proposes a premerger notification, it will also launches a waiting period and require antitrust conditions between the merging parties to be in the same premerger level. Therefore, the Bill includes both the formal consummation of the transaction and prevents behavior by the parties that might restraint competition. Unlike the U.S. regulation, it does not establish successive waiting periods, and does not contain a provision of automatic acceptance of the transaction in the case of the expiration of the authorities' deadlines for analysis.

The automatic approval of the transaction provision when there is no answer from the authorities is an incentive to follow up with the analysis period. However, the implementation of certain incentive in the Brazilian authority could lead to perverse results and approval of monopolistic merger transactions. If the regulation is approved, it will not only establish new procedures, but also will change the dynamics of the authorities. This can eventually results in delays. The interested merging parties, on the other hand, have and must respect the waiting period established, or serious fines might be imposed onto the parties that do not follow the rule.

2. Reasonable Time Period: Finishing the Race

The period of time the authorities take to review the merger shall not be extended to disincentivize the merging parties to continue the transaction. The review will

be better exercised by the authorities in a reasonable time frame. The antitrust authorities shall have sufficient time to analyze the transaction, but delay can create excessive costs and disincentives to efficient deals. A similar time frame following notification employed by the U.S. authorities is proposed in the Bill. The premerger review system in analysis in the Brazilian Congress proposes that the first analysis of the notification documents will be in 20 days. At the end of those twenty days, authorities will either approve the transaction or required more specific documents to continue the analysis. In a 50 days maximum period, the authorities will then either declare the transaction as *not complex*, and pronounce a decision in 60 days, or establish the transaction as *complex* and require more information and documents for the merging parties. The authorities will have 10 days after the instruction is completed by the parties to assess the new information and judge the transaction.

The proposal in the steps analysis described above intents to provide the Brazilian antitrust authorities with all the essential information about the transaction and if any competitive concerns are not well evaluated the authority will have the discretion to determine the transaction as *complex* and require the production of further information.[29] The choice of the Bill to embrace a similar structure exhibits the influence of the U.S. antitrust regime in Brazil. Thus, its adoption will facilitate examination of merger parties in both countries.

IV. Conclusion

The revision of the Brazilian antitrust law today confirms the relevant and modern international discussion to manage and increase efficiency of the rules in a context of proliferation of international business. The development of the Brazilian economy and the increasing participation of Brazilian companies nationally and internationally, require changes for a more effective set of rules. The development of a uniform process intends to prevent contradictory Courts and administrative

court ruling in how to deal with international transactions that have business in a variety of different jurisdictions.

At this time, legal systems have been developing from a modest standard of internal enforcement relying on technical assistance from a foreign country to a strong system that cooperates in the international level, embracing and adopting the objective of convergence and harmonic regulation.[30] That is Brazil's goal and this should be continuously pursued

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[1] *See* Dane Holbrook, *International Merger Control Convergence: Resolving Multijurisdictional Review Problems*, 7 UCLA J. INT'L L. & FOREIGN AFF. 345 (Fall 2002/Winter 2003).

[2] *See* Alan Devlin and Michael Jacobs, *Antitrust Divergence and the Limits of Economics,* NW. U. L. REV. (forthcoming 2009), *available at* http://ssrn.com/abstract=1429541.

[3] See Daniel A. Crane, *Substance, Procedure, and Institutions in the International Harmonization of Competition Policy*, 10 CHI. J. INT'L L.143 (Summer 2009).

[4] See Holbrook, *supra* note 1.

[5] *Id*.

[6] See Andrew G. Howell, *Why Premerger Review Needed Reform – And Still Does,* 43 WM. & MARY L. REV. 1703 (2002).

[7] DEPARTMENT OF JUSTICE, ANTITRUST DIVISION, CONGRESSIONAL SUBMISSION FY 2008 PERFORMANCE BUDGET, *available at* http://www.usdoj.gov/jmd/2008justification/pdf/21_atr.pdf.

[8] See Holbrook, *supra* note 1.

[9] *See* Alexandr Svetlicinii**,** *Competitiveness and Competition: International Merger Control from the Business Prospective* (European University Institute, Working Paper), *available athttp://ssrn.com/abstract=1311069,* ("A system based in notification prior to the merger transaction is designed for the ex ant control of the level of the concentration on the relevant market preventing the elimination of competition that might follow the proposed concentration. Unlike the ex post competition control (…) merger control is always based on the degree of prediction of the future structure of the market and behavior of market participants.").

[10] *See* Crane, *supra* note 3 (stating that some preconditions may be satisfied for a effective harmonization to facilitate international business transactions, such as (i) the legitimacy of government control and market economies to intervene to correct the failures of the private enterprise, (ii) the purpose and to whom is the antitrust law addressed and (iii) an analytical mode free from explicit balancing considerations of interest groups).

[11] FEDERAL TRADE COMMISSION, THE EVOLUTION OF U.S. MERGER LAW, *available at* http://www.ftc.gov/speeches/other/dvperumerg.shtm

[12] Howell, *supra* note 6.

[13] Brazilian Antitrust Law no. 8.884 (June 6, 1994) (Br)

[14] *Id.*

[15] *Id.* Section Title II, Section I and Title IV. The Brazilian Competition Policy System is composed by the Secretariat of Economic Law (SDE), the Secretariat for Economic Monitoring of the Ministry of Finance (SEAE) and the Administrative Council for Economic Defense (CADE). *Id.* SDE and SEAE play an investigative and analytical role, while CADE is an administrative tribunal and only Courts can review its decisions. *Id.*

[16] Resolution for CADE Procedures and Formalities Applicable to Concentration Acts, Laws and Res. No. 15, Sec. I Article 2 (Aug. 19, 1998) (Br). That meaning of "occurrence of the transaction" has been interpreted by CADE as the execution of the binding document among the parties. *Id.*

[17] BRAZILIAN DELEGATION, ANNUAL REPORT ON COMPETITION POLICY DEVELOPMENTS IN BRAZIL, 2008 *available at* www.mj.gov.br.

[18] Antitrust Bill No. 3.937 (2004) Title VII, Chapter 1 (Br.).

[19] *See* Spencer Weber Waller, *Public Choice Theory and the International Harmonization of Antitrust Law*, 48 ANTITRUST BULLETIN 427 (2003), *available at* http://ssrn.com/abstract=1146607.

[20] *See* Holbrook, *supra* note 1.

[21] DEPARTMENT OF JUSTICE, *supra* note 7.

[22] Holbrook, *supra* note 1.

[23] 15 U.S.C.A. § 18A, the Hart-Scott-Rodino (HSR).

[24] ILENE K. GOTTS, THE MERGER REVIEW PROCESS 67 (American Bar Association, 2001).

[25] See INTERNATIONAL COMPETITION NETWORK, SETTING NOTIFICATION THRESHOLDS FOR MERGER REVIEW, available at http://www.internationalcompetitionnetwork.org/media/library/mergers/Merger_WG_2.pdf ("Jurisdiction should be asserted only over transactions that have a nexus with the jurisdiction concerned that meets an appropriate standard of materiality, based on the merging parties' activity within that jurisdiction. The "local nexus" thresholds should also be confined to the relevant entities or businesses that will be combined in the proposed transaction. In particular, the relevant sales and/or assets of the acquired party should generally be limited to the sales and/or assets of the business being acquired.").

[26] See MERGERS AND ACQUISITIONS, UNDERSTANDING THE ANTITRUST ISSUES 32, ABA Section of Antitrust Law (2008).

[27] *Id.*

[28] GOTTS, *supra* note 19.

[29] MERGERS AND ACQUISITIONS, UNDERSTANDING THE ANTITRUST ISSUES, *supra* note *20*.

[30] *See* Gesner Oliveira, *Competition Policy in Brazil and Mercosur: Aspects of the Recent Experience*, 24 BROOK. J. INT'L L.465, 466-70 (1998)

STATISTICAL SAMPLING: WEIGHING COSTS VERSUS PRECISION IN PROVIDING TAXPAYER GUIDANCE

I. Introduction

In the months preceding elections in the United States it is difficult to avoid statistical sampling, as polling projections are everywhere. Only a sample is used to make these projections because it would take too much time and be too expensive to determine how every voter will vote. [1] Statistical sampling has many others uses as well, including being used as evidence in a trial [2] or being used to estimate how much a taxpayer owes the government on their tax return. [3] As with elections, to determine the exact result for a tax return, every item in the population would need to be investigated. As a population gets larger, this gets more time consuming and more expensive, especially when the information is collected by experts, lawyers, and accountants. Furthermore, each additional item of the population collected will not result in a proportionate change in the precision of the estimate, because the precision of an estimate varies inversely with the square root of the sample size. [4]

II. Statistical Sampling in Trials and Usage by the IRS

Statistical sampling has not always been used as evidence in trials or in preparing tax returns. Early courts were skeptical of statistical sampling estimates and did not admit these estimates. [5] However, modern courts have begun to accept sampled evidence in a wide variety of contexts, including mass torts cases. [6] Similarly, the Internal Revenue Service ("IRS") utilized statistical sampling in performing tax audits as early as 1964 [7], but it has taken the IRS more time to provide taxpayers guidance for using statistical sampling in preparing tax returns. [8] Some evidence that the IRS is allowing increased use of statistical sampling for taxpayers, is that the IRS provided guidance on using

statistical sampling for substantiating meal and entertainment expenses that are excepted from the 50% disallowance rule under Code section 274(n) in 2004 [9], and provided guidance for calculating qualified production activities for the Domestic Manufacturing Deduction in 2007. [10]

The IRS has yet to provide similar guidance for calculating the Research and Development Tax Credit ("R&D Tax Credit") [11], however recent court decisions have allowed taxpayers to use estimates in calculating their R&D Tax Credits. In *Union Carbide and Subsidiaries v. Commissioner*, the United States Tax Court accepted estimates based on extrapolations "as a close approximation of all of the qualified research activities." [12] Similarly, the Fifth Circuit in *U.S. v. McFerrin* held that employee testimony and estimates may be used to substantiate qualified research expenditures, against arguments by the IRS. [13] As the IRS has not yet provided guidance to taxpayers for using statistical sampling in calculating the R&D Tax Credit [14], and they may in the future [15], the R&D Tax Credit provides a good context for examples that follow.

A major benefit for a taxpayer or for a party in a trial who uses statistical sampling, is the costs that can be saved by using a sample rather than using the entire population. [16] This is especially true when there is a large sample and when amounts are being calculated by expert witnesses, lawyers, or accountants. There are additional benefits as well. For example, additional valuable information can be gained by using the resources available to determine a carefully drawn smaller sample or to collect more information on each item in the sample. [17] Also, there may be drawbacks from using an entire large population, as one recording the entire sample results may get tired or bored enough to start recording information incorrectly. [18]

Even if the costs to calculate a tax deduction or a credit equaled the cost to calculate that deduction or credit, benefits are induced by the presence of the

deductions and credits. [19] For example, as the name suggests, the R&D Tax Credit was added to encourage research and development in the United States and as part of the American Jobs Creation Act of 2004, the Domestic Manufacturing Deduction was added to encourage increasing the quality of manufacturing and jobs in the United States. [20] A study of the effectiveness of the R&D Credit has shown a positive impact on R&D activity and "[t]here is significant evidence that nations and states that adopt an R&D tax credit will experience an increase in R&D investments." [21] If the incentive to participate in these activities was cheaper and easier to calculate, it follows that more people would consider using them.

III. Precision vs. Costs to Increase Precision

The R&D Tax Credit is a difficult credit to calculate because it requires intrusive examinations to determine how many of the costs of a particular research project qualifies as a research expense for the credit. [22] For example, qualified research expenses include qualified wages paid to engineers. [23] It may not be difficult to determine how much a company paid its engineers by looking at payroll detail, but it is more difficult to determine how much of an engineer's wages qualify as a research expense. This is the case because qualified research expenses, as defined within I.R.C. § 41, which outlines how the R&D Tax Credit is calculated, do not include all wages. [24] Even a twenty minute phone conversations with each engineer, to determine wages that qualify, will add up quickly when you take into account that the engineer could be continuing to conduct research instead, and the costs paid those conducting the interviews. When a company does extensive research and development and has multiple locations with multiple engineers, it adds up even faster.

The precision of an estimate calculated from a sample varies inversely with the square root of the sample size. [25] Therefore, in the example above, if ten engineers were originally interviewed, in order to double the precision the

taxpayer would be required to interview forty engineers. [26] Similarly, to increase the precision of a sample by a factor of ten, it would require interviewing one hundred engineers. [27] Adding more numbers to this example, if a sample of ten determines that the mean percentage of time engineers spend doing qualified research is 60%, and you can be 95% sure that the mean of the population falls between 40% and 80%, to be 95% sure that this amount is between 50% and 70%, one would have to have to sample forty engineers. [28] To further increase precision so that you can be 95% sure that the percentage was between 59% and 61% would require interviewing four hundred engineers. [29] Although the "longstanding" [30] rule developed in *Cohan v. Commissioner* is that absolute certainty is not required and that close approximations are acceptable when calculating deductions [31], it would be difficult to argue that such a wide range would be acceptable. This would be especially true when it is possible to calculate a more precise number. Using a sample to claim a deduction or credit of $60, that a taxpayer is 95% sure that is between $40 and $80, does not appear to be a close approximation. However, it would be easier to argue that if it was determined that the deduction or credit was $60 with 95% certainty that that the deduction or credit was between $59 and $61, that $60 is a close approximation. However, if it costs the taxpayer $1 to determine that they are 95% sure the deduction or credit is between $40 and $80, and $400 to determine that they are 95% sure the deduction or credit is between $59 and $61; it is not worth it for the tax payer to calculate the deduction or credit at all if such a high degree of precision is required.

IV. A Compromise is Needed to Make Statistical Sampling Effective

When you have a range of how much tax liability exists, the IRS will always want the taxpayer to pay more and the taxpayer will always want to pay less. When precision is not very high, this difference may be large. Consider if instead of the example above that used tens of dollars, a credit of tens of millions was being

calculated. In continuing to provide guidance to what extent statistical sampling is acceptable, the IRS should take into account how much can be saved by using statistical sampling. While they have a legitimate concern over requiring tax returns that are precise, the IRS should realize that the money saved could go elsewhere. Even if a deduction or credit fails to net as much revenue for the government, the presence of the deductions and credits encourage other activities for the benefit of the United States. [32] If it costs the taxpayer more to collect the information needed to calculate a potential benefit, the taxpayer may not participate in the potentially beneficial activity at all. [33]

V. Conclusion

Statistical sampling allows for substantial savings when making conclusions about populations. At the same time, there comes a point when asking for increased precision may cost more than it is worth to have this precision. Tax deductions and credits may be difficult to calculate, but rather than render them worthless to taxpayers or get rid of them completely, statistical sampling should be encouraged when calculations would otherwise be too difficult to calculate.

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[2] Id at 208.

[3] Rev. Proc. 2004-29, 2004-20 I.R.B. 918.

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[5] LAWLESS, ROBBENAULT, & ULEN, *supra* note 1, at 208.

[6] Id.

[7] Rev. Proc. 64-4, 1964-1 C.B. 644.

[8] WILL YANCEY, SAMPLING FOR INCOME TAX AND CUSTOMS, http://www.willyancey.com/sampling-income-tax.html#cases (last visited Oct. 11, 2009).

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[10] Rev. Proc. 2007-35, 2007-23 I.R.B. 1349.

[11] YANCEY, *supra* note 8.

[12] *Union Carbide Corp. and Subsidiaries v. Comm'r.*, 97 T.C.M. (CCH) 1207, 110 (2009).

[13] *U.S. v. McFerrin*, 570 F.3d 672, 679 (5th Cir. 2009).

[14] YANCEY, *supra* note 8.

[15] Mary Batcher, Statistical Sampling in Tax Filings: New Confirmation from the IRS, Tax Executive (2004), *available at*http://www.thefreelibrary.com/_/print/PrintArticle.aspx?id=143304208.

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[17] Id at 191-192.

[18] Mary Batcher, Statistical Sampling: A Potential Win for Business Taxpayers, Tax Executive (2001),http://www.thefreelibrary.com/Statistical+sampling:+a+potential+win+for+business+taxpayers-a095446866.

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[21] Gitell & Tebaldi, *supra* note 19.

[22] Batcher, *supra* note 15.

[23] I.R.C. § 41(b)(2)(A)(i) (2008).

[24] Id.

[25] ZEISEL & KAYE, *supra* note 4.

[26] Id.

[27] Id.

[28] Id.

[29] Id.

[30] *U.S. v. McFerrin*, 570 F.3d at 679.

[31] *Cohan v. Comm'r*, 39 F.2d 540, 544 (2d Cir. 1930).

[32] Gitell & Tebaldi, *supra* note 19.

[33] Mary Batcher, *supra* note 18.

INTELLECTUAL PROPERTY RIGHTS: THE LAST BARRIER TO INTERNATIONAL FREE TRADE

I. Introduction

The world today is highly technologically advanced in that works of art, literature, designs and other goods are highly digitalized.[1] Whereas in previous generations, trade agreements dealt in hard goods that could be accounted for and of which value was readily determined, the commodities of today are digital and informational.[2] These intangible goods are harder to track and almost impossible to value. As such, the goal of international free trade is being impeded by the reluctance of certain companies to invest overseas either directly in new upcoming firms or through trading of patented information.[3]

Some nations are reluctant to stringently enforce, or even create, laws for the protection of intellectual property rights. These nations argue that protection of intellectual property rights through patents and copyrights would raise market prices to a level near a monopolistic environment.[4] The belief is that an innovative foreign company will not pay royalties for the imported product while the domestic company has to do so, thus resulting in the product being more expensive in the importing country.[5] This is the big problem when it comes to trying to break down the remaining barriers of international free trade. Overall, the traditional Northern, or more developed countries have been accused of taking advantage of the poorer, underdeveloped Southern countries for many years. This is reflected in the fact that most of the intellectual property patents are held by individuals residing in these countries.[6] United States business representatives and politicians have four primary complaints about foreign copyright system: (1) the failure of foreign copyright law itself to meet U.S. standards of adequate copyright protection for copyright holders; (2) the lack of strict sanctions to deter

potential violators; (3) the lack of government efforts to enforce the law; and (4) the lack of judges and lawyers who have experience with intellectual property issues.[7] This paper will argue that despite the fact that the trend is beginning to change, countries such as China and Brazil have seen increases in applications for patents, this problem will never be solved unless the underdeveloped countries fundamentally change their views on intellectual property laws.

II. Background

Although the World Trade Organization ("WTO") and World Intellectual Property Organization ("WIPO") currently help dictate multilateral trade agreements, the fact of the matter is that enforcement and general respect to these agreements still widely varies from country to country.[8] The source of these differing attitudes towards intellectual property law can be seen in the history of the countries. For example, in China, a country whose history has been primarily communist, traditionally believes that intellectual property should not be protected as strictly as the United States. Magistrates in the Tang Dynasty in early China were also eager to avoid the formal legal system and so encouraged parties to resolve disputes amicably between themselves.[9] In contrast, the United States' patent law can be seen in the case of *Twentieth Century Music Corp. v. Aiken*, in which the Court states:

The creative work is to be encouraged and rewarded, but private motivation must ultimately serve the cause of promoting broad public availability of literature, music, and other arts. The immediate effect of our copyright law is to secure a fair return for an "author's" [or artist's] creative labor. But the ultimate aim is ... to stimulate artistic creativity for the public good. The sole interest of the United States and the primary object in conferring the monopoly lie in the general benefits derived by the public from the labors of authors and artists.[10]

Enforcement in China is lax especially when put into context of the Chinese legal system in which many of the most minor crimes are punished more severely than

in Western countries.[11] It is this lack of enforcement that is troubling. The National Intellectual Property Law Enforcement Coordination Council was established in 1999 and is charged with coordinating domestic and international intellectual property law enforcement among federal and foreign entities.[12] However, the problem lies not in coordinating domestic and international property law, the problem is in the valuation and subsequent enforcement of these laws. This lack of enforcement or respect of intellectual property rights could be seen in the famous Nelfinavir scandal in 2001 in which Brazil "became the first country to break an international patent when it began producing the generic drug 'Nelfinavir' in order to address its huge AIDS problems."[13] According to Brazilian national law, one can bypass a patent if the holder is abusing his position as a monopolist.[14] The holder of the Nelfinavir patent, a Swiss pharmaceutical company named Roche, argued that they had conceded to give the Brazilian government a discount of 13% on the drug following extensive talks between the two parties.[15] The true fact of the matter was that Brazil spends over $300m per year on Nelfinavir alone because the country has the highest number of AIDS infected patients in South-America.[16] In bypassing the international patent for Nelfinavir and thus producing a similar drug domestically, Brazil cut its spending by nearly 40%.[17] Attempts to punish Brazil in the WTO negotiations were subsequently dropped in June 2001 due to the public outrage over the case.[18] This sets a daunting precedent in that it shows so-called "public good" is allowed to override established international law.

III. Analysis

Problems arise when considering the integration of two phenomena: the explosive growth of digital technology, and the movement toward a uniform international copyright legal system.[19] First, these trends make it difficult to create a system of intellectual property rights that is compatible with all nations, cultures, and

societies.[20] Second, traditional Western copyright concepts, which are predominant in international copyright concepts, are incompatible with the burgeoning culture of digital information, where physically intangible works are made, copied, transferred, viewed, and modified through copious mediums across the world in seconds for little to no cost.[21] In order to attempt to solve this problem, the WIPO and WTO should model the so-called uniform international intellectual property rights law after taking into consideration the customs of each nation.[22]

The first step to changing the state of affairs in international intellectual property rights lies in the misguided view that intellectual property rights are only for the developed countries to make profit. Some argue that protection of intellectual property rights can be good for poorer countries as well. For example, it has become increasingly difficult for musicians in Mexico to get recording deals with record companies due to the fact that two thirds of all the cassettes and CDs sold in Mexico are counterfeit.[23] India is another example, due to the country's nearly non-existent intellectual property rights legislation many pharmaceutical companies choose not sell their products there for fear of copycats.[24] Underdeveloped countries need to realize that stringent enforcement of intellectual property rights benefits them domestically just as much as it would internationally. When countries develop more advanced states of intellectual property right protection, they would attract more foreign investment. This foreign investment would lead to a stimulation of the local economy which results in benefits for both the importing country as well as the exporting country.

The problem that exists now is not in establishing uniform intellectual property law across differing continents or establishing an agreed upon law through systems like the WTO or WIPO, but rather less developed nations should re-evaluate their basic beliefs of intellectual property rights. The less developed nations need to move into the economic environment of the present rather than

maintaining outdated beliefs and practices. There needs to be a re-education of these countries that currently do not value intellectual property rights as they should. This could occur through sending representatives from the WIPO and WTO to talk with legislators or leaders of these countries so as to explain to them the importance of valuing intellectual property rights. Seen from this point of view, protection of intellectual property rights encourages the domestic industry, secures foreign investment and creates incentives for the creation and use of new technology. Proof of this strategy working is China.

In the past decade, as trade with China increased, more and more pressure was put on China through the sending of government representatives by the United States and Japan to try and change China's intellectual property rights laws so that they are more compatible on the global scale.[25] The result of this is that patent applications have been increasing consistently despite the global economic crisis. If this result can be repeated with other trading nations and subsequently reflected in multilateral trading agreements, international intellectual property rights would no longer be a barrier to international free trade.

IV. Conclusion

Although the cultures and attitudes regarding intellectual property rights differ between Eastern and Western, Northern and Southern, we must learn to compromise and educate in order to overcome the barriers posed by these differences and achieve a world where international free trade is possible. Currently the ball has been set in motion in that these underdeveloped or beginning industrialized nations have begun changing their ways; however this change is largely motivated by external pressures from highly industrialized trading partners. The barrier that intellectual property rights poses to international free trade will never be fully broken down until these countries realize on their own what benefits can be reaped when they change their ways.

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R.I.P. VANILLA DREAMS, YOU WILL BE MISSED

I. Introduction

In smoke-filled rooms, Big Tobacco executives are patting themselves on their backs while local smoke shops and flavored-cigarette aficionados are increasingly disgruntled by the loss of their Djarum cloves, Cherry Jubilee and Vanilla Dreams. The ban was introduced by the U.S. Food and Drug Administration (FDA) as an important step in curbing cigarette use among teenagers, branding flavored cigarettes as a "gateway for many children and young adults to become regular smokers." [1] However, as the ban approaches is second week of implementation, gaping loopholes within the prohibition has left the ban to open attack by others. [2] This paper will attempt to cast doubt on the effectiveness of the recent ban on teenage smoking cessation efforts, showing that the tobacco products favored by teenagers are not affected by the ban. Consequently, this paper will argue that the ban will mainly profit major U.S. cigarette producers, Phillip Morris USA, Lorillard and Reynolds American Inc., allowing them to further monopolize the tobacco market under the guise of federal regulation.

II. Background: The Family Smoking Prevention and Tobacco Control Act

On March 21, 2000, the Supreme Court was tasked with determining whether the FDA had the authority to regulate tobacco products under the Food, Drug, and Cosmetic Act (FDCA). [3] [4] The Court held that, reading the FDCA as a whole, Congress never intended to give the FDA jurisdiction over tobacco products and invalidated FDA regulations in question. [5] In the ongoing battle of tobacco-related litigation, the Court effectively confirmed the fact that tobacco products have largely escaped regulation by federal health and safety laws for decades.

As a result, the Family Smoking Prevention and Tobacco Control Act (the Act) was signed into law on June 22, 2009, amending the FDCA and allowing the FDA to regulate the manufacturing, marketing, and sale of tobacco products for the first time. [6] The Act does not allow the FDA to place a complete ban on conventional tobacco products, including cigarettes or smokeless tobacco products, or on nicotine levels within these devices. [7] However, the FDA may now directly implement FDCA provisions that will, among other things, restrict tobacco advertising, prohibit the use of terms such as "light" or "mild" on tobacco product packages, strengthen warning labels on existing and new tobacco products, and herald federal efforts to stop tobacco smoking among minors. [8] Interestingly, the Act also directly prohibits the manufacture or sale of all cigarettes that have a "characterizing flavor," other than tobacco or menthol. [9] The relevant provision of the statute states:

"A cigarette or any of its component parts (including the tobacco, filter, or paper) shall not contain, as a constituent (including a smoke constituent) or additive, an artificial or natural flavor (other than tobacco or menthol) or an herb or spice, including strawberry, grape, orange, clove, cinnamon, pineapple, vanilla, coconut, licorice, cocoa, chocolate, cherry, or coffee, that is a characterizing flavor of the tobacco product or tobacco smoke." [10]

In effect, the production and sale of fruit, candy, or clove-flavored cigarettes have been banned in the U.S. as of Sept. 22, 2009. [11] The ban plainly excludes menthol-flavored cigarettes, which the FDA has singled out to examine its options regarding the product's regulation. [12]

III. Casting Doubt on the Act: Brand Preferences and the Current State of the U.S. Tobacco Industry

In announcing the ban on flavored cigarettes, the FDA placed particular emphasis on the special appeal that characterizing flavors such as fruit, candy, or cloves

have on children, and how they would "allure kids into addiction." [13] Another highly quoted figure in support of the ban comes from the Roswell Park Cancer institute, which claims that the use of flavored cigarettes is more likely among 17 year olds vis-à-vis 20 to 26 year olds. [14] Teens are more prone to use flavored cigarettes because they prefer "high-impact" flavors, while their adult counterparts prefer "mild and natural flavors." [15]

Despite such bold statements, recent statistics would argue otherwise. According to a survey conducted by the Centers for Disease Control and Prevention (CDC), out of 54,301 established smokers between the ages of 12 and 17, 52 percent of high school students preferred Marlboro, 21 percent favored Newport, while 13 percent smoke Camel cigarettes. [16] Similar figures are shown among middle school students, with 43 percent, 26 percent, and 9 percent favoring each brand, respectively. [17] A different study by the American Lung Association shows that among regular high school smokers, only 6.8 percent smoked clove cigarettes while 1.7 percent smoked candy-flavored cigarettes. [18] In fact, figures from the CDC 2007 National Study on Drug Use and Health show that teen preferences mirror that of adults, finding that the most popular brands among adults were also Marlboro, Newport and Camel, respectively. [19]

In other words, both teens and adults appear to favor tobacco and menthol-flavored cigarettes – both which the Act explicitly excludes from the ban. This begs the question as to why such a gaping loophole has been written into the Act if Congress and the FDA truly purport to ensure the health and safety of teenagers, and undercut "the most preventable cause of premature death in our society." [20]

Furthermore, a breakdown on the national tobacco market supports the futile nature of banning flavored, as defined by the Act, but not tobacco or menthol-flavored cigarettes. The U.S. Tobacco industry currently operates under the iron fist of "Big Tobacco," referring to the three big tobacco manufacturers that have

dominated the $70 billion national market (2007 figures) [21] – Phillip Morris USA (Altria), Reynolds American (RJR), and Lorillard, Inc. [22] Phillip Morris owns the Marlboro brand, which accounts for 40 percent of national retail sales in cigarettes [23], and has just launched a new menthol brand, Marlboro Blend No. 54, this June. [24] Meanwhile, Lorillard owns Newport, which continues to be the best-selling menthol cigarette [25], and Reynolds American holds the Camel brand and its menthol line Camel Crush. [26] These companies would hardly be adversely affected by the ban. In fact, Phillip Morris doesn't even produce cigarettes that would trigger the ban. [27]

On the other hand, clove cigarettes represent .09 percent of all cigarettes purchased in the U.S. and the figures are far slimmer for flavored cigarettes [28], while menthols account for an overwhelming 28 percent. [29] Here's an interesting twist – 99 percent of all cloves sold in the U.S. are imported from Indonesia, sparking a potential trade skirmish if Indonesia were to bring a protectionist complaint to the World Trade Organization. [30] No wonder Big Tobacco supports the ban – they have nothing to lose. [31] The ban, in effect, allows Big Tobacco to further monopolize the U.S. tobacco industry by doing away with what competition they faced from cloves and flavored cigarettes.

IV. What's the Next Step?

The absence of a logical explanation for banning cigarettes with "characterizing flavors" but not tobacco or menthol-flavored cigarettes undermines the purpose of the ban in the first place. This is not to say that the rest of the Act will not work to hinder children and young adults from smoking, or will not protect the general health of the nation as a whole. Other provisions of the Act have yet to come into effect: the terms "light," "low," and "mild" will be banned from use on tobacco

products by July 2010; warning labels for smokeless tobacco products will be revised by July 2010; warning labels for cigarettes will be revised by Oct. 2012, to include larger warning signs and pictures depicting the harmful effects of cigarettes. [32] Given the recent enactment of the Act, much of its consequences are of a wait-and-see scenario.

However, one thing is for sure – the FDA still has a long way to go before they can envision a world without smokers and cigarettes. Moreover, the commercialization of various non-traditional tobacco products, such as tobacco candies and e-cigarettes, will provide for new and particularized challenges to regulating tobacco products that the FDA has yet to encounter. As for right now, the FDA should stop hiding behind the ban of certain flavored cigarettes and come up with a legitimate answer to explain why we have lost our cloves and flavored cigarettes.

V. Conclusion

The Family Smoking Prevention and Tobacco Control Act may have given the FDA some teeth to reduce the prevalence of tobacco-related illnesses within the U.S. Yet, the Act has yet to manifest any concrete results regarding smoking cessation among teenagers, or in challenging the long-standing, monopolistic power that Big Tobacco companies have enjoyed before the enactment of the Act. The ban on cigarettes with certain "characterizing flavors" has done little to help the FDA's cause. Today, the ban stands strong, with little rationale supporting its binding nature. Therefore, we bid adieu. R.I.P. Vanilla Dreams, you will be missed.

End Notes

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[28] Paul Smalera, *Cool, Refreshing Legislation for Philip Morris*, SLATE, June 8. 2009, http://www.thebigmoney.com/articles/judgments/2009/06/08/cool-refreshing-legislation-philip-morris.

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[31] *Id.*

[32] FindLaw's Common Law, *FDA Flavored Cigarette Ban: What's Covered and What's Next?*, http://commonlaw.findlaw.com/2009/09/fda-flavored-cigarette-ban-whats-covered-and-whats-next.html (last visited Oct. 2, 2009).

LOOKING EAST: THE ROAD TO RECOVERY

I. Introduction

The current global recession has experts around the world searching for a solution in a place never looked to before. For the first time, Asian economies are leading the way out of a global economic slump. While the United States and Europe have pioneered past recoveries from world recessions, recovery seems to have already begun in Asia with China at the forefront. Massive government stimulus and expansionary fiscal policies have spurred growth in Asia with other strong economic indicators seemingly providing a foundation to a full-fledged recovery. Despite a drop in exports, Asian economies have offset the decline in this major source of revenue by slashing interest rates, keeping savings levels high, increasing infrastructure demand and harnessing the potential for expansion in domestic consumer demand. Many Asian nations are net creditors [1], with significant current account surpluses supplied by capital inflows over recent years. Asia now has a comparatively high ability to lend and borrow, as opposed to most Western nations which are running high trade and fiscal deficits. [2] However, the long-term sustainability of this potential recovery is questionable due to the huge amount of government-backed investment and generous policy measures that cannot continue indefinitely. In order for these Asian economies, in particular China, to return to normalized growth, private investment needs to increase as well as domestic consumption. No longer can the world wait for the Western consumer to jumpstart the global economy. Increasing Asian domestic consumption is a necessary driver for getting the world out of this current recession.

II. The Global Recession

The heart of this current crisis was ultimately an overleveraged United States economy that fueled much of global consumption. [3] From a broad perspective, it may have begun in the early 1980's with both the budget and trade deficits. [4] Financial magic tricks and easy money ignited consumer spending leading to an inevitable collapse of the bubble. [5] Beginning with the subprime crisis and flowing over to nearly all other asset classes, the United States economy ground to a halt, affecting the entire world. As the developed Asian economies are mostly export oriented, they were clearly impacted by the steep drop in U.S. and global consumption as well as the decline in asset values. [6] This caused their respective domestic consumption levels to drop as people lost jobs, portfolio holdings, and overall general wealth. [7]

Despite collapsing Western credit leading to a global recession, Asian economies have been the first to show signs of recovery. Growth of middle classes in population giants China and India have led to increases in consumer spending as well as vast infrastructure spending, notably China. [8] Low-cost production in countries like Vietnam and Korea has also spurred economic recovery. [9] Despite drops in Western consumer appetite, countries in Asia continue to export due to the intra-continental domestic market. [10] The domestic market is key to fueling this recovery in the long run and the Asian Development Bank says efficient and effective stimulus is what will bolster domestic demand to offset the weak external environment. [11]

III. The Current Situation in Asia

Empirical data indicates that Asia is indeed spurring a recovery during these rough times. Favorable fiscal conditions in China have led to a surge in bank lending in the first half of 2009 while countries all across Asia have slashed interest rates. [12] China has increased growth from 6 percent in the first

quarter to 8 percent in the second. Other Asian areas like Singapore and South Korea are also showing greater output. [13] Unemployment rates in Asia are among the lowest in the world [14] and drops in Western consumer demand have been offset by increases in exports to other Asian countries. China has become the largest trading partner for developed countries like Korea, stressing the importance of the intra-continental Asian consumer. [15] Because many Asian countries have lower debt to GDP ratios than developed countries, Asian nations are armed with the financial firepower to stimulate growth in the future. [16] However, much of this growth has been led by government-backed investments leading to questions regarding the sustainability of this growth and problems in current stimulus measures. [17]

Vast amounts of liquidity poured into these Asian economies through drastic drops in policy rates and other financial measures that have expanded lending have created a positive outlook for now, but the question remains as to what will happen in the long term. Inflationary pressures will emerge and banks will be forced to raise interest rates and be less generous with monetary policy. [18] Whether these Asian economies can withstand this inevitable period or experience a "double-dip" will determine how quickly the world recovers from this economic slump. Countries like China that have injected nearly $1,079 billion USD into their economy have caused experts to question the sustainability of current growth. [19] There are worries that private consumption will fail to take the baton as well as concern that the lack of external demand from the Western market will slow these Asian economies that depended on exports in the past.

IV. Allow the Asian Domestic Consumer to Fuel the Recovery

Unless private investment and domestic consumption are able to pick up the slack, it is clear that the current bright outlook in Asia will dim once

government-backed investment decreases. Since economic indicators currently show that Western markets are not yet able to increase consumer spending, Asian domestic consumption rates must increase to spur a global recovery. The Asian Development Bank has stated that current GDP growth in emerging East Asia is sourced more from domestic stimulus than an increase in external demand. [20] Although this bodes well for now, one must remember that the government has played a huge part with expansionary policy measures. While these countries have promised to maintain such measures until the recovery is solidly on its way, [21] one only needs to remember the concerns mentioned above to see why the domestic consumer needs to play a larger role.

Recent economic indicators show that the Asian consumer is primed to take on this responsibility. Slowdowns in growth along with lower oil and food prices have helped calm inflation worries across the region, making it possible for authorities to continue their easing of monetary and fiscal policies. The fact that many Asian nations are net creditors has allowed a decrease in core inflation and interest rates, increasing the level of capacity to lend and borrow. [22] By controlling inflation, these Asian economies will cash in on the long-term potential for expansion of domestic consumer demand.

The worry that these export-driven countries will "double dip" once government stimulus measures are stopped and plunge once again into recession are another indication that the Asian domestic consumer must pick up the slack in the decrease of global consumption. However, recent signs are promising. Although Asian exports to the United States have fallen, those to other countries in Asia like China and Hong Kong have increased. Korea has reported an increase in exports to China from 16% to 28.4% during 2000 to 2009 while the Philippines have increased their exports to China from 6.1% to 33.8% in the same period. [23] The large stockpile of cash reserves in Asian

economies from all their exporting activities, coupled with high savings rates, give the Asian domestic consumer an advantage that must be utilized to increase both domestic and global consumption.

V. Conclusion

There is no clear way out of this current global recession and signs of recovery are often questioned. There are even indicators of a "double dip" that says things might get worse before they get better. However, emerging markets in Asia and generous government policies have given the Asian consumer the power to fuel a global recovery. Asian domestic consumption rates must continue to increase in order for these countries to truly stake their first claim as leaders out of a global recession.

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[3] KEVIN PHILLIPS, BAD MONEY: RECKLESS FINANCE, FAILED POLITICS, AND THE GLOBAL CRISIS OF AMERICAN CAPITALISM 53 (2008).

[4] BRUCE ARNOLD, CONGRESSIONAL BUDGET OFFICE,CAUSES AND CONSEQUENCES OF THE TRADE DEFICIT: AN OVERVIEW (2000), http://www.cbo.gov/doc.cfm?index=1897&type=0.

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[7] ASIAN DEVELOPMENT BANK, ASIAN ECONOMIC MONITOR 2009 (2009), http://www.aric.adb.org/asia-economic-monitor.

[8] Id.

[9] OECD Statistics, Key Short Term Economic Indicators: Production, Sales, and Orders, http://stats.oecd.org/index.aspx (last visited Sep. 20, 2009).

[10] ASIAN DEVELOPMENT BANK, ASIAN ECONOMIC MONITOR 2009 (2009), http://www.aric.adb.org/asia-economic-monitor.

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[13] OECD Statistics, Key Short Term Economic Indicators: Quarterly National Accounts, http://stats.oecd.org/index.aspx (last visited Sep. 20, 2009).

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[15] WORLD BANK, EAST ASIA & PACIFIC UPDATE (2009), http://www.worldbank.org/eapupdate.

[16] Id.

[17] ASIAN DEVELOPMENT BANK, ASIAN ECONOMIC MONITOR 2009 (2009), http://www.aric.adb.org/asia-economic-monitor.

[18] Stephen Roach, *Kidding Ourselves About an Asian Recovery*, TIME, Jun. 8, 2009, http://www.time.com/time/magazine/article/0,9171,1901366,00.html.

[19] Id.

[20] ASIAN DEVELOPMENT BANK, ASIAN ECONOMIC MONITOR 2009 (2009), http://www.aric.adb.org/asia-economic-monitor.

[21] Brian Love, *Global Recession Ending: OECD*, NEWSDAILY, Sep. 3, 2009, http://www.newsdaily.com/stories/tre5821z4-us-economy-recovery-oecd/.

[22] Kevin Brown, *Asia eyes sustained recovery*, FINANCIAL TIMES, Sep. 10, 2009, http://www.ft.com/cms/s/0/2cca3436-9e39-11de-b0aa-00144feabdc0.html.

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THE SKINNY ON TAXING FATTY FOODS

I. Introduction

In case you have not read a newspaper, surfed the internet, or been outside your home recently, there is an obesity epidemic in the United States.[1] Search Google News for "'obesity epidemic'" and one will find about seven hundred stories in the last month.[2] Not to dwell on the prevalence of obesity, but according to the Centers for Disease Control and Prevention (CDC) in 2005-2006 "more than one-third of adults, or seventy-two million people [in the United States] were obese;" a number which had "doubled among adults from 1980 to 2004" and which has not decreased since.[3]

They say the first step to solving a problem is admitting one has one; America we have a problem. But simply admitting a problem exists does not necessarily mean it should be the government's job to alleviate the problem. Even if it was the government's job to alleviate the problem, taxing unhealthy foods[4] may not be a possible or preferable solution. To understand the situation it is helpful to briefly look at the history of "Pigouvian" taxes, that is, taxes levied to correct an oversupply of a good or service that has negative externalities, and then examine whether obesity is a good candidate to be attacked with such a tax.

II. Pigouvian Taxes

Pigouvian taxes are used to correct markets when the consumer of a good does not pay the true cost of the good, which is to say, externalities exist. An externality is simply a consequence of one's economic activity that causes "another to benefit with our paying or suffer without compensation."[5]

In the case of unhealthy food, the consumer pays for the good, its packaging, its marketing and many other things, but he does not pay for the

additional health care costs that eating such foods levy on other tax payers, through publicly funded health insurance, or his coworkers, through increased insurance premiums.

III. Have Pigouvian Taxes Been Effective in the Past?

The most common example of a successful Pigouvian tax is cigarettes. In 1965 42.5 percent of Americans smoked but by 2007 on 19.8 percent did.[6] To be sure, Americans in 2000 have a better understanding of the health consequences of smoking. As well, other public policies, such as banning smoking in public places and limiting advertising, make it impossible to say how much tax policy affected the decrease in smoking and how much other public policies did. However, most people are comfortable saying that taxing cigarettes, at the very least, contributed to the decline in the number of people who smoke and how often the average smoker lights up.

Like the cause of the decline in smoking, the question of whether taxing unhealthy foods will be as effective as taxing cigarettes is complicated. To judge the possible effectiveness of taxes one has to first define success. One definition is increasing the health of American citizens. A second definition is a more accurate allocation of the costs of eating unhealthy food. These two definitions of success need not be mutually exclusive.

A. Healthier Citizens

If a healthier citizenry is what is sought the usefulness of taxing fatty foods is questionable. A ten percent tax is associated with only a .22 decline in body mass index (BMI) within two years, though in twenty or thirty years a person's BMI might decrease one to two points.[7] It would be naïve to think the tax code could quickly affect something as fundamental as what Americans eat, how much Americans eat, and how frequently Americans eat. In the case of cigarettes it took more than a generation to reduce the number of smokers from

about forty percent to about twenty percent, but those changes occurred. There is hope.

Additionally, as the Urban Institute study points out, there are important similarities and between cigarettes and food. Some similarities include increased risk of chronic disease and premature death, as well as industry action including aggressive marketing campaigns and additives that trigger "hard-to-control cravings that increase consumption of fattening food, in some cases using the same neurological pathways involved with substance abuse and other classically addictive behaviors."[8] Conversely, the differences between cigarettes and fattening foods include the fact that some unhealthy foods do provide more than a trivial amount of nutrition and that exercise can reverse the overconsumption of unhealthy food.

Finally, food plays an immeasurable role in our overall health. As the health care debate continues in Washington, some point out that insuring more people and doing so more efficiently, without changing what we put into our bodies will be a fruitless strategy if we seek to improve our health and slowing the rising cost of care.[9]

B. Fair(er) Distribution of Health Care Costs Associated with Overweight and Obesity

A second measure of success for taxing unhealthy foods would be a fairer distribution of the cost of consuming such foods. Because the added cost of health care may escape the cost of a Quarter Pounder with Cheese, some argue that it makes sense to levy a tax to reduce the gap between the "true" cost (that is, the cost of the burger and the increased cost of care) and the price on the menu.

For starters, overweight and obesity cost tax payers money, a lot of money. The CDC estimated that in 1998 the cost of overweight and obesity to be between 51.5 and 78.5 billion dollars.[10] The Urban Institute estimates tax payers directly pay one hundred billion dollars annually due to overweight and

obesity.[11] But there are indirect costs as well. According to a recent study, more than a quarter of the per capita inflation adjusted rise in the cost of health care between 1987 and 2001 can be attributed to the obese.[12] Furthermore, non-obese workers pay more than a quarter billion dollars extra in private insurance premiums because of their co-workers obesity.[13] It seems that one who consumes more of a good, in this case healthcare, should be asked to pay his fair share.

IV. Will a Tax on Unhealthy Foods Help Solve Either of these Problems?

Despite the fact that Americans weigh more than ever and the above suggestions that eating unhealthy foods are to blame for this outcome, the problem is not so simple. For starters, whether a person exercises has an effect on his health. Presumably a tri-athlete who eats fast food regularly does not pass health care costs on to his neighbors. Additionally, it has been suggested that eating unhealthy foods is itself a symptom of a change in food culture in the United States (and some of these changes were precipitated by government intervention in the market in the first place).[14] Another worry is the prevalence of "food deserts" which are "often urban residential areas with no grocery stores and where food-buying options are limited to fast food and convenience stores."[15] Finally, some reject the problem of overweight and obesity concluding that "our attitudes about fatness have much more to do with our concerns about social status, race, and sex than they do with health.[16] By ignoring the many opportunities to stop the possible negative health and financial consequences between ingestion and outcome one would certainly be simplifying the problem. But with a problem as complicated as eating habits some simplification may be necessary.

Despite the complexity of American lifestyles the government creating incentives for Americans to make better choices is not a bad idea. A Pigouvian tax would not disallow unhealthy foods from being made, marketed, or

consumed. Rather taxing unhealthy foods would nudge people to make better choices about what to consume more frequently. Furthermore, it is hard to argue that non-obese Americans should subsidize the diets of consumers of unhealthy foods through higher taxes and insurance premiums. Taxing a Whopper would make its price more accurately reflect its true cost.

At some point everyone is responsible for his own choices and the outcomes they lead to. But in the case of unhealthy food, one's choices increase the costs to other people. It only seems fair that we allocate those costs to the people who incur them. Inviting Uncle Sam to the dinner table might seem like an overreaction, but obesity is an epidemic, and a better solution has yet to be offered.

[1] The Centers for Disease Control and Prevention define overweight as adults with Body Mass Index between 25.0-29.9 and obese as a BMI 30.0 and over. For example, a man who is 5'9" tall would be in the "healthy weight" range if he weighed 125-168, "overweight" if he weighed 169-202, and "obese" if he weighed more than 202 lbs. See Centers for Disease Control and Prevention, Defining Overweight and Obesity, Aug. 19, 2009,http://www.cdc.gov/obesity/defining.html.

[2] Google News, www.google.com (last visited Sept. 9, 2009) (using search term "obesity epidemic"). The term "'obesity'" returned 10,946 results. *Id*.

[3] CENTERS FOR DISEASE CONTROL AND PREVENTION, OBESITY AMONG ADULTS IN THE UNITED STATES – NO STATISTICALLY SIGNIFICANT CHANGE SINCE 2003-2004 (2007), http://www.cdc.gov/nchs/data/databriefs/db01.pdf.

[4] What constitutes "unhealthy foods" is beyond the scope of this article. However, a number of policy proposals have been made including only taxing sugared drinks. *See* Peter Moore, *President Obama has a Health Plan for America*, MEN'S HEALTH, Sept. 2009,*available*

at http://www.menshealth.com/cda/article.do?site=MensHealth&channel=health&category=doctors.hospitals&conitem=72387ea369683210VgnVCM10000030281ea;*see* Heather Knight, *Newsom Wants to Charge Stores that Sell Soda*, SAN FRANCISCO CHRONICLE, Sept. 18, 2009, *available at*http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2009/09/17/MNF619OSF4.DTL. A second option would be taxing foods which are below a certain level on the Rayner Scale – a model which balances a food's nutritionally risk elements such as calories, fat, and sugar with its beneficial elements. *See* CAROLYN L. ENGLEHARD ET AL., REDUCING OBESITY: POLICY STRATEGIES FROM THE TOBACCO WAR 13 (Urban Institute 2009), *available at*http://www.urban.org/UploadedPDF/411926_reducing_obesity.pdf. A third option would be using a something akin to the Rayner model, but not the Rayner model. *Id*.

[5] BLACK'S LAW DICTIONARY (8th ed. 2004).

[6] Centers for Disease Control and Prevention, Trends in Current Cigarette Smoking Among High School Students and Adults, United States, 1965-2007, 2008, http://www.cdc.gov/tobacco/data_statistics/tables/trends/cig_smoking/index.htm.

[7] *Waist Banned*, THE ECONOMIST, Aug. 1, 2009.

[8] ENGLEHARD, *supra* note 4, at 10.

[9] Mike Pollan, *Big Food vs. Big Insurance*, N.Y. TIMES, Sept. 9, 2009, *available at*http://www.nytimes.com/2009/09/10/opinion/10pollan.html?pagewanted=2&_r=1.

[10] Centers for Disease Control and Prevention, Aggregate Medical Spending, in Billions of Dollars, Attributable to Overweight and Obesity, by Insurance States and Data Source, 1996-1998, 2003, http://www.cdc.gov/obesity/causes/economics.html.

[11] ENGLEHARD, *supra* note 4.

[12] Kenneth E. Thorpe et al., *The Impact of Obesity on Rising Medical Spending*, HEALTH AFFAIRS, 2004, at 481, *available at*http://content.healthaffairs.org/cgi/reprint/hlthaff.w4.480v1.

[13] ENGLEHARD, *supra* note 4, at 10.

[14] MIKE POLLAN, IN DEFENSE OF FOOD: AN EATERS MANIFESTO(Penguin Books 2009).

[15] Emily S. Achenbaum, *Food Desert Seeks Relief*, CHICAGO TRIBUNE, Sept. 1, 2008, at C3.

[16] ERIC J. OLIVER, FAT POLITICS: THE REAL STORY BEHIND AMERICA'S OBESITY EPIDEMIC 15 (Oxford University Press 2006).

KNOCK-OFF THE KNOCKOFFS: THE FIGHT AGAINST TRADEMARK AND COPYRIGHT INFRINGEMENT

INTRODUCTION

Gucci, Fendi, Prada, Coach; Designers most individuals know, but few can afford. Yet, despite their high prices, countless individuals sport these designer labels on a daily basis. Chances are however, the majority of these 'designer duds', including sunglasses, handbags, electronics, and even drugs, are not authentic. Over the past few years, this knockoff fetish has become increasingly popular throughout the world, especially with the recent economic downfall. With a high demand for these items and popular acceptance of this act, few consumers consider the illegality and danger of owning and supporting these unlawful products.

Throughout this article, the reader will discover the legal process of product copyright and trademark infringement and how counterfeit items directly hinder intellectual property laws. Additionally, the reader's awareness of the trouble that these items create within not only the United States, but also worldwide, as well as recommendations on how to counter this rising problem, will be raised.

BACKGROUND

In order to protect their product from infringement, designers engage in both trademark and copyright practices. In cases of product design, trademark looks largely at its trade dress or "overall appearance of a product's packaging or dress." [1] Trademarks assist consumers when individuals take note of the packaging of merchandise, effectively lowering the search cost and providing a reliable guide to finding such items. [2]

When claims of trademark infringement arise, a creator must prove that the supposed infringer's design is not functional and that their original design is

distinctive and has acquired secondary meaning prior to the introduction of the possible infringer's product to the market. [3] By trying to prove functionality, the purpose of the product and its effect on the marketplace is analyzed; the greater the disadvantage to others in the marketplace in conjunction with exclusivity, the more functional the design becomes. [4] After functionality of the product has been demonstrated, distinctiveness of the design is analyzed through (1) a combination of the design's elements which identifies the original brand; and (2) that the general public identifies the design of the brand through a variety of factors such as consumer surveys, advertisements, sale records, and unsolicited media coverage. [5] Taken together, this process serves to identify trademark infringement.

Copyrights on the other hand, encompass rights in the producer's original work. [6] This includes reproduction, distribution, and future access to generate products from the original source. [7] However, unlike trademarks, "copyrights are not apt to be infringed without conscious duplication of copyrightable subject matter." [8] Therefore, those who look at a product and reproduce it in a manner similar to the original product would be liable for copyright infringement.

When testing for copyright infringement, there are certain tests the creator can initiate in order to protect their product. In *Van Cleef & Arpels Logistics, S.A. v. Landau Jewelry*, the Court found the defendant's product was an infringement of the plaintiff's design using the 'substantially similar' test. [9] Under this two part test, an individual infringes upon another's copyright when (1) themes, ideas, patterns, organization, or other details of the product are substantially similar to the original design; and (2) whether an individual outside the case would find the 'concept and feel' of the product design to be similar to the original. [10] Often the difference between copyright infringement and fair use hinges on the minute details of the product. [11]

Through implementing both copyright and trademark protection, original creators guard their design against possible infringers. In order to stop individuals from duplicating other's designs and products, injunctions and sometimes statutory damages are awarded as punishment. [12] Although injunctions and damages do not always prove the best deterrent for infringers due to their lack of rigidity and severity, they serve as the best alternative until stricter laws are enacted. [13]

ANALYSIS

Counterfeit products would cease to exist if individual consumers' demand stopped. However, this impracticality is realized by both lawmakers and companies who analyze why the general public strives to obtain these illegal products rather than purchase authentic merchandise. This issue is not merely a localized problem, but rather has swept far and wide across the globe. [14] As companies look to reduce the number of counterfeit purchases, a variety of factors must first be considered.

First and foremost, the recent downturn of the economy has caused less disposable income for individuals to spend on luxury items such as designer merchandise. [15] In fact, the International Anti-Counterfeiting Coalition found that over the past two decades, intentionally infringing an established trademark has risen over 10,000 percent and accounts for almost seven percent, roughly equally $600 billion, of goods sold globally. [16] Hence, the belief that consumers value purchase quantity over quality becomes evident. [17] Many Americans feel that the price of the counterfeit item, be it drugs, movies, or the like, ranks high amongst the factor list, whereas the ability to obtain such items falls below the importance of price. [18] However, if consumers continue to look out for their own self-interests and remain unaware of the problems that imitation products create, they cease to see the issues that result from the knockoff industry.

Issues with counterfeiting affects countless industries ranging from apparel to medicine to entertainment and even technology. Companies such as Abercrombie & Fitch and New Balance Athletic Shoe have seen the effect of counterfeiting and now limit consumer purchases as a way to counteract the illegal activity of creating and selling knockoff versions of in-store items. [19] Although this activity worries some companies regarding their short-term success, the majority worry about counterfeiting's longevity, which could ultimately bring about company and even industry failure. [20]

As a method to attempt and counteract the possibility of industry failure, companies such as Tiffany are suing those who facilitate the successful exchange or purchase of these goods. In the Southern District of New York, Tiffany & Co. sued eBay for the promotion and sale of 'bogus goods.' [21] Tiffany accused eBay of being responsible for the sale and encouragement of counterfeit merchandise by suggesting that the items were genuine Tiffany jewelry. [22] If eBay falsely presented the knockoff items as real Tiffany jewelry, an unassuming consumer would be easily confused and mislead, leading to the continuation of the illegality of the act if a purchase resulted.

The consumer's misdirection is not the only problem that results from the exploitation of illegal and counterfeit materials. In fact, health and safety risks, reduction in employment, loss of innovation and profit, funding of terrorism, and United States government tax revenue loss would ensue. [23] In recent years, technology has also aided this problem. In fact, the internet "is the Wild West for counterfeiters and pirates because of the anonymity." [24] Despite the fact that the internet helps the knockoff industry to reach all corners of the world, the largest problem is still the source of product creation.

The American movie, as well as software and music, industries estimate that Chinese pirated goods cost the United States industry over $2 billion in sales per year. [25] In April 2009, more than 100,000 Chinese-made counterfeit items

were seized in Bay Bridge, Brooklyn, leading to an arrest and second-degree trademark counterfeit charge. [26] With items easily shipped out of China to the United States, companies currently have little power to fight this production. As a result of this outcry from companies claiming that their intellectual property has not been adequately protected, China's government has pledged to help attack the problem head on. [27] Following through on this pledge seems questionable; however, because China still serves primarily as a manufacturer rather than a designer, the country would therefore reap little benefit from such action. [28] Until stricter standards are taken with China, it seems as though only a slap on the wrist has been executed. However, China is not the only country that fails to protect foreign company's intellectual property rights. In fact, United States businesses remain leery about putting serious effort into selling and distributing their product in India due to a lack of reliable standards. [29] Before a company feels secure in selling and distributing their product, more stringent intellectual property practices must be arise. In order for this to be possible, countries must heed recommendations to secure the rights of the original producer.

RECOMMENDATION

After witnessing the effects of intellectual property theft, in 2006 President Bush signed the *Stop Counterfeiting in Manufactured Goods Act* to allow the government to confiscate both knockoff products as well as any equipment used to make them. [30] Although this bill clearly does not solve the infringement problem, it is a step in the right direction for the protection of designers and creators. Rather than relying solely on Congress to pass bills further protecting intellectual property rights, companies have begun to take matters into their own hands. [31]

In fact, companies take greater precaution against trademark and copyright infringers, many typically spending between $1 million to $2 million of their own revenue for extra protection. [32] Consequently, not only do companies pay

experts to help guard their goods, but also try and advertise to consumers to stop buying illegal products. [33] Through this advertising, companies can warn individuals about the potential dangers of some knockoff items such as drugs, whose use could lead to serious consequences, or even about the illegality and unethical action of counterfeiting products. [34] Furthering the source of advertisements, a few years ago, the International Anticounterfeiting Coalition initiated a 'fight the fakes' message at Hunter College in New York City. [35] Although the results of these advertising campaigns might not become clearly evident, if the message is constantly in the media that counterfeit product purchase is unacceptable, companies may save money in the future for protection when sales of knockoffs falter.

After the July 2008 holding in *Tiffany v. eBay*, a French court rejected L'Oreal's clam that eBay was profiting off of counterfeit perfume purchases. [36] This Court noted eBay's good faith efforts in trying to detect the sale of counterfeit items as well as determining that "preventing counterfeits will only be effective through a close collaboration between rights holds and eBay." [37] Working together may be one of the most important mechanisms in which to foster greater protection for the products and serve as a deterrent to product infringers.

CONCLUSION

Counterfeiting products has become a staple in today's society. Almost anywhere one goes they are bound to see consumers carrying, holding, or wearing illegally manufactured goods. What most individuals are not aware of are the problems that these knockoff items create. With safety risks, decreasing incentives for creators, as well as profit loss, counterfeit products initiate more harm than benefit. With more industries working together as well as the support of the government, illegally copyrighted and trademarked items will hopefully fade. Until that time however, consumer awareness serves as the most powerful weapon against such a prominent market.

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[31] Myers, *supra* note xiv.

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SHOULD CHEERLEADING BE A SPORT?

I. Introduction

There is an ongoing debate among the media and cheer world as to whether or not cheerleading should be recognized as a sport under Title IX.[1] A recent poll found that 60% of people thought cheerleading was a sport, while 35% did not.[2] Cheerleaders sometimes a> Opponents argue that because the primary function of cheerleading is not competition, it does not meet the qualifications of a sport.[3][4] The answer to this debate depends on your definition of a sport.[5] The NCAA, the U.S. Department of Education's Office for Civil Rights (OCR) and the Women's Sports Foundation (WSF) all have their own definition of "sport" that a competitive cheerleading squad could possibly qualify under.[6] The question also brings up other issues that would need to be addressed. Cheerleading is an estimated half-billion dollar industry,[7]and an underlying problem to solving this debate stems from national for-profit cheerleading associations that would prefer cheerleading to remain an "athletic activity" for financially-based reasons.[8] There is also speculation of educational institutions upgrading cheer squads to varsity status in order to save money off of traditionally more expensive women's sports.[9] Cheerleading's classification as a sport under Title IX may also influence courts' decisions regarding liability issues arising from cheerleading injuries.[10] This paper will discuss whether or not cheerleading should be sport and why it depends on if you are in favor of more regulated competitive cheerleading program governed by educational institutions or a less competitive self-regulated cheerleading program.

II. Cheerleading as a Sport under Title IX

Approximately half of the U.S. states have already recognized high school cheerleading under Title IX.[11] Cheerleading has grown significantly in

popularity among women, almost 25%, since 2000.[12] Cheerleading's largest barrier to achieving Title IX status nationwide seems to be its inferior status as a second-rate sport to others that are more traditionally known.[13] Raising a woman's cheerleading club to that of a varsity sport status is the easiest way a school can comply with Title IX.[14] A cheerleader that wants their club to be a sport would need to show the school was out of Title IX compliance and raising their status to a varsity sport would constitute compliance."[15] Determinations of whether cheerleading is a sport needs to be made on a case-by-case basis, beginning with whether the competitive squad meets the qualifications under the definitions traditionally used to make that determination.[16] The way in which Title IX applies to cheerleading usually depends on whether the educational institution defines it as a sport or an extracurricular activity.[17] Common authorities on the definition of "sport" are the OCR, the WSF and the NCAA.

a. OCR's definition of "Sport"

The OCR's criteria are as follows: (1) athletic ability; (2) athletic competition; (3) preparation similar to other athletic teams; (4) multi-level championship competitions; and (5) administration by an athletics department.[18] If a cheerleading squad selects it's members according to their athletic ability, makes it their primary purpose to compete against other squads, prepares for competitions like other sports, competes in regional championships and allows their athletic department to administer their activity, then it seems like cheerleading may easily qualify as a sport under the OCR's definition.[19] Because the OCR's definition requires squads to make it their primary purpose that they compete against other teams,[20]cheerleading clubs that traditionally cheered for other sports might not be able to do so anymore if they're trying to achieve varsity sport status.[21] The OCR's definition does not exclude sideline cheering,[22] but it would be to a squad's detriment if they still engaged in cheering for other sports.[23]

b. WSF's definition of "Sport"

The WSF's definition of a sport is: (1) physical activity involving mass resistance; (2) against/with an opponent; (3) governing rules; and (4) skill-based competition.[24] Cheerleaders compete against other squads and function under the regulations of the NCAA.[25] As long as cheer squads in pursuit of becoming a varsity sport make it their primary purpose to compete against other similar squads, they should qualify under the WSF's definition as well.[26] Currently, the WSF has found that cheerleading is not a sport because their purpose is not to compete and "most competitions are not structured like school sport competitions."[27] By assuming that all cheerleading squads have the same purpose, WSF has not allowed room for judgments to be made on a case-by-case basis.[28]

c. NCAA's definition of "Sport"

For purposes of reviewing emerging sports, a sport is defined by the NCAA as: (1) An institutional activity involving physical exertion with the purpose of competition within a collegiate competition structure;[29] (2) at least five regularly scheduled competitions within a season; and (3) standardized rules with official rating/scoring systems.[30] Many educational institutions choose not to elevate their cheerleading clubs to the level of varsity sport because they do not want increased regulations imposed by the NCAA,[31] nor do many schools want to phase out the non-competitive sideline activities of cheerleaders altogether.[32] Although the NCAA does not recognize cheerleading as a sport, "an estimated 225 junior and four-year colleges award some kind of cheerleading scholarships."[33] Cheerleaders can practice and compete more hours a week than other sports because they are not recognized as a varsity sport by the NCAA, which requires no more than twenty hours of practice per week.[34]Cheerleaders are not forced to follow requirements such as mandatory physical examinations, collegiate participation past four years or only practicing certain times of the

year.[35] These risk factors increase their chances of injuries,[36] and leave educational institutions susceptible to negligence litigation depending on the cheerleading stance of the court.[37] Educational institutions that unintentionally or recklessly create risks outside of the ordinary activities related to cheerleading may not be able to claim that the cheerleaders assumed the risks of the dangerous athletic activity.[38]

III. Liability Issues Arising from Cheerleading Injuries

High school and college cheerleading accounted for 57% of catastrophic injuries and direct fatalities in U.S. female students from 1982-1997. [39] From 1982 to 1992, partner stunts caused 41.9% of college cheerleading injuries and gymnastic routines accounted for 20.5%.[40] In 1995, the Consumer Product Safety Commission data found that, "an estimate of 16,982 cheerleading injuries involved an individual going to a hospital emergency room."[41] Most female cheerleaders have had at least one injury in their cheerleading careers.[42] A university will either take a hands-off approach that views their cheerleading squad as a club or a full-service approach that organizes cheerleading like an athletic team by providing coaches, safety training and regulations.[43] This is why a sport classification would mean so much for liability purposes.

a. Assumption of Risk

Although courts generally hold that cheerleaders assume the risk of injuries while cheerleading, this assumption may not completely bar them from recovery.[44] However, some courts still find that since there is a high and definite risk of physical harm involved, a school does not owe a duty to cheerleaders to provide adult supervision and monitor their activities.[45] To build a case for assumption of risk, educational institutions often use exculpatory clauses to shield themselves against future negligence liability that may arise in the course of cheerleading.[46] These clauses may appear in the form of a

warning, waiver or release that a cheerleader must sign in order to engage in cheerleading activities.[47]

b. Duty of Care

If a duty of care exists, injuries caused by cheerleading may be a result of negligence.[48] Most courts have agreed with juries that, "schools owe a duty to provide its student cheerleaders with adequate supervision, training, and coaching for its student cheerleaders."[49] University administrators must be aware of any factors that may constitute a special relationship between the university and its cheerleaders."[50]If there is a mutual benefit to both parties, a court may find a special relationship exists between the parties that designate a duty of care by the educational institution.[51]

c. Governmental Immunity

Some courts have statutes that provide them immunity from "negligence actions for participants in a recreational activity that involves physical contact between persons in a sport involving amateur teams."[52] The Wisconsin Supreme Court held on January 27, 2009 that cheerleading is a contact sport, and as such they are "immune from negligence actions under *Wis. Stat*. § 895.525(4m)(a) (2005-06) because they participate in a recreational activity that includes physical contact between persons in a sport involving amateur teams."[53] The Wisconsin Supreme Court defined "sport" as "an activity involving physical exertion and skill that is governed by a set of rules or customs"[54] According to the National Cheer Foundation, "this is the first decision of its kind in the nation."[55] This ruling also meant that coaches and school districts may not be sued for lack of supervision.[56] If more courts agree with the Wisconsin Supreme Court and adopt their contact sport rule, cheerleaders may need to take out insurance policies to guard themselves against future injuries.[57]

III. Cheerleading is Big Business

It would be to the largest cheerleading governing institutions' detriment for cheerleading to be classified as a sport under Title IX.[58] These associations make their money from merchandise sales, cheer camps and privately run competitions.[59] "Cheerleading is big, serious business, right down to the network of state, regional and national cheerleading competitions the two big companies hold each year."[60] If educational institutions were given the power to govern cheerleading, these private for-profit organizations would lose a lot of money.[61] Varsity Spirit, the largest cheerleading company, made almost 150 million dollars in revenue in 2001.[62] Recent movies such as *Bring it On* have heightened interest in cheerleading, along with the *Dallas Cowboy Cheerleaders* reality television show series.[63] Privately owned institutions have no reason to push for cheerleading to be classified as a sport if it's going to cut into their revenues.[64]

IV. Conclusion

Whether cheerleading should be classified as a sport should vary on a case-by-case basis for those squads that deem competitions more important than "raising school unity through leading the crowd at athletic functions."[65] It is possible for cheerleaders to fulfill the qualifications of commonly used and accepted "sport" definitions, but it's unclear whether cheerleaders themselves actually want this to happen. If more educational institutions qualify their cheerleading squads for sport status, the cheerleaders themselves would be better regulated under safety guidelines,[66] injuries would most likely decrease,[67] and women would have a greater chance to compete participate in a varsity sport at their respective institutions.[68]Although these are important concerns for cheerleaders nationwide, the for-profit cheerleading governing institutions have too much influence over the cheerleading world for there to be a push towards a more school-regulated sport classification for cheerleading.

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NO STARTS, NO STATS, NO PROBLEM

I. Introduction

Virtually everyone has looked for a job and found that they just did not meet the previous experience requirements laid out in the description. The salary looks great, but you may not have three to five years of Big Four accounting experience. Society generally rewards those that have been through the rigors of the profession before. However, the growing trend in the NFL is to hand over bags of money to college athletes who have not yet played a snap in the NFL or faced the challenge of competing against the world's best. [1] The NFL does have a rookie salary cap in place, with a pool of money allotted to each team stating how much it can spend on salaries. [2] However, guaranteed money and signing bonuses have allowed teams to continue to shell out more and more money for their new "face of the franchise," and still miraculously stay under the salary cap. [3] Is there hope for resolution before the uncapped year and potential future lockout? This article will discuss the problems with the current system in the NFL as well as potential resolutions that would benefit the NFL, current players and fans.

II. Amidst CBA discussions the Rookie Pay Scale Continues to be a Hot Topic

The NFL is heading full steam into an uncapped year in 2011, and while the problems facing the NFL talking heads and the NFLPA are vast and numerous, the lack of a manageable rookie pay scale is a glaring issue that needs to be resolved. [4] Writers, veteran players, and NFL Brass alike are pining for a system that would be more reflective of the contributions of players. [5] While owners and the NFLPA quibble over revenue sharing and (hopefully) a new Collective Bargaining Agreement, the issue of a proposed rookie pay scale or the

like will most likely be vigorously supported by the NFL. [6] In fact, Roger Goodell himself has vehemently pushed for such a system through the media. [7] Going forward into the offseason, the absence of a rookie pay scale seems as though it may be a sticking point in labor negotiations.[8] However, although their voices have been heard across various media athletes, the simple truth is that without NFLPA and NFL supported resolution, the NFL draft will continue to be a windfall for 22 year-olds with no experience playing on Sundays, and the league and players in it will suffer. [9]

III. The NFL is not Growing as Fast as First Round Salaries and Veterans are Suffering

The reality of the current situation is that NFL first round salaries are increasing faster than team revenues. While the NFL continues to operate the most successful professional league in the United States, the teams within have not been impervious to the economic downturn or, more permanently, the exponential rise of the rookie salary cap. The Green Bay Packers have been fortunate enough to turn a sizeable profit, but that is not enough to convince the Team President and Chief Executive, Mark Murphy, that the system is working. [10]Furthermore, NFL rookie salaries are increasing faster than the salary cap and veterans are feeling the hit. [11] From 2003-2007, the average guarantee for first round draft picks rose by approximately 67%. [12] Contrast that with the fact that the NFL salary cap only increased by 45% in the same time period. [13] Matthew Stafford was recently signed to a $78 million contract, with over $41 million coming in guaranteed money. [14] Matthew Stafford was a good NCAA quarterback, with admittedly great measurables. However, Tom Brady, the golden boy of the NFL, has three Super Bowls to his name, but his “paltry” $8 million this year cannot hold a candle to Stafford’s Trump-esque take home pay.[15] Pittsburgh Steelers’ quarterback Ben Roethlisberger had to win two Super Bowls before he could come close to Stafford’s numbers. [16] Although it seems absurd that Tom Brady

and Ben Roethlisberger, with five Superbowls and numerous Pro Bowls between them, would not get paid as much as a 21 year-old rookie quarterback, the Mt. Olympus of the NFL are not the group being slighted the most in the current system. [17] NFL veterans, the few that have defied the odds and made it through multiple seasons, proving themselves time and time again, are being most affected. [18] Teams have recently had to make conscious decisions to pay a Stafford-like salary to a first round pick, trade down in the draft to reduce salary demands for draft picks, or re-sign important and proven veterans.

[19] Unfortunately, it seems like the trend is to get rid of valuable or roster filling veterans to bring in the glamour of a first round draft pick. The system also has first round draft picks and their agents feeling entitled to ridiculous salary increases each year, and often times this leads to the player sitting out of camp, or potentially the whole season. This hurts not only the team, but the player as well. [20] The amount of holdouts in the past five years is incredible, with the most recent example being Michael Crabtree and his potentially sitting out the 2009 season because he feels he is not getting paid what he is worth at the number ten pick overall. [21]

IV. The NBA Rookie Scale – A Workable Model

With all the problems with getting players in camp, as well as financial concerns of teams and veterans, what is the league to do? One idea supported by various columnists and athletic academia is to put a rookie pay scale in place, much like the NBA. In the NBA, players are signed to contracts reflective of where they were chosen in the draft. Players are paid similarly to the player chosen last year in their draft slot, with a slight raise from year to year. [22] The benefits to this system are numerous. First, contract disputes over money would be minimized, getting players into camp and meshing with their new teammates. [23] This would also help alleviate the massive increase in salaries from year to year for first round draft picks in the NFL, with the only raise coming by way of a natural

increase. [24] This would also allow teams to spend money on players that have proven themselves on the field and off. This is especially true with teams like the Detroit Lions who need not only a new quarterback, but valuable veterans to fill out their roster and provide depth. While this may not sound like the best solution to future first round draft picks, they will embrace it in years to come when they are veterans fighting for contracts and roster spots. Just ask Joey Harrington.

V. Conclusion

The NFL is reaching the critical point for negotiations. The allure of the NFL is partly because of the great parity in the league. The Dolphins went from nearly winless to the toast of the division in one year. This is due in large part to the fact that teams are on the same level in the NFL, and an uncapped year would bring this crashing down. Teams like the Washington Redskins will become the New York Yankees of professional football. While a rookie salary cap would not completely alleviate the concern, it would be a monumental step towards a resolution.

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PROTECTING "THE PROGRESS OF SCIENCE AND USEFUL ARTS."

I. Introduction

Patents have recently received a great deal of attention as tradable commodities, attracting the attention of several hedge funds, and giving rise to investment firms that specialize in patent acquisition.[1][2] This aspect is not unanticipated, and in fact is on its face congruent with the original means for attaining the goals behind patent law – "to promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries." [3] The idea behind providing this protection is simple: encourage innovation by giving the innovator certain property rights and protections under the law which in turn encourages market participation.[4] The ability to monetize innovation is the means by which the U.S. Constitution proposed to incentivize the research and distribution of innovations. Nowhere else has this been more relevant than in the "Technology Sector," where patents can make or break market share, and mean big bucks for the holders of those patents.[5] With the increasing number of patents issued and the amount of money tied up in them, the amount of litigation regarding those patents has increased accordingly[6]. This paper will address some of the issues created by the right to in IP litigation.

Part II will outline a specific scenario which creates several problems in IP litigation, and discuss some of those problems in depth.

Part III will outline the need for alternative remedies in this scenario, and discuss some possible alternatives.

Part IV presents and conclusion that highlights the difficulties with current IP regulation and stress the need for alternatives to follow the goals illustrated in the constitution.

II. Discussion

Of the rights afforded to the patent holder ("Holder") none is more powerful than the right to an injunction.[7] Injunctive relief allows the Holder to obtain a court order requiring the defendant to cease any infringement, thereby protecting the aforementioned monetary interests which incentivize innovation. In order to obtain this relief the Holder must show "(1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction."[8] The Supreme Court's holding in eBay, which eschewed the matter of course right to injunctive relief in favor of the aforementioned four part test, followed traditional notions of equitable relief and was a crucial step towards a more logical application of injunctive relief in IP law.[9] [10] Injunctive relief achieves its greatest utility as a means protecting the interests of one market participant ("Producer") against infringements by another. In this situation injunctive relief affords the Holder the ability to eliminate potential future losses, and the ability to protect their current market share. The utility of injunctive relief in this situation is further highlighted because it reduces the burden placed on the courts – an injunction allows the court to avoid costly damages calculations for future and past infringements.[11] A recent holding congruent with this theory can be seen where a Holder was found to be using the patent in question and thus granted an injunction.[12]

However, when reasonable royalties are the only damages claimed and the Holder shows little to no inclination towards market participation the utility of, and the rights protected by, injunctive relief rarely fit the purpose of "promot[ing] the progress of the arts and useful sciences."[13] In this situation the right to an injunction does very little to increase the incentive to bargain, affords the Holder unfair bargaining advantages, and can cause a loss to society. The reason for the inefficiencies associated with injunctions in the aforementioned scenario stems from the fact that the possible desirable outcomes create more externalities under regimes with injunctions than without. It should be noted that the scope of this article is restricted to the scenario in which the Holder seeking reasonable royalties and an injunction is neither a market participant ("Producer") nor an exclusive licensor, and a design workaround ("workaround") is either excessively cost prohibitive, or unavailable to an Infringer– other scenarios are beyond the scope of this argument.

Firstly, the right to an injunction creates little additional incentive to bargain because it does not change the most desirable outcome (the outcome which both parties have the most incentive to achieve), but rather only affects the results when bargaining fails (the outcomes which both parties have more or the most incentive to avoid). The most desirable outcome in both schemes is for the parties to come to an agreement which reduces transaction, administrative, and social costs. The infringer wants to bargain because he can continue selling his product. The holder wants to bargain because a licensed patent generates more revenue than an unlicensed one. In fact, if the Holder's only profit interest is royalty revenue their best goal would be to obtain as many licensing agreements as possible. By saturating the market with their idea the Holder would increase the volume of his profits, as well as hedge off any losses due to downstream market competition. Therefore, if both parties wish to maximize profits they will want to reach an agreement, preferably out of court to reduce transaction costs. An

injunction would be the least desirable outcome for either party because it would decrease the total revenue each party would be able to obtain. If an injunction is granted the Infringer would no longer be able to sell its product, decreasing its revenue, which would in turn decrease the amount of reasonable royalties the Holder would be able to claim. Even if the parties fail to reach an agreement, it would appear that the most desirable outcome would be for the infringer to keep producing and selling such that the Holder could maximize its profits from the reasonable royalty damages obtained by a lawsuit.

Secondly, injunctive relief affords the Holder an additional unfair bargaining advantage because the only interest injunctive relief protects, beyond those protected by reasonable royalties, is the ability to leverage the potential losses against the infringer. When bargaining, each party has a certain threat value, or in other words the maximum price which a party is willing to pay to obtain a benefit, avoid a cost, or some combination of the two. An infringer in an injunction regime faces the additional threat of an injunction and in settling avoids a higher cost than he would in a regime without injunctions. Therefore the infringer in such a scheme is more inclined to pay a higher (or more burdensome) premium to avoid the additional costs of an injunction, which is typically quantified as an increased threat value. The Holder in this case, aside from lost reasonable royalty claims, suffers little potential damage as a result of an injunction when compared to the potential losses the infringer may suffer. Although a Holder may run the risk of losing potential royalties from the period of the injunction, the Holder's ability to leverage the threat of a continued injunction allows them recoup or offset those losses should an agreement be reached. The threat of increased costs does not necessarily increase the incentive for the infringer to bargain, but rather it increases the amount the infringer is willing to pay. This cost is created regardless of the reasonableness of the infringers negotiations thus penalizing the unwitting infringer or potential licenser

who attempts to reach a reasonable agreement. Furthermore the consumer and society has a high likelihood of bearing this cost because the additional value that the Holder is able to demand will likely affect the sale price of the finished product. If a particular product is in high demand the value lost by the producer because of an injunction will be greater, thus the price that can be leveraged by the Holder will increase. An excellent example in the similar area of copyright law is how Apple, in response to record label pressure, increased the prices on many of the most popular songs.[14] Because injunctive relief only affords the Holder the ability to leverage additional royalties created by potential costs associated with the threat of an injunction this relief should be avoided unless a significant showing congruent with the "Progress of Science and useful Arts"[15]

Thirdly, the consumer will be disadvantaged by no longer having access to the infringer's product, creating waste and arguably slowing the progress of "Science and Useful Arts."[16] If a preliminary injunction is granted and unsuccessfully appealed in this situation the results could have a dramatic effect on the market, and the ability of consumers to use certain products. Stopping new and useful technology from entering the stream of commerce could significantly slow the development of that technology, and interfere with the development of other technologies. Furthermore the damages to an unwitting infringer that would result from an injunction could be far in excess of the damages to the Holder as a result of the infringement. If the purpose of patent law is to "to promote the Progress of Science and useful Arts," then the laws enacted should recognize that the dissemination of knowledge is the cornerstone of innovation.[17][18] Dissemination of knowledge or innovations "allows more people to enjoy [their] advantages [,]" this dissemination can lead to improvements of that specific knowledge or facilitate innovation in other fields, by the sheer fact of increased "static-efficiency" and exposure.[19]

III. Resolution

The right to Injunctive relief is generally best used as a means to give "Producers" incentive to innovate.[20] Injunctive relief gives "Producers" incentive to innovate because it allows them to invest the capital to do so with the security that their hard earned innovations will be protected and allow them to gain an advantage in the market.[21] If the Holder was a producer and did not have the right to injunctive relief he would lack an adequate remedy at law, and would stand a much stronger chance of showing irreparable harm. Injunctive relief is a fair and adequate solution in this situation because a bargaining or licensing agreement may never happen between a Holder who is a producer and any other party.

However, in the situation addressed in this article injunctive relief, in addition to reasonable royalties, protects little if any right which furthers the progress of "Science and useful Arts," because the Holder in this situation still has revenue maximizing incentive.[22] Though it can be argued that the threat of injunction serves as a cheap and effective means of deterring willful infringement, the willful infringement doctrine takes care of this problem quite nicely by allowing the damages (which will already be calculated in this scenario) to be tripled.[23] Thus a willful infringer already risks significant damages and the remedy afforded to the Holder does not necessarily afford the Holder an unfair bargaining advantage.

In situations where a reasonable agreement between the Infringer and the Holder cannot be reached the court should strive to achieve a remedy that would put the Holder in a situation which he would have been in had the parties been able to strike a reasonable agreement. The doctrine of willful infringement can still apply in this scenario in order to deal with Infringers who are unreasonable in their dealings or obviously copied or stole the Holder's

innovation.[24] Furthermore the unwitting infringer should be afforded a similar mechanism to combat the problem of a Holder who holds a patent and waits to initiate a suit after an infringer has already begun production of a product in thereby increasing the Holder's bargaining advantage. This practice "pejoratively referred to as 'patent troll[ing]" has created many problems in its own right.[25] In the U.S., several companies, universities, and tech firms have founded non-profit patent acquisition firms to combat this practice.[26] Several legal systems have systems which combat this practice by affording infringers or potential infringers the ability to seek a compulsory license[27] Though the courts do not have to embrace this doctrine in its entirety the concept here could apply to function as a de facto non-exclusive license a finding for which could be supported by the Holder's unwillingness to license his innovation for unreasonable means. Though this practice might be at " tension with *Continental Paper Bag Co. v. Eastern Paper Bag Co.*, 210 U.S. 405, 422-430, 28 S.Ct. 748, 52 L.Ed. 1122 (1908)," it would provide a workable alternative to merely obtaining a permanent injunction. [28] In short the leverage created by the threat of an injunction (the current remedy) in this situation is created solely by the law; any future remedy (or alteration to the current one) should not force citizens to resort to private practices to protect themselves from oversight in policy.

IV. Conclusion

The rights afforded to patent holders are not the goal of patent but rather the means for lubricating "the Progress of Science and the useful Arts." [29] The right of injunctive relief in the scenario discussed does not protect any right that furthers the constitutional goals of patent law. Minimizing the externalities created by these transactions is more important to the long term progression technology. The progress desired in the constitution relies as much on innovation

as it does on the proliferation of and access innovation. Having access to new and useful technology allows society to function better as a whole, thereby increasing the likelihood of future innovation. The increased commoditization of patents needs to take this effect into account, many patent holders these days are not interested in developing and producing their items, but rather receiving money from someone who is willing to do it. Profit maximizing incentives that lubricate bargaining can be achieved through policy that does not impede the proliferation of innovation.

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

[3] U.S. CONST. art. 1, § 8.

[4] *See* ROBERT COOTER AND THOMAS Ulen, LAW & ECONOMICS (Pearson Addison Wesley 2008).

[5] Alamy, *supra* note 1.

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[8] *Id.*

[9] *Id.*

[10] Boomer v. Atlantic Cement Co., Inc., 257 N.E.2d 87 (N.Y. App. Ct. 1970).

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[12] John Timmer, *Killing the cash cow: Microsoft ordered to stop selling Word,* ARS TECHNICA, Aug. 12, 2009, http://arstechnica.com/microsoft/news/2009/08/court-gives-microsoft-60-days-to-stop-shipping-word.ars.

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[17] *Id.*

[18] Cooter, *supra* note 4.

[19] *Id.*

[20] *Id.*

[21] *Id.*

[22] U.S. CONST. art. 1, § 8.

[23] *See* In re Seagate Tech., *LLC,* 497 F.3d 1360, 1371 (Fed.Cir.2007).

[24] eBay v. MercExchange, 126 S. Ct. 1837 (2006).

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[26] Ashby Jones, *In Fight Against 'Patent Trolls,' a New Arrow in the Quiver?*, WALL ST. J., Nov. 24, 2008, http://blogs.wsj.com/law/2008/11/24/in-fight-against-patent-trolls-a-new-arrow-in-the-quiver/.

[27] Cooter, *supra* note 4, at 133-34.

[28] eBay v. MercExchange, 126 S. Ct. 1837 (citing ContinentalPaper Bag Co. v. Eastern Paper Bag Co., 210 U.S. 405, 422-430, (1908)).

[29] U.S. CONST. art. 1, § 8.

CAN I GET A PIECE OF THAT? POLICIES ON SAMPLING AND HOW IT AFFECTS CREATIVITY IN HIP HOP

By: Brittany A. Estell

I. Introduction

Jay-Z's *Blueprint III* [1] was released on September 11, 2009 with an abundance of featured artists as well known producers.[2] Exactly two months after his release date, this huge name will be at Assembly Hall performing for thousands of students, fans, adults, and professors. [3] In 2005 there was a grave controversy about DJ Danger Mouse's mixtape *The Grey Album,* [4] a compilation created by sampling Jay Z's *The Black Album* [5] and the Beatles' *The White Album* [6][7] DJ Danger Mouse was sought out by record companies who owned both Jay-Z and The Beatles' music for copyright infringement, after his mixtape became popular all over the internet as well as the radio airwaves. [8] More about DJ Danger Mouse and his legal troubles and how it relates to sampling will be discussed at length below. Today, on *Blueprint III,* [9] Jay Z has producer Kanye West, who is famed, among other things, for his use of sampling in his very popular beats.[10] On his album *Graduation* (2007)[11] he gave sample credit on ten out of the fifteen songs on the CD. [12]

What is intriguing about these two sampling situations are the dichotomy between persons who have the means to sample, and those who do not. Persons who have the power and who are surrounded by people with knowledge of the music industry have everything they need at their fingertips and creativity is endless. On the other hand, there are persons who are creative, and their creativity and popularity can be stifled for fear of being prosecuted by the law for not having the proper licenses and copyrights to publish their work. The following will discuss

this dichotomy at length. This article discusses sampling and the policy/law affects on hip-hop. Part I will define the term sampling. Part II will give a small background on sampling and how it affected DJ Danger Mouse, he would represent the ordinary citizen. Part III will discuss how hip-hop creativity is stifled. Part IV will discuss an expression of the dichotomy between the famous and the general public and how sampling creativity affects each of these groups. Also, Part IV will discuss options the industry and the Supreme Court should seek in creating policies about sampling music. Part V will be the conclusion.

II. What is Sampling?

At its most basic definition, sampling is when a producer, "chops, screws, arranges, and assembles" a previously recorded sound and then use it for their own purposes. [13]Sampling is taking a snippet of music, a loop repeated through an entire song, or five notes taken from a song, and re arranged, similar to a collage, sampling is like that with music, and it is really one of the building blocks of hip hop is on. [14] The type of sounds that are used can be anything from nature sounds to actual speech, any type of previously recorded sound. [15] Central ideas in policy revolve around "a chain of concepts: property, originality, ownership, possession, authenticity, authority, creation, and genesis." [16] These variables are responsible for creating policy. The sixth circuit court made a decision about sampling which again altered the way it was governed in *Bridgeport Music, Inc. v. Dimension Films*.[17] In *Bridgeport*, several publishing groups including Bridgeport Music, Inc. brought suit against Dimension Films and No Limit Records, for using a piece of a song, which they had the copyright to, in their movie. [18] It was held that no matter how much of

a musical work is sampled, it never be defined by being insubstantial enough to not grant copyright protection. [19]
Furthermore, the Supreme Court used this act to help define originality of work by law. The Supreme Court stated that the time when a sample is something original is when it is something vastly different from what was taken from the first musical selection in other words transformative. [20]

III. Effects of Policy

In the case of sampling, one of the most notable affects that policy has had on society at large is the case of DJ Danger Mouse and the *Grey Album*. [21] This case in point exemplifies confusion within the courts on sampling. Courts agree that if an artist takes more than a few notes this is infringement. [22] However, courts are in dispute over whether a piece that is entirely transformative infringes copyright, even though a large portion of vocal or non-vocal pieces are used. [23] In a transformative piece, the artist creates something exemplary differential from the original piece so much so that it can be called his own. [24]
DJ Danger Mouse was an underground DJ who complied vocals of Jay Z's *Black Album* and the Beatles *White Album* and created his own *Grey Album*. [25] Not expecting it to get much play, he distributed 3,000 copies. [26] Once the album became distributed on the Internet it gained a wider audience and critical acclaim. [27] Jay Z and Roc-A-Fella Records did not object to Danger Mouse use of vocals; however EMI, Capitol Records, and Sony Music/ATV Publishing did find serious issues with his "creative art." [28] Publishing groups: EMI, Capitol Records, and Sony Music/ATV took steps to shut down this successful DJ. [29] EMI, Capitol Records, and Sony Music/ATV took steps to shut down this successful DJ. [30] However, brining the issue to the DJ himself, people in the interest of the Beatles White Album, went to his Internet Service Provider and

threaded to get them involved in a lawsuit because their subscriber was committing copyright infringement. [31] They were able to get the Internet Company to agree as they proceeded to take action against DJ Danger Mouse for his infringement practices. [32] EMI Group issued a cease and desist letter to Danger Mouse, and his retailers, ordering them to stop distributing the album. [33] Danger Mouse agreed to avoid further legal action.[34]

IV. What Does All This Mean?

There is value in copyright law in protecting people's creativity, but there is the question of how much value, ownership, and rights do individuals have? Individuals cannot create music without having to worry that someone could take their work and credit for themselves. It seems as though the Courts are beginning to crack down on people for sampling, only because their music becomes popular, as in the case of DJ Danger Mouse. [35] Therefore, do people have to worry that if society likes their music too much they could be charged with committing various crimes? Clearing samples is not as easy as companies make it seem. There are a lot of loop holes and knowledge that the common person would have to acquire just to attain the rights to be sampled. [36] The record companies hold a vast amount of power because they have the employees who will take care of getting copyrights for them. [37] With this monopoly of power, creativity is constrained. Many artists believe that the copyright laws that are being imposed on the public are not actually protecting their music. [38] The owner of the music receives compensation for the sample not the artist him/her self. [39] This is why the Beatles don't get paid if one of their songs gets sampled; Michael Jackson bought their entire library of music copyrights so he gets paid. [40] The recording industry is the reason why copyright policy functions to maintain the monopoly. It is hard when major companies have conglomerated

into the big five, where a small amount of companies are responsible for a whole lot of work. [41]

Would an artist without copyright protection have his creativity stifled? Would a person create music for the love of music or would a person only be concerned with the profit? As of right now, law and policy are doing both a service and injustice to the music art form. Policy is protecting creativity through shielding people's work from being stolen without due credit while protecting a capitalistic market. There must be a change in policy in order for copyright to fully function in the interest of hip-hop artist, hip-hop producers, and the public. In *Bridgeport* the court states that "the purpose of copyright laws is to deter wholesale plagiarism of prior works. [42] However, a balance must be struck between protecting an artist's interest, and depriving other artists of the building blocks of future works." [43] It seems as though the court has the right idea, but there is a question on where is the line drawn? The court attempts to make a "bright line" rule stating that, when determining whether a copyright has been infringed on the court must determine whether the sample has created something original which is substantially different from sampled music. [44] However, who is to be the judge? No pun intended. Is it the record labels that have their hands out attempting to gain some sort of profit after lost in monies from pirates. Is it the artist who determines whether too much of their work has been used? Or is it the producer using the work who is responsible for making his own decision? Artist work should be protected; it is their ideas and work which is being put out on the market. Therefore, they should take a more active role in policy making behind sampling. Artist should advocate to legislature for leniency against public persons who merely use the artist work to create a new original piece. However, once profit is beginning to be made off of another artists work, there should be steps taken before seeking legal action. For example, the

record company could contact the DJ to request the ability to contract with them for the sampling product used. If measures such as these do not work, legal action could then be sought.

V. Conclusion

It seems to me that creativity comes with some sort of limit of success. If a DJ wants to use his creative abilities to sample another artist's work, he better hope that he does not gain too much success for the fear that he will be sued for infringement. On the opposite end of the spectrum, there are producers and DJ's like Kanye West who understands the copyright system and is thus, able to get all necessary licenses and permission to sample as much as they want from whoever they want. If the court system cannot establish a bright line rule of when copyright is being infringed, then what is it that the general artists are supposed to do? Those without means, it seems, are left in the dark once again, to figure out for themself what is right and what is wrong.

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[4] DJ Danger Mouse – The Grey Album, http://www.illegal-art.org/audio/grey.html (last visited September 20, 2009).
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[20] Webber, *supra* note 5, at 375.

[21] DJ Danger Mouse, *supra* note 4.

[22] Becker, *supra* note 16, at 93.

[23] Schietinger, *supra* note 19, at 13555

[24] DJ Danger Mouse, *supra* note 3

[25] Durbin, *supra* note 7, at 1021.

[26] *Id.*

[27] *Id.*

[28] *Id.* at 1022.

[29] *Id.*

[30] *Id.*

[31] *Id.*

[32] *Id.* at 1023.

[33] *Id.*

[34] *Id.*

[35] *Id.*

[36] Webber, *supra* note 5, at 392.

[37] *Id.*

[38] *Id.* at 396

[39] *Id.*

[40] *Id.* at 395

[41] Ben Bagdikian, The New Media Monopoly 27-54*:* (Beacon Press 2004).

[42] Bridgeport Music, Inc v. Dimension Films, 401 F.3d 647 (6th Cir. 2004).

[43] *Id.*

[44] Schietinger, *supra.* note 19, at 13557.

THE IMPACT OF THE FINANCIAL CRISIS ON NONPROFITS

I. INTRODUCTION

Nonprofits play an important role in the American economy, accounting for 5.2% of the domestic GDP and 8.3% of US wages and salaries. [1] At a time when most sectors of the American economy feel the pinch of the recession, the nonprofit sector's financial struggles should raise additional concerns for the US government, because of the increasing amount of Americans seeking assistance from the nonprofits. This article will detail some of the statistics regarding the financial struggles of the nonprofits during the current recession. Additionally this article offers insight into advice from the legal community regarding counseling such nonprofits. Finally, this article provides a recommendation and conclusion as to the steps that nonprofits should keep in mind while coping through the recession.

II. BACKGROUND

Nonprofits provide a variety of widely needed benefits in our communities, such as serving the needs of low-income neighborhoods, children, and providing additional educational resources. Several articles and surveys have discussed the impact of the financial crisis on the nonprofit sector. [2] One concern for nonprofits has come from the decline in donations from bank executives and other corporate executives. [3] In 2007, banks were the second largest corporate donator to nonprofits. [4] Now, since the recession, bank executives and corporate executives have contributed less resulting in fewer resources for the nonprofits. [5] Adding further to the problem, the Nonprofit Finance Fund reported earlier in the year that out of 1,100 nonprofits surveyed on the effects of the economy to their organization, 93% of the organizations that provide essential services expected a 2009 increase in demand while 31% did not have more than a month's operating cash on hand. [6]

The National Council of Nonprofits reported similar results in a survey of 2,279 nonprofits. [7] The survey indicated that while demand for services is increasing, nonprofits are facing escalating operating costs and decreasing revenues. [8] The report highlighted the decrease in revenues from the five traditional sources of funding for nonprofits, specifically corporate donations, reduction in fees for services, the shrinking of the nonprofits' assets, the governments delay or nonpayment for services provided by the nonprofits, and the decline in individual contributions. [9]

The Johns Hopkins University compiled the *Listening Post Project*, a report of the recession's impact on 363 nonprofit organizations with a focus on the period of September 2008 thru March 2009. [10] The report found that about 40% of the nonprofits surveyed as well as a third or more of child-serving and elderly-serving nonprofits indicated their fiscal stress to be "severe or very severe." [11] The majority of nonprofits facing the most difficulties are mid-sized organizations with revenues between $500,000 and $3 million. [12] However, the report also found that due to the steps the nonprofits were taking to reduce the financial impact on their organizations, a substantial portion of them indicated a good financial performance even after months of the recession. [13] Another sign of the nonprofits' resilience appears in the Midwest as Michigan nonprofits, although facing a heavier stress of financial difficulties than other nonprofits surveyed, were able to cope and increase their services to their patrons to a larger measure than their counterparts. [14]

Overall, the statistics indicate that the ever-growing requests for services from their patronage are weighing heavily on the nonprofits resources, which are further exacerbated by the reduction in donations and government spending.

III. ANALYSIS

In this section, I will analyze some of the methods nonprofits are using in order to cope with the recession, as well as review the advice that attorneys are recommending for nonprofit clients that are on the brink of closing their doors.

The practices of reducing staff and cutting programs are typically the most common way of cost saving initiatives. [15] Nonprofits are creatively finding new ways to cope with the financial crisis, such as partnering with other nonprofits, and attracting new individual donors. [16] The National Council of Nonprofits provided several additional tips in a report released August 10, 2009. [17] The tips include "staying close to funders." [18] In essence the nonprofits need to make their donors aware of their financial situation and the steps they are taking to manage the issues. [19] Additionally, the National Council of Nonprofits recommends reducing travel and professional development costs while exploring new ways to develop the training of the nonprofits' staff in a more cost effective manner. [20]

Many of the larger nonprofits have an array of attorneys to consult with them as to the legal ramifications of failing to meet their obligations to creditors or their employees or which paths to take considering the state of their balance sheet. [21] However, many attorneys are faced with counseling the smaller nonprofits that already have a tight budget and not much access to legal counseling. [22] Usually for smaller nonprofits, that will avoid the legal costs of counsel, they seek advice when they are on the brink of closing their doors. [23]

According to *Business Law Today,* attorneys should make sure the nonprofits are aware of the consequences of filing for bankruptcy petition as well as fully understand the nonprofits' financial position to determine if filing the petition is the best path. [24] As with any other type of commercial counseling, the attorney needs

to understand the many facets of the nonprofits' organization in order to provide a thorough legal opinion. [25] Further steps in counseling a nonprofit include determining what the assets and liabilities of the nonprofit are and the outlook for future donations. [26] These determinations allow the attorney to make the necessary recommendations as to bankruptcy or selling assets of the nonprofit or various alternative measures in order to keep the nonprofits' doors open. [27] Additionally for many nonprofits no further additional legal steps may be necessary past an initial counseling session with an attorney, which should relieve some stress on their budgets. [28]

IV. RECOMMENDATION

Nonprofits as with other struggling sectors of the economy need to reassess where they can best reduce costs while serving the community's needs with the same mindset and business ingenuity of a "for profit" corporation. Taking steps such as merging with other nonprofits or creatively outreaching towards individual donors may be the best way to ensure the doors stay open and the people are served.

In regard to legal counseling, nonprofits should have a good idea of their financial position and think about the possible options for recovery prior to seeking counsel. Nonprofits should keep an open-mind regarding the options that they are provided by the attorney, and try to seek out attorneys that are willing to counsel them on a pro bono basis.

V. CONCLUSION

As with all aspects of the economy the nonprofit sector has been impacted by the current financial crisis. The key to surviving the challenging times will require a focus on keeping the needs of the patronage in mind and creating new ways to cope with the financial stress. In sum, the difficulties facing the nonprofit sector has led to another area of the law in which legal assistance is required to assist our economy in rebounding from the financial crisis.

End Notes:

[1] Bonnie Erbe, *Nonprofits Escape Economic Slowdown*, U.S. NEWS & WORLD REP., Jan. 28, 2008, http://www.usnews.com/blogs/erbe/2008/01/28/nonprofits-escape-economic-slowdown.html.

[2] *See generally* Stephanie Strom, *Financial Safety Net of Nonprofit Organizations Is Fraying, Survey Finds*, N.Y. TIMES, Mar. 25, 2009, at A17, *available at* http://www.nytimes.com/2009/03/26/us/26charity.html; Dianne Walker, *5 Effects on Nonprofit Funding Due to Tough Economic Times*, EXAMINER, June 30, 2009, http://www.examiner.com/x-12811-DC-Nonprofit-Business-Examiner~y2009m6d30-5-effects-on-nonprofit-funding-due-to-tough-economic-times; GUIDESTAR USA, THE EFFECT OF THE ECONOMY ON THE NONPROFIT SECTOR (2009), http://www2.guidestar.org/ViewCmsFile.aspx?ContentID=2319.

[3] Aili McConnon, *Wall Street's Financial Crisis Rocks Nonprofits*, BUSINESSWEEK, Sept. 25, 2008, available at http://www.businessweek.com/magazine/content/08_40/b4102042668936.htm?chan=magazine+channel_news.

[4] *Id.*

[5] *Id.*

[6] *Nonprofit Finance Fund Survey: America's Nonprofits in Danger*, NONPROFIT FIN. FUND, Apr. 2009, http://www.nonprofitfinancefund.org/content.php?autoID=166.

[7] *Id.*

[8] NATIONAL COUNCIL OF NONPROFITS, A RESPECTFUL WARNING CALL TO OUR PARTNERS IN GOVERNMENT: THE ECONOMIC CRISIS IS UNRAVELING THE SOCIAL SAFETY NET FASTER THAN MOST REALIZE (2009), http://www.councilofnonprofits.org/?q=specialreport8

[9] *Id.* at 2.

[10] JOHNS HOPKINS UNIVERSITY CENTER FOR CIVIL SOCIETY STUDIES LISTENING POST PROJECT, COMMUNIQUÉ NO. 14 IMPACT OF THE 2007-2009 ECONOMIC RECESSION ON NONPROFIT ORGANIZATIONS (2009), http://www.ccss.jhu.edu/pdfs/LP_Communiques/LP_Communique_14.pdf

[11] *Id.* at 1.

[12] *Id.* at 4.

[13] *Id.* at 22.

[14] *Id.* at 11-12.

[15] NATIONAL COUNCIL OF NONPROFITS, STRATEGIES BEING USED BY NONPROFIT LEADERS TO COPE WITH THE NATION'S ECONOMIC CRISIS (2009), http://www.councilofnonprofits.org/?q=specialreport9

[16] *Id.* at 2.

[17] *Id.* at 2-5.

[18] *Id.* at 2.

[19] *Id.*

[20] *Id.* at 4.

[21] Shelly Crocker, *Counseling the Nonprofit Debtor in Financial Stress*, BUS. L. TODAY, Aug. 18, 2009, at 21.

[22] *Id.*

[23] *Id.*

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

[25] *Id.* at 23.

[26] *Id.*

[27] *Id.* at 22.

[28] *Id.* at 24.

MARVEL AND DISNEY: A MERGER WITH CHARACTER

I. Introduction

On August 31, 2009, The Walt Disney Company ("Disney") and Marvel Entertainment, Inc. ("Marvel") entered into a merger agreement in which Disney would acquire Marvel. [1] At this time, it is up to debate whether the acquisition is a horizontal, vertical, or conglomerate/lateral transaction. Both Disney and Marvel are involved in a very broad range of products and services, but both companies center their business models on intangibles, particularly characters. As a result, much of Disney and Marvel's business revolves around intellectual property. Unlike the products of technological and software companies, the intellectual property rights created by Disney and Marvel are less concrete but more versatile, and decidedly harder to enforce. As such, this article will consider the nature of characters as property rights, particularly those of Disney and Marvel, as they relate to the Department of Justice ("DoJ") and Federal Trade Commission ("FTC") Merger Guidelines and suggest areas of consideration that will require more study for a full antitrust analysis of the merger.

II. Background

Disney was formed in 1923 [2] and has grown to very significant size in the time since then. Disney owns many varied assets in several different industries. Several are of interest for this merger. The Disney family of companies contains a motion picture arm that owns and operates film studios, and produces films based both on Disney intellectual property as well as the worlds and characters of other creators. [3] Furthermore, Disney controls a publishing company that is involved both in traditional books as well as comic book and magazine publications. [4] Finally,

Disney relies a great deal on merchandising and licensing opportunities that arise out of their intellectual properties, especially characters. [5]

Marvel was founded in 1933 and exists mainly as a character-based entertainment and licensing business. Marvel owns and then licenses its intellectual properties, existing in the form of characters, and describes itself as a character-based entertainment company. [6] Marvel further owns and operates Marvel Publishing, Inc, which acts as the publishing arm of Marvel, with a focus on comic books. [7] Furthermore, Marvel owns and operates a film production office, known as MLV Productions, Inc. [8] Marvel does not, however, create films in-house and does not own or operate any movie studios. [9]

Under the terms of the agreement of merger, Disney is acquiring Marvel so that each share of common stock in Marvel will be converted into a receivership right to either $30 in cash, or 0.7452 shares of Disney common stock. [10] Furthermore, the agreement provides that Marvel Characters licensing and publishing offices will continue to be based in their original home cities. [11]

III. Analysis

The Merger guidelines of the DoJ and FTC make a distinction between horizontal and non-horizontal mergers. [12] Each requires different analysis, but both treat efficiencies similarly. Because the Disney-Marvel merger has characteristics of both horizontal and non-horizontal mergers, each will be addressed separately, and then the concept of efficiencies, which the guidelines treat in the exact same way [13], will be addressed last.

Horizontal

Many analysts have speculated on the horizontal nature of the merger. Their approach centers on the idea that Marvel and Disney intellectual properties, especially characters, compete for the attention of the same market. [14] Several of these analysts point out that Disney has repeatedly tried and failed to capture the young male market share with their characters, especially in the television and film realms, but succeeded with young women. [15] These analysts point to Marvel's strong hold on young males and weakness towards female in the comic book realm as indication that the two companies have synergistic competition and could significantly benefit from a merger. [16]

The merger guidelines provide that the first step in analyzing a merger that is considered to be horizontal is to define the markets in question, both geographically and in terms of product. [17] Disney and Marvel both operate as national corporations and make their products available across the United States, so the geographic market is clearly national. However, it is more problematic to try and identify the exact product market.

For two goods to be in the same market, they must be at least general substitutes. [18] If the price of Disney properties were to go up, or if they were to become unavailable, their customers would have to substitute with Marvel properties for the two to be competitors. It is questionable what portion of either customer base would substitute from one to the other. The nature of the products alone raise questions as to whether the two companies operate in a single market. Marvel has generally produced character properties in the realm of superhero, detective, and horror story characters. Disney, on the other hand, has a vast realm of fairies, princesses, dashing princes, and anthropomorphic critters. Furthermore, Marvel's properties typically skew towards older customers whereas Disney properties typically skew towards the younger, family-appropriate crowds.

More specifically, the merger guidelines call for the identification of markets using the small-but-significant price increase method. [19] This method calls for the assumption of a monopolist, and then considering the effect of a price increase by said monopolist with all other prices held constant. [20] If Disney is considered a monopolist, and it increases the price of its character properties by five percent, would consumers shift towards Marvel?

The Guidelines' method seems to fail at this juncture. What is the price of an intellectual property as versatile as a character? There is no simple answer. Characters and the worlds that have been built around them can be sold for use in movies, television programs, books, advertisements, etc. There are few, if any, real limits to their use. Furthermore, Disney and Marvel generally create their own products based on their characters. Perhaps the price of a character property should be one that the end consumer pays. A new issue arises with this approach in that we must determine what media to consider. We must further question whether the traditionally movie-based characters of Disney can be compared alongside the generally comic book-based characters of Marvel fairly in any single media, and whether it is wise to compare across medias.

Existing data regarding the competition between Disney and Marvel at the intellectual property level is scarce and would serve no purpose in this instance. Historically, Marvel properties have been focused in a comic book format whereas Disney properties have been focused on animated and film media. As a result, it is hard to examine whether the properties can compete each other when their current preferred formats do not. It may well be impossible to ascertain whether Mickey Mouse and Wolverine are competing properties at this time. It will be critical for the regulators, however, to approximate date in this field so as to get a clearer picture of this character market. Doing so will be critical in

determining whether concerns in this market should affect the agencies' stance on the overarching merger.

Non-Horizontal

Disney does not solely create and own intellectual properties. They also publish books and comic books, produce movies and television shows, and create amusement parks, all of which use the properties as a base for the product. [21] As a result, Disney is a significant consumer of intellectual properties as well a producer thereof. Marvel, on the other hand, publishes comic books, but does not own movie or television studios and does not operate any theme parks. As a result, Marvel could be considered to be a supplier for Disney if Disney were to use Marvel properties in creating such products as movies and television shows. Disney perhaps acquired Marvel for its intellectual properties as an act of vertical integration, to save itself the costs of acquiring such properties for use in their other ventures.

This approach has been suggested by several analysts. [22] However, some are quick to point out that, on the vertical level, this merger would be a less than favorable deal for Disney. [23] Marvel properties are already embroiled in license agreements that are set to last for several more years and, as a result, the merger may only work to Disney’s favor in a longer time horizon. [24] As a result, the non-horizontal effects of the merger on the markets is hard to fully quantify as there are both present and future effects.

The non-horizontal merger guidelines call for an examination of effects of the merger on barriers to entry. [25] They further call for an analysis centering on whether Disney owning both Marvel and its own character-property producing facilities raises the barriers to entry in Disney's primary market. [26] However,

the issue is further confused by the difficulty in ascertaining, as mentioned above, whether Disney and Marvel characters, and therefore any products based on such characters, are in the same market.

Finally, the greatest question that arises is whether there could ever be barriers of entry in an industry that requires only imagination to create a product. Characters can be created by anyone, at any time, simply by imagining the character, and then publishing its characteristics to the world in some way. This raises a question as to whether barriers to entry can exist at all. No matter how big Disney and Marvel get, they cannot physically stop individuals from imagining characters and cannot stop individuals from consuming those characters in some way, whether it be through formalized media like television, or through an informal media, such as stories posted on a blog on the internet. As such, it seems that the non-horizontal merger guidelines are either not equipped to consider a merger where one of the primary products is non-technical intellectual property, or not interested in regulating a merger in such an industry.

Efficiencies

The legal world surrounding intellectual properties such as those produced by Disney and Marvel is complicated and murky. Multiple legal debates have arisen, and much of legal framework seems inefficient. Characters have long been established as copyrightable separate of their originating work. [27] A test was first created in *Nichols v. Universal Picture Corp*. for the copyright protection of characters, but it is considered unclear and generally inconclusive. [28]
In *Nichols*, the court explained that “the less developed the characters, the less they can be copyrighted” and further stated that identifying characteristics were critical for the copyrighting of characters, but did not elaborate a strict test. [29]

The tests that have since emerged continue to leave much to the imagination of lawyers and judges. Names cannot be copyrighted, but characters cannot be copyrighted without a name. [30] Stock characters, characters who are generic and generally only identifiable by their general purpose, such as two lovers who are "loving and fertile [and] that is really all that can be said of them", are not copyrightable, as Judge Learned Hand recognized in *Nichols* [31], but at what point does a character exit the stock and become delineated? According to author Gregory Schienke, the answer remains unclear and requires further clarification to this day. [32]

This background creates a complicated legal landscape in which character-based entertainment companies such as Marvel or Disney must operate. This is further complicated by the ways in which characters can be infringed, and the decisions that must be made as to which infringements must be stopped and which should be allowed as fostering fan dedication and appreciation (the "fandom" as some refer to it). [33]

Disney derives a great deal of its market share and market power from copyright and its ability to control its intellectual properties. [34] However, the intangible nature of copyright infringement as well as the relatively loose and vague judicial guidelines discussed above mean that Disney may be accruing a great deal of costs in enforcing its rights with regards to these properties. The emergence of a significant international intellectual property issue further complicates this problem and acerbates the costs involved. [35]

Marvel has had a myriad of intellectual property issues of its own. The Superhero genre that Marvel operates in has been particularly prone to infringement from varied sources. [36] Only recently, a significant case arose from the video game industry, Marvel v. NCSoft, which considered whether the operator of an online

game had a duty to prevent users from replicating Marvel characters and whether the game operators and designers had made it too easy to replicate such characters. [37] The case, though ultimately settled, relied heavily on the question of what constitutes the character and whether appearance or name was enough to be infringement. [38] The legal problem arises out of the difficulty of defining exactly what a character and what he or she represents. [39] Author Michael Price, in an article titled When Phone Booths are Inadequate Protection: Copyright and Trademark Infringement of Superheroes, points to the importance of flexibility in copyright protections in acknowledgment that a character is more than a name and appearance. [40] As a result, litigation arising out of these concepts is evidence-intensive and likely expensive to pursue.

A merger by Disney and Marvel may well operate to combine the legal aspects of the character-based business and afford the two companies a greater economy of scales in policing and enforcing their intellectual property rights. As a result, it would be critical for antitrust authorities to consider the exact ramifications of such efficiencies when considering the merger. Efficiency is typically recognized as a significant positive in a merger and may serve to convince antitrust authorities that a merger may be positive for the economic landscape. [41]

IV. Recommendation

When two companies merge, antitrust authorities must regulate the merger and determine, based on the economic data before them, whether it will result in too great a reduction in competition. In this case, however, the two companies have a significant level of involvement in creating intangible products: characters. The only thing that can be clearly ascertained are the efficiencies gained by a merger of two such character-producing entities. As such, it becomes critical for the regulatory agencies to closely consider the exact ramifications of the merger, as

the negative effects on competition are hard to quantify, and the positive effects are much clearer. However, it appears most likely that the approach delineated in the merger guidelines will not be sufficient to fully appraise this merger. This is a likely sign that the guidelines are not yet flexible enough to approach every type of industry and may require further revision.

V. Conclusion

The nature of intellectual property does not meld well with that of merger regulation. One requires a flexible approach that allows for close consideration of the facts in each case; the other approaches the world with an inflexible viewpoint that requires hard facts. Any time the two meet, difficulties arise. However, the specific realm of intellectual property focusing on multimedia, creative properties leads to even greater difficulties in analysis. Unlike technological intellectual property such as software, or technical plans, or other such products, characters have nearly limitless use. Furthermore, the markets are hard to define, because these characters can base themselves in a number of media that do not directly compete for the same end consumer. Characters further cannot be clearly defined, and the boundaries between copyrighted character and similar but legally-acceptable character are extremely blurry. These characteristics lead to an awkward fit between such a merger and the “ideal” merger implied by the merger guidelines. As a result, these transactions will undoubtedly be hard to regulate, and may well push for a revision of the guidelines to a more flexible approach.

[1] Marvel Entertainment, Inc., General statement of acquisition of beneficial ownership (Schedule 13D/A) (Sept 10, 2009)

[2] The Walt Disney Company, The Walt Disney Company and Affiliated Companies – Company Overview, http://corporate.disney.go.com/corporate/overview.html (Last visited Sept. 20, 2009)

[3] The Walt Disney Company, *2008 Annual Report* (2009), available at http://amedia.disney.go.com/ investorrelations/annual_reports/WDC-AR-2008.pdf.

[4] *See Id.* at 29.

[5] *See Id.* at 28, 63.

[6] Marvel Entertainment, Inc., *Annual Report for the Year Ended December 31, 2008.* (2009), *available at*http://marvel.com/company/pdfs/2008_annual_report.pdf.

[7] *Id.* at 7.

[8] *Id.* at 9.

[9] *Id.*

[10] Marvel Entertainment, Inc., General Statement of Acquisition of Beneficial Ownership (Schedule 13D/A) (Sept 10, 2009)

[11] Marvel Entertainment, Inc., Policies for the Management of the Marvel Business (Form 425, EX-99.1) (Sept 4, 2009)

[12] U.S. DEP'T OF JUSTICE, U.S. DEP'T OF JUSTICE MERGER GUIDELINES (1984) *available at*http://www.usdoj.gov/atr/public/guidelines/2614.htm . [hereinafter1984 MERGER GUIDELINES]

[13] *Id.*

[14] Brooks Barnes & Michael Cieply, *Disney Swoops into Action, Buying Marvel for $4 Billion*, N.Y. TIMES, Aug. 31, 2009, *available at*http://www.nytimes.com/2009/09/01/business/media/01disney.html; Sarah Jaffe, *Can Marvel-Disney Help Close the Comic Book Gender Gap?*,

http://www.newsarama.com/comics/090902-Disney-Marvel-Girls.html (Sept. 2, 2009) (Last visited Sept. 14, 2009).

[15] Barnes & Cieply, s*upra* note 14.

[16] Jaffe, *supra* note 14.

[17] U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, U.S. DEPARTMENT OF JUSTICE AND THE FEDERAL TRADE COMMISSION HORIZONTAL MERGER GUIDELINES §1.1 (1992, revised 1997) available at http://www.usdoj.gov/atr/public/guidelines/horiz_book/hmg1.html [hereinafter 1997 MERGER GUIDELINES].

[18] Michael E. Porter, *The Five Competitive Forces that Shape Strategy*, HBR 79 (January 2008).

[19] 1997 MERGER GUIDELINES, *supra* note 17, at §1.11.

[20] *Id.*

[21] *See* The Walt Disney Company, 2008 Annual Report, s*upra* note 3.

[22] *See* Steven Zeitchik, *Analysis: Disney-Marvel Deal Brings Changes,* ADWEEK, Sept 1, 2009, available at http://www.adweek.com/aw/content_display/news/media/e3i76e7bfe15f67e9f1832a6af63f7c353c; Alex Dobuzinskis,*ANALYSIS – Disney-Marvel benefits come with time lag, risks*,Reuters, http://in.reuters.com/article/businessNews/idINIndia-42170020090902 (Last visited Sept 14, 2009).

[23] Dobuzinskis, s*upra* note 22.

[24] *Id.*

[25] 1984 MERGER GUIDELINES, s*upra* note 12, §4.2

[26] *Id.*

[27] Nichols v Universal Pictures Corp., 45 F.2d 119 (2d Cir. 1930).

[28] Gregory S. Schienke, *The Spawn of Learned Hand – A Reexamination of Copyright Protection and Fictional Characters: How Distinctly Delineated Must the Story be Told?*, 9 MARQ. INTELL. PROP. L. REV. 63, 70 (2005).

[29] Nichols, 45 F.2d at 121

[30] Schienke, s*upra* note 28, at 81.

[31] Nichols, 45 F.2d at 121-22 (1930).

[32] Schienke, *supra* note 28, at 83.

[33] Britton Payne, *Super-Grokster: Untangling Secondary Liability, Comic Book Heroes, and the DMCA, and a Filtering Solution for Infringing Digital Creations*, 16 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 939, 955 (2006).

[34] Michael J. Meurer, *Copyright Law and Price Discrimination*, 23CARDOZO L. REV. 55, 83 (2001).

[35] *See* Marshall A. Leaffer, P*rotecting United States Intellectual Property Abroad: Toward a New Multilateralism*, 76 IOWA L. REV. 273 (1991).

[36] Michael T. Price, *When Phone Booths are Inadequate Protection: Copyright and Trademark Infringement of Superheroe*s, 43 WAYNE L. REV. 321, 321-22(1996).

[37] *See* Payne, *supra* note 33, at 958.

[38] *Id.*

[39] Price, *supra* note 36, at 323.

[40] *Id.*

[41] *See* Alan A. Fisher & Robert H. Lande, *Efficiency Considerations in Merger Enforcement* , 71 CALIF. L. REV. 1582, 1582 (1983); 1984 MERGER GUIDELINES, *supra* note 12 , at §4.24; 1997 MERGER GUIDELINES, *supra* note 17, at §4.

PLUG THE LEAK: EMPLOYEE TURNOVER- A CONSEQUENCE OF DISCRIMINATORY BEHAVIOR?

I. Introduction

What does employee turnover look like these days? Well, much like pouring liquid into a sieve- analogous to employees passing through a company much too rapidly. According to the Bureau of Labor Statistics, which collects and compiles monthly data on a sampling of business establishments, the total number of employees who left their jobs exceeded those being hired from July 2008 through June 2009. [1] "Over the 12 months ending in June, hires totaled 51.8 million and separations totaled 57.1 million, yielding a net employment loss of 5.3 million." [2] The increasing problem of employee turnover seems to revolve around two vital issues. Companies do not fully understand what causes employee turnover, and they do not know how to go about correcting the problem. This article will discuss: 1) the costs and causes of employee turnover; 2) the methods by which different companies have approached the problem; and 3) how excessive employee turnover can be a direct result of conscious or unconscious discriminatory behavior by employers.

II. Financial Impact of Employee Turnover

John McConnell, author of *Hunting Heads, How to Find and Keep the Best People*, describes employee turnover as the number of employees a company loses each year, whether they are asked to leave or not. [3] Despite popular belief, employee turnover is not always negative. [4] It tends to purge an organization of the inadequately skilled, less productive, and objectionable employees. [5] In contrast, a company exhausts valuable time and resources in

recruiting, interviewing, hiring, processing, orienting, and training new employees. [6] A major study of the employee turnover dilemma within the supermarket industry estimated that the total cost of replacing a supermarket cashier earning $6.50 per hour was a minimum of $3,637. [7] Consider the negative impact on the overall business profit for a supermarket having to replace several cashiers in any given fiscal period. In an attempt to address these concerns, many theories have been developed to analyze why employees leave.

III. Causes of Employee Turnover

According to Aubrey C. Daniels, Ph.D., an internationally recognized author, speaker and expert on management and human performance issues, “surveys consistently show that more than 40% of people who quit do so because they feel that they weren’t appreciated for their contributions.” [8] More specifically, there are five important factors that can contribute to employees leaving their jobs. These factors consist of 1) incompetent managers, 2) lack of employee recognition, 3) scarcity of employee advancement and growth opportunities, 4) problems with employees balancing work and life issues, and the 5) erosion of trust between company, management, and employees. [9] In response to these rationales, companies have employed a variety of methods to retain a greater percentage of employees.

IV. How Companies Have Managed Employee Turnover

Applebee’s International Incorporated has recently endeavored to deal with its employee turnover problem by instating a system in which managers play a significant role in reducing employee turnover. [10] Applebee’s managers have an opportunity to earn merit raises and bonuses based upon their successful contributions to employee retention. [11] This has inspired the restaurant managers to devise creative motivational techniques including point systems, prizes, and even ice cream desserts to encourage employee attendance. [12]

Applebee's credits their system with successfully reducing employee turnover by nearly fifty percent within four years. [13] This approach has alleviated the turnover crisis with monetary solutions and short term incentives. However, at some point, the novelty of receiving prizes and ice cream will eventually subside for those employees who have more important concerns.

In another unique approach, McDonald's Corporation is attempting to reduce their employee turnover by offering employees health care incentives and other employee benefits. [14] After calculating that experienced employees and proficient managers could accrete as much as $100,000 in additional annual sales and could potentially save $10,000 in annual overhead costs, McDonald's restaurants began training their managers to tactically interview employees to determine what they value most about their jobs and suggestions they might have to improve them. [15] Since health insurance coverage is considered so essential by job applicants, McDonald's restaurants across America are now offering employees' health insurance benefits at group rates, along with "computerized English-language classes and other life-enhancing skills that can be learned during breaks or after shifts," says Rich Floersch, the company's chief human-resources officer. [16]

Amongst all employment sectors, the government appears to manage employee turnover most efficiently. According to the Bureau of Labor Statistics, federal, state and local governments were the only sectors besides health care services that have seen more employee hires than employee separations from July 2008 to July 2009. [17] This could be an ancillary consequence of the recent high unemployment rate and overall depressed economy or it may be attributed to the way in which governments treat their employees. Governments acting as a role model have a foremost objective to respect their employees through compliance with the law. For example, the "Federal Retirement Thrift Investment Board" has established statutes to provide stock bonuses, pensions, and profit-sharing plans

exclusively for those employed in government positions. [18] Perhaps the government recognizes the importance employees place on such laws.

V. Role of Discriminatory Behavior by Employers

Whether companies realize it or not, a significant portion of their employee turnover is, in all probability, a direct result of the conscious or unconscious discriminatory behavior by employers. [19] In evidence of this, "every fiscal year since 2001, the Equal Employment Opportunity Commission (EEOC) has received more than 22,000 retaliation charges" says Donald Names, director of special staff services in the EEOC's Office of Federal Operations. [20] To make matters worse, this statistic is not comprehensive and does not incorporate all forms of discriminatory charges that the EEOC receives annually.

There are many forms of discriminatory behavior in the workplace that federal statutes are designed to curtail. [21] Employees are protected in regards to the following characteristics: race or color, national origin, ancestry, sex and gender, sexual orientation, marital status, pregnancy, age, physical or mental disability, medical condition, and religion or military status. [22] Some statutes protecting these aspects from discrimination include Title VII of the Civil Rights Act of 1964, Age Discriminating in Employment Act (ADEA) of 1967, Americans with Disabilities Act (ADA) of 1990, the Rehabilitation Act of 1973, and the Equal Pay Act (EPA) of 1963. [23] The EPA which bans wage discrimination between males and females performing the same job became the subject of one of the largest discrimination lawsuits in United State's history, Dukes v. Wal-Mart Stores. [24]

In the class action case filed in mid-2004 against Wal-Mart, 1.5 million current and former female Wal-Mart employees claimed that they suffered discrimination under the Equal Pay Act of 1963.[25] This employee class was sending a clear message that they felt less appreciated by their employer, one of the main reasons why employees leave a company, as previously suggested. [26]

With massive amounts of EEOC claims flooding the courts, employers have to be particularly careful that they are not overlooking the rights of their employees. [27] Arkady Itkin, a California attorney specializing in employment law suggests there are five common, subtle and "circumstantial" ways in which employers engage in discrimination against employees. [28] They include: 1) applying the rules of discipline unequally, 2) stating untrue reasons for termination, 3) asking or reminding older employees about retirement plans, 4) not investigating complaints or allegations prior to terminating the accused employee, and 5) terminating an employee shortly after he has exercised his legal rights. [29] Whether intentional or not, these discriminatory behaviors could be contributing to employee turnover by causing employees to leave a company at or against their will.

Employment policies and practices are the foundation to creating an efficient company with “a productive and satisfied workforce.” [30] There are an abundance of laws at federal, state and local levels that employers can utilize to their advantage not only to boost employee morale, but also to maintain legal compliance. [31] For example, employers should actively review employee backgrounds to assess whether workers are eligible for insurance premiums and other benefits from programs such as ERISA, HIPAA, or COBRA. [32] Companies can also educate their staff about discrimination and develop systematic policies to address discipline and termination procedures. [33] The legal solutions are endless.

VI. Conclusion

The government provides the prototype to legal compliance and employee satisfaction within the workplace. Companies will continue to struggle with high

employee turnover and other negative repercussions if they do not approach their employee needs from all perspectives, including the law. If companies fully understand the underpinnings of discrimination in the workplace and how they can alleviate this misdeed, perhaps, one day, companies will eventually plug the leak that drains from their organization their most valuable asset, their valued employees.

End Notes:

[1] Press Release, BUREAU LAB. STAT., Job Openings and Labor Turnover Survey (Sept. 9, 2009) (on file with the U.S. DEP'T. LAB.) *available at*http://www.bls.gov/news.release/jolts.htm.

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[3] JOHN H. MCCONNELL, HUNTING HEADS, HOW TO FIND AND KEEP THE BEST PEOPLE 20-23 (Kiplinger Washington Editors) (2000).

[4] Not All Employee Turnover Is Bad- Celebrate "Losing the Losers,"http://www.ere.net/2009/04/06/not-all-employee-turnover-is-bad-celebrate-losing-the-losers/ (last visited Sept. 18, 2009).

[5] *Id.*

[6] Rod Hawkes, *Retaining Good Employees is Smart Marketing*, VEGETABLE PRODUCTION & MARKETING NEWS, Jan. 2001, *available at* http://aggie-horticulture.tamu.edu/extension/newsletters/vpmnews/apr01/art3apr.html.

[7] *Id.*

[8] Aubrey C. Daniels, *How to Prevent Employee Turnover*, ENTREPRENEUR, Apr. 7, 2003,http://www.entrepreneur.com/humanresources/employeemanagementcolumnistdavidjavitch/article60740.html

[9] Employee Retention: 5 Reasons That People Quit Their Jobs,http://www.examiner.com/x-13521-SF-Workplace-Communication-

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[10] Erin White, Editorial, *Theory & Practice: How to Reduce Turnover – Restaurant Chain Retains Workers Using Rankings and Rewards,* WALL ST. J., Nov. 21, 2005 at B5.

[11] *Id.*

[12] *Id.*

[13] *Id.*

[14] Richard Gibson, Editorial, *Building Pride Into a "McJob,"* WALL ST. J., May 7, 2008, at B3C.

[15] *Id.*

[16] *Id.*

[17] Press Release, BUREAU LAB. STAT., *supra* note 1.

[18] *See* 26 U.S.C.A. § 401 (West 1986).

[19] Hr411.com, Unconscious Discrimination: Could you be Guilty?, https://www.hr411.com/hr-tip/Unconscious-Discrimination-Could-you-be-Guilty%3F_68800 (last visited Sept. 15, 2009).

[20] David L. Hudson Jr. & Lawrence D. Rosenthal, Editorial, *Targeted at Work,* 31 LEGAL TIMES 7, Feb. 18, 2008.

[21] Diskinlawfirm.com, Grounds by Which an Employer Discriminates, http://deskinlawfirm.com/grounds_by_which_an_employer_discriminates (last visited Sept. 18, 2009).

[22] *Id.*

[23] Hr411.com, How to Ensure Compliance EEO Laws, https://www.hr411.com/hr-tip/How-to-Ensure-Compliance-with-EEO-Laws_26953,(last visited Sept. 15, 2009), *supra* note 19.

[24] Mike Scarcella, Editorial, *Size Matters in Wal-Mart Discrimination Case*, 32LEGAL TIMES 13, Mar. 30, 2009.

[25] *Id.*

[26] *Employee Retention: 5 Reasons That People Quit Their Jobs, supra* note 9.

[27] Unconscious Discrimination: Could you be Guilty?, *supra* note 19.

[28] Posting of Arkady Itkin to Employment Law Firm Blog,http://www.sanfranciscoemploymentlawfirm.com/2009/07/how_employers_discriminate_and.html (July 15, 2009).

[29] *Id.*

[30] Hr411.com, When was the last time your company reviewed its Human Resources policies and practices?, https://www.hr411.com/hr-tip/How-to-Ensure-Compliance-with-HR-Laws_26922(last visited Sept. 15, 2009), *supra*note 19.

[31] *Id.*

[32] *Id.*

[33] *Id.*