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1. Papers should be no more than 20 single-spaced pages, including footnotes. For fonts, use 12 point, Times New Roman. Skip lines between paragraphs and between section titles and paragraphs. Indent paragraphs 5 spaces. Right-hand justification is desirable, but not necessary.
2. Number pages in pencil on the back in the lower right corner. Do not number the front of the page. Please do not fold or staple your paper.
3. Margins: left—1-1/2 inches, right, top, bottom (except first page)—1 inch.
4. Upon acceptance, the first page must have the following format:
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  - b. Following the title, center the word "by" and the author's name, followed by an asterisk (\*).
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  - d. Please add a solid line (18 spaces in length) beginning from the left margin, toward the bottom of the first page, leaving enough room under the line to type on the next line an asterisk, the author's position or title and affiliation. This information should appear as the last line on the page.
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6. Footnotes should conform to The Bluebook: *A Uniform System of Citation*, 19th edition.
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## ELECTRONIC REPRODUCTION OF COPYRIGHTED CONTRIBUTIONS TO COLLECTIVE WORKS: COPYRIGHT INFRINGEMENT OR PERMISSIBLE REVISION?

by WILLIAM E. GREENSPAN\*

### I. INTRODUCTION

The *Business Law Review*, a refereed journal, is published by Husson University, Bangor, Maine, for the North Atlantic Regional Business Law Association (NARBLA). Since 2006, the editors of the *Business Law Review* at Husson University have reproduced copies of the journal on the Internet at [http://www.husson.edu/index.php?cat\\_id=1595](http://www.husson.edu/index.php?cat_id=1595). Each Internet publication appears in the same context and format as the print edition. The editors did not seek permission from the professors who contributed original papers published in the print edition of the journal to reproduce their papers on the Internet. Have the editors committed copyright infringement?

In the near future, the editors may have the opportunity to have past and future issues of the *Business Law Review* licensed for publication on an electronic database such as Lexis/Nexis. If the editors do not seek permission from the professors who contributed original papers published in the print edition of the journal to reproduce their papers on Lexis/Nexis, have the editors committed copyright infringement?

The answer to these questions would be of interest to several authors, including freelance photographers (in the case of photos) and writers (including college professors) whose works were first published, with

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their consent, and now reproduced without their consent in an electronic database.<sup>1</sup> Educators may wish to have control over the publication of their original works while, at the same time, have easy access to educational materials.<sup>2</sup>

This paper will (1) review relevant statutory law and legislative history as it relates to reproductions as revisions of copyrighted materials in collective works, (2) identify and discuss case law regarding revisions of collective works on electronic databases, and (3) make recommendations for publishers and editors on how to legally reproduce copyrighted works on electronic databases.

## II. RELEVANT STATUTORY LAW AND LEGISLATIVE HISTORY

In exercise of the constitutional power "To promote the Progress of Science ..., by securing for limited Times to Authors ... the exclusive Right to their ... Writings ...,"<sup>3</sup> Congress enacted the first copyright law of the United States in 1790. Congress made comprehensive revisions in 1831, 1870, 1909 and 1976.<sup>4</sup> The United States Supreme Court has noted the "immediate effect of our copyright law is to secure a fair return for the author's creative labor. But the ultimate aim is, by this incentive, to stimulate artistic creativity for the general public good."<sup>5</sup> Copyright law creates a balance between "the interest of authors ... in the control and exploitation of their writings ... on the one hand, and society's competing interest in the free flow of ideas [and] information on the other hand."<sup>6</sup>

### *A. Requirements, Exclusive Rights, Subject Matter, Remedies*

The Copyright Act gives one who creates an original<sup>7</sup> of authorship in any tangible medium of expression<sup>8</sup> six exclusive rights, including the

<sup>1</sup> See *Auscipe Intern. v. National Geographic Soc.*, 409 F.Supp.2d 235, 237 (S.D.N.Y. 2004) (unauthorized reproduction on a CD-Rom and microform, and electronic versions of a magazine).

<sup>2</sup> *Golan v. Holder*, 132 S.Ct. 873, 888 (2012) (recognizing the phrase "Progress of Science" in the U.S. Constitution refers broadly to "the creation and spread of knowledge and learning").

<sup>3</sup> U.S. Const. Art. I, § 8, cl. 8.

<sup>4</sup> 17 U.S.C. §§ 101 *et. seq.*

<sup>5</sup> *Twentieth Century Music Corporation v. Aiken*, 422 U.S. 151, 156 (1975).

<sup>6</sup> *Sony Corp. v. Universal City Studios*, 464 U.S. 417, 429-30 (1984).

<sup>7</sup> "Original" as the term is used in copyright "means only that the work was independently created by the author (as opposed to copied from other works), and that it possesses at least some minimal degree of creativity." *Feist Publications, Inc. v. Rural Tel. Serv. Co.* 499 U.S. 340, 345 (1991); *Jackson v. Booker*, No. 11-3400, 2012 WL 506323 at \*2, (3<sup>rd</sup> Cir. Feb. 16, 2012) (noting that to establish copyright infringement of his novella, the plaintiff must prove two elements: "ownership of a valid copyright, and copying of constituent elements of the work that are original").

right to reproduce<sup>9</sup> and distribute<sup>10</sup> copies of the work. The subject matter of a copyright includes eight categories, two of which are literary works<sup>11</sup> and pictorial works.<sup>12</sup> The Copyright Act allows a copyright owner to sue an infringing party for either: (1) actual damages and any additional profits of the infringer, or (2) statutory damages ranging from \$200 to \$150,000 per violation depending upon the whether the court finds the infringement was committed willfully.<sup>13</sup> However plaintiffs may not elect statutory damages unless they can show they registered their works with the U.S. Copyright Office either before the alleged infringement or within three months of first publication.<sup>14</sup> Another remedy is an injunction to restrain the infringer from continuing violations.<sup>15</sup> Registration after the infringement does not preclude any recovery for copyright infringement. Under the Copyright Act, copyright begins at creation, but the cause of action for infringement is unenforceable until registration.<sup>16</sup>

Thus a professor who submits a paper for publication in the *Business Law Review* is the initial owner of a copyrighted, literary work and retains the exclusive rights, remedies, and conditions afforded by the Copyright Act as described above. The professor's copyright begins at creation, even if initially there is no notice of copyright on the paper.<sup>17</sup> What rights does a professor retain after his paper is accepted and published in the *Business Law Review*?

#### B. Ownership of Copyright

The author or authors of a work initially own the copyright in the work. The authors of a joint work are co-owners of the copyright in the

<sup>8</sup> 17 U.S.C. § 102 (a) (2012).

<sup>9</sup> *Id.* at § 106 (1) (2012).

<sup>10</sup> *Id.* at § 106 (3) (2012).

<sup>11</sup> *Id.* at § 102 (a) (1) (2012). "Literary works" are works, other than audiovisual works, expressed in words, numbers, or other verbal or numerical symbols or indicia, regardless of the nature of the material objects, such as books, periodicals, manuscripts, phonorecords, film, tapes, disks, or cards, in which they are embodied. 17 U.S.C. § 101 (2012).

<sup>12</sup> *Id.* at § 102 (a) (5) (2012). "Pictorial works" include photographs. 17 U.S.C. § 101 (2012).

<sup>13</sup> *Id.* at § 504 (2012).

<sup>14</sup> *Id.* at § 412 (2) (2012).

<sup>15</sup> *Id.* at § 502 (2012).

<sup>16</sup> *Id.* at § 411 (2012); *Edmark Indus. SDN.BHD v. South Asia Int'l (H.K.)*, 89 F.Supp.2d 840, 844 (E.D.Tex. 2000).

<sup>17</sup> 17 U.S.C. § 405 (b) (2012) (precludes actual and statutory damages against "innocent infringers" of a work that lacks notice of copyright status). However, note that a single notice of a copyright applicable to a collective work is sufficient to protect both the individual author's copyright as well as the collective work copyright. 17 U.S.C. § 404 (a) (2012).

work.<sup>18</sup> The situation becomes more complicated in the case of works made for hire,<sup>19</sup> or a situation involving contributions to a collective work.<sup>20</sup> This paper focuses on contributions to collective works. A collective work is a subcategory of a compilation. The Copyright Act defines a compilation as “a work formed by the collection and assembling of preexisting materials or of data that are selected, coordinated, or arranged in such a way that the resulting work as a whole constitutes an original work of authorship.”<sup>21</sup> A collective work is a compilation. The Copyright Act defines a collective work as “a work, such as a periodical issue, anthology, or encyclopedia, in which a number of contributions, constituting separate and independent works in themselves, are assembled as a collective whole.”<sup>22</sup> The *Business Law Review* is a collective work.

The 1909 Copyright Act contemplated a single copyright. Copyright owners risked losing exclusive rights in their works if they made a contribution to a collective work.<sup>23</sup> The 1976 Copyright Act makes it clear that copyright owners may make contributions to collective works and still retain the exclusive rights to further reproductions and distributions of their separate contributions.<sup>24</sup> Thus, in the absence of an agreement otherwise, professors retain ownership of copyrights in papers submitted to the *Business Law Review*, but the editors of the *Business Law Review* obtain a copyright in their original contributions to the journal, including selecting, coordinating, and arranging materials so that the *Business Law Review* as a whole constitutes an original work of authorship.<sup>25</sup> What rights or privileges do the editors of

<sup>18</sup> 17 U.S.C. § 201 (a) (2012); See Marshall W. Woody, *The Collaborative Calamity: Moving Joint Authorship Analysis Toward Statutory Uniformity*, 80 UMKC L. REV. 511, 535-36 (2011) (comparing the unity and merger requirements in joint works with collective works and compilations).

<sup>19</sup> 17 U.S.C. § 201 (b) (2012); See *Community for Creative Non-Violence v. Reid*, 490 U.S. 730 (1989) (explaining the rules for determining whether a work is for hire).

<sup>20</sup> 17 U.S.C. § 201 (c) (2012).

<sup>21</sup> *Id.* at § 101 (2012).

<sup>22</sup> *Id.*

<sup>23</sup> See John D. Schuff & Geoffrey T. Holtz, *Copyright Tensions in a Digital Age*, 34 AKRON L. REV. 556, 558, n.4 (2001).

<sup>24</sup> 17 U.S.C. § 201 (c) (2012).

<sup>25</sup> See *Dataworks, LLC v. Commlog, LLC*, No. 09-CV-00528-WJM-BNB, 2011 WL 2714087 at \*5 (D.Colo. July 13, 2011) (explaining that a “compilation is deemed original and hence protected by copyright if the author has independently and with at least a minimal degree of creativity made choices as to which facts to include, in what order to place them, and how to arrange the collected data so that they may be used effectively by readers”); *Bean v. Houghton Mifflin Harcourt Publishing Co.*, No. CV10-8034-PCT-DGC, 2010 WL 3168624 at \*2 (D. Ariz. Aug. 10, 2010) (explaining that “an applicant may obtain copyright protection for the compilation itself – that is, the original work of compiling the various data or materials included in the compilation – even if the applicant does not

the *Business Law Review* have in the professors' papers that are published in the journal?

### *C. Privileges Afforded the Owner of a Collective Work*

The Copyright Act states that the owner of a copyright in a collective work is presumed to have acquired only three enumerated rights. Section 201 (c) of the 1976 Act reads:

**Contributions to Collective Works** – Copyright in each separate contribution to a collective work is distinct from copyright in the collective work as a whole, and vests initially in the author of the contribution. In the absence of an express transfer of the copyright or of any rights under it, the owner of copyright in the collective work is presumed to have acquired only the privilege of reproducing and distributing the contribution as [1] part of that particular work, [2] any revision of that collective work, and [3] any later collective work in the same series.<sup>26</sup>

While the first sentence in § 201 (c) affirms that the author of the contribution to a collective work is the first owner,<sup>27</sup> the second sentence enumerates the three privileges given to the owner of the copyright in the collective work.<sup>28</sup> The first privilege allows the editors of the

actually own or have a copyright in the individual data or materials that make up the compilation").

<sup>26</sup> 17 U.S.C. § 201 (c) (2012). Authors' rights to retain their individual copyrights when contributing to a collective work is further underscored in Section 103 (b) which states that "[t]he copyright in a compilation ... extends only to the material contributed by the author of such [collective] work, as distinguished from the preexisting material employed in the work, and does not imply any exclusive right in the preexisting material"; Section 201 (d) which states that "ownership of a copyright may be transferred in whole or in part," and "[a]ny of the exclusive rights comprised in a copyright ... may be ... owned separately"; and Section 404 (a) which states that a single notice of copyright applicable to a collective work is sufficient to protect both the individual author's copyright as well as the collective work copyright. 17 U.S.C. §§ 103 (b), 201 (d), 404 (a) (2012).

<sup>27</sup> "Subsection (c) of section 201 deals with the troublesome problem of ownership of copyright, in contributions to collective works, and the relationship between copyright ownership in a contribution and in the collective work in which it appears. The first sentence establishes the basic principle that copyright in the individual contribution and copyright in the collective work as a whole are separate and distinct, and that the author of the contribution is, as in every other case, the first owner of copyright in it...." H.R. Rep. No. 1476, 94<sup>th</sup> Cong., 2d Sess. 122, *reprinted in* 1976 U.S. Code Cong. & Admin. News 5659, 5737-38.

<sup>28</sup> "[T]here is] a presumption that, unless there has been an express transfer of more, the owner of the collective work acquires 'only the privilege of reproducing and distributing the contribution as part of that particular work, any revision of that collective work, and any later collective work in the same series.' The basic presumption of § 201 (c) [to preserve the author's copyright in a contribution] is fully consistent with present law and practice, and represents a fair balancing of equities. At the same time, the last clause of the subsection, under which the privilege of republishing the contribution under certain limited



*Business Law Review* to publish accepted papers in the upcoming volume of the journal. However, does the second privilege - reproducing and distributing the contribution as any revision of that collective work - allow the editors to place the papers on the Internet or license the papers for publication on a database without permission from the individual copyright owners? When Congress wrote this section, it did not foresee the possibility of an exponential number of reproductions on electronic databases on the Internet.<sup>29</sup> Thus it has been left to the courts to decide, consistent with the aim, purpose, and presumption of copyright law, whether an unlicensed reproduction of a collective work on an electronic database constitutes a privileged revision within the meaning of § 201 (c) of the Copyright Act.<sup>30</sup>

### III. RELEVANT CASE LAW

Two significant cases summarize what do or do not constitute permissible revisions of collective works on electronic databases. The United States Supreme Court delivered an opinion in 2001 concerning the rights of freelance authors and a presumptive privilege of their publishers in *New York Times Co., Inc. v. Tasini*.<sup>31</sup> Seven years later in 2008, in light of *Tasini*, the Eleventh Circuit Court of Appeals took consolidated cases in *Greenberg v. National Geographic Soc.* to decide whether the reproduction of the *National Geographic Magazines* from print to CD-ROM fell within the "revision of that collective work" privilege of § 201 (c) of the Copyright Act.<sup>32</sup>

#### A. Tasini

Between 1990 and 1993 six freelance authors, including Jonathan Tasini, submitted articles to newspaper and magazine publishers such as *The New York Times*, *Newsday*, and *Sports Illustrated*. Each writer had a different type of contract, but in no case did any contract

circumstances would be presumed, is an essential counterpart of the basic presumption. Under the language of this clause a publishing company could reprint a contribution from one issue in a later issue of its magazine, and could reprint an article from a 1980 edition of an encyclopedia in a 1990 revision of it; the publisher could not revise the contribution itself or include it in a new anthology or an entirely different magazine or other collective work." *Id.*

<sup>29</sup> See Sidney A. Rosenzweig, *Don't Put My Article Online!: Extending Copyright's New-Use Doctrine to the Electronic Publishing Media and Beyond*, 143 U. Pa. L. REV. 899, 907 (1995) (commenting on the fact that rights in electronic reproductions "will have wide-ranging consequences for the publishing industry no matter which side prevails").

<sup>30</sup> The third privilege of the publisher - to reproduce and distribute the contribution as any later collective work in the same series - is not at issue in the following cases.

<sup>31</sup> 533 U.S. 483 (2001).

<sup>32</sup> 533 F.3d 1244 (11<sup>th</sup> Cir. 2008), *cert. denied*, 555 U.S. 1070 (2008).

specifically give the publishers the right to reproduce or distribute the articles on an electronic database. LEXIS/NEXIS entered into contracts with the publishers to publish their collective works online.<sup>33</sup> *The New York Times* and University Microfilms International (UMI) made similar arrangements whereby UMI produced and distributed CD-ROMs of the collective works.<sup>34</sup> The databases were designed so that any subscriber or user could search for an article in isolation, such as by author, subject, date, publication, headline, key term, or words in text.<sup>35</sup> Since the profits earned from the subscribers to these digital collections accrued to the publishers and database services, while the freelance writers received nothing, the six freelance writers sued the publishers and database services for copyright infringement of 21 articles sold for publication between 1990 and 1993, seeking an injunction and damages.<sup>36</sup>

The district court granted summary judgment for the publishers, deciding that electronic reproduction was a permissible revision under § 201 (c) of the Copyright Act, especially since the electronic reproductions preserved "some original aspect" of the collective works.<sup>37</sup> The Court of Appeals for the Second Circuit reversed, explaining that the publishers of the collective works could not authorize the reproduction of the freelance authors' contributions on electronic databases without permission or compensation. Electronic reproductions are not "revisions" of the collective works. Instead they are "at best a new anthology of innumerable editions ... and at worst a new anthology of innumerable articles from these editions, [which] cannot be said to be a 'revision' of any (or all) particular editions."<sup>38</sup> Fearing they would be forced to remove tens of thousands of freelance contributions from databases and CD-ROMs, the publishers asked the United States Supreme Court to review the case. The United States Supreme Court granted *certiorari*.<sup>39</sup>

The United States Supreme Court affirmed the decision of the Court of Appeals for the Second Circuit holding the publishers were not protected by the revision privilege in § 201 (c) "because the databases reproduce and distribute articles standing alone and not in context." Both the print publishers and the electronic publishers infringed the copyrights of the freelance authors.<sup>40</sup> The Court distinguished between

<sup>33</sup> 533 U.S. at 489.

<sup>34</sup> *Id.* at 490.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.* at 492.

<sup>37</sup> *Tasini v. New York Times Co.*, 972 F.Supp. 804, 806 (1997).

<sup>38</sup> *Tasini v. New York Times Co.*, 206 F.3d 161, 169 (2<sup>nd</sup> Cir. 2000).

<sup>39</sup> *New York Times Co., Inc. v. Tasini*, 531 U.S. 978 (mem.) (2000).

<sup>40</sup> *New York Times Co., Inc. v. Tasini*, 533 U.S. 483, 486 (2001).

a "compendium," which is not privileged by § 201 (c), and a "revision" which is privileged. The articles in the databases are "parts of a new compendium namely, the entirety of works in a database; ... each periodical represents only a miniscule fraction of the ever expanding database.... Revision denotes a new version, and a version is, in this setting, a distinct form of something regarding by its creators or others as one work...."<sup>41</sup>

The Court was not impressed with the publishers' warning that a ruling for the authors would have devastating consequences. The Court suggested that the authors and publishers "may enter into an agreement allowing continued electronic reproduction of the authors' works," and left remedial issues open "for initial airing" and decision in the district court.<sup>42</sup>

### *B. Aftermath of Tasini*

After the Supreme Court decision in *Tasini*, *The New York Times* gave notice that any freelance writer's work affected by *Tasini* would be removed from the electronic databases unless the writer agreed in writing to release *The New York Times* from liability to compensate freelance authors for claims of copyright infringement. Jonathan Tasini filed a complaint in district court claiming this policy was unconscionable, especially since the damages in *Tasini* had not yet been determined.<sup>43</sup> Jonathan now had the choice to press for compensation or give up the lawsuit in favor of keeping his articles on the electronic databases.<sup>44</sup> The district court dismissed the complaint for lack of subject matter jurisdiction.<sup>45</sup>

In anticipation of an unfavorable decision in *Tasini*, many publishers in the mid 1990's rewrote their contracts with freelance authors requiring the authors to assign all rights in electronic reproductions to the publishers.<sup>46</sup> Several commentators felt *Tasini* was correctly decided, noting the ruling was consistent with the purpose of the 1976 Copyright Act, § 201 (c), which intended to give authors greater protection and an improved negotiating position.<sup>47</sup> Other commentators

<sup>41</sup> *Id.* at 500.

<sup>42</sup> *Id.* at 503-505.

<sup>43</sup> *Tasini v. New York Times Co., Inc.* 184 F.Supp.2d 350, 352 (S.D.N.Y. 2002).

<sup>44</sup> *Id.* at 353.

<sup>45</sup> *Id.* at 360.

<sup>46</sup> See Holly J. Kimball, *Electronic Republication Infringes Freelancers' Copyrights—New York Times Co. v. Tasini*, 533 U.S. 483 (2001), 36 SUFFOLK U. L. REV. 599, 605 (2003) (noting that "*Tasini* has little prospective impact because publishers have dealt with this issue contractually since the mid-1990's").

<sup>47</sup> See, eg., Diana G. Ratcliff, *Reproduction of Copyrighted Articles*, 4 J. LEGAL ADVOC. & PRAC. 249 (2002) (commenting that "authors and publishers remain free to enter into

found negative implications such as a publisher's decision to remove articles from electronic databases, thus depriving Internet users with a wealth of information.<sup>48</sup> The balance of power between authors and publishers remained uncertain.

C. Greenberg

In *Greenberg v. National Geographic Soc.*,<sup>49</sup> National Geographic Society, which had been publishing its monthly magazine since 1888, decided in 1997 to produce *The Complete National Geographic (CNG)*, a thirty-disc CD-ROM set containing each monthly issue of the Magazine, as it was originally published, for the 108 years from 1888 through 1996 – roughly 1200 issues of the Magazine.<sup>50</sup> In addition, the *CNG* contained some new elements: a search function, zoom capacity, indexes, and an introductory, short opening montage.<sup>51</sup> When Greenberg sued National Geographic, alleging it had committed copyright infringement by reproducing in the *CNG* the print magazine issues that included Greenberg's photographs, National Geographic claimed in defense that the *CNG* constituted a privileged revision of the print issues of the Magazine under § 201 (c) of the Copyright Act.<sup>52</sup>

The court of appeals ultimately held for National Geographic distinguishing this case from *Tasini*. In *Tasini*, the Court focused on the fact that the articles were removed from their original context and the articles were now isolated in an entirely different context. The users of any of the databases could only view articles in isolation of the context of their original print publications.<sup>53</sup> However, in this case, the *CNG* used the identical selection, coordination, and arrangement of the individual contributions in the original collective works. A user viewing one screen of the *CNG* would see two pages at a time, including the Magazine fold in the middle, and with the page numbers in the lower outside corners, exactly as they appeared in the print editions.<sup>54</sup> The court commented on the new elements in the *CNG*, stating that the addition of the new elements – search function, zoom capacity, index, and short, opening montage – did not take the *CNG* outside the § 201 (c) revision privilege

agreements allowing electronic reproduction).

<sup>48</sup> See, eg., Mili Kamlesh Vakil, *New York Times Co., Inc. v. Tasini: A Rational United States Supreme Court Ruling on the Rights of Freelance Authors*, 13 WASH. U. J.L. & POL'Y 383, 394-95 (2003).

<sup>49</sup> 533 F.3d 1244 (2008). For the procedural history leading up to this court of appeals decision, see 533 F.3d at 1247-48.

<sup>50</sup> 533 F.3d at 1247.

<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> *Id.* at 1250.

<sup>54</sup> *Id.* at 1252.



because the *CNG* was still a revision, or a version of the original print edition, and not a whole new compendium. The addition of the new elements did not change the context of the entries in the original print editions.<sup>55</sup> Neither *Tasini* nor *Greenberg* decided at what point elements of newness or novelty make a republished collective work more than a revision.<sup>56</sup> The more relevant question was “not whether a user can generate a revision of a collective work from a database, but whether the database itself perceptibly presents the author’s contribution as part of a revision of that collective work.”<sup>57</sup>

In support of its decision in *Greenberg*, the court cited legislative history revealing that “Congress intended the § 201 (c) privilege to allow publishers to make revisions to collective works, but not to the individual contributions themselves.”<sup>58</sup> In *Greenberg* each individual contribution appeared exactly as it did in the original print edition.<sup>59</sup>

#### *D. Aftermath of Greenberg*

*Greenberg* appeared to tip the scales in favor of publishers over authors, but questions remained. How many new elements can a publisher add to an electronic reproduction of an original, printed, collective work without losing the § 201 (c) revision privilege? If a publisher loses the § 201 (c) revision privilege, how should a court determine appropriate remedies consistent with the aim and purpose of copyright law? What effect will these rulings have on the respective rights of the public who want access to educational information, authors who seek a fair return for their creative efforts, and publishers who wish to maximize profits?

Recent cases involving § 201 (c) have dealt with procedural issues, rather than on the merits of each case. In *Dallal v. New York Times Co.*, the court held that a grant of an exclusive license to publish an article, but precludes Internet publication, requires a written contract where

<sup>55</sup> *Id.* at 1255-56.

<sup>56</sup> *Id.* at 1251, n. 11.

<sup>57</sup> *Id.* at 1251. *See also* *Faulkner v. National Geographic Enterprises Inc.*, 409 F.3d 2005 (2<sup>nd</sup> Cir. 2005) (holding publication of a digital archive of freelance photographers and writers works in printed version of magazine was a privileged revision because any *CNG* user would see exactly what he would see if viewing an open page of the original paper version; additional elements did not substantially alter the original context); Shan Sivalingam, *Broadening the Scope of Electronic Reproductions: The Interpretation of Section 201 (c) in Faulkner v. National Geographic Enterprises Inc.*, 3 SHIDLER J. L. COM. & TECH. 1 (2006) (criticizing *Faulkner* because it limits the rights of periodical contributors to have greater control over the use of their works).

<sup>58</sup> 533 F.3d at 1253-54.

<sup>59</sup> *Id.* at 1258.

there is a transfer of copyright ownership, including the grant of an exclusive license.<sup>60</sup>

In the suit by freelance authors against *The New York Times* and other publishers in *Tasini*, the authors and publishers finally reached a settlement which was designed "to achieve a global piece in the publishing industry."<sup>61</sup> Even though the district court certified and approved the settlement, several of the freelance authors objected to the settlement claiming, among other things, that the class action should not have included both authors who had registered their copyrighted works and those who did not. Thus the issue on appeal was whether the district court had jurisdiction to certify a class consisting of claims arising from the infringement of unregistered copyrights and to approve a settlement with respect to those claims.<sup>62</sup> In *Reed Elsevier, Inc. v. Muchnick*,<sup>63</sup> the United States Supreme Court, reversing the decision of the court of appeals, held that even though § 411 of the Copyright Act requires one to register a copyright before filing a copyright infringement claim, a copyright holder's failure to comply with that requirement does not restrict a federal court's subject matter jurisdiction over infringement claims involving unregistered works.<sup>64</sup> The Supreme Court remanded the case without deciding on the settlement's merits.<sup>65</sup>

Most recently, regarding this class action originating from *Tasini*, the Second Circuit Court of Appeals ruled that the district court abused its discretion in certifying the class and approving the Settlement, because the named plaintiffs failed to adequately represent the interests of all class members.<sup>66</sup> The court remanded the case to the district court to create a subclass for every category of claim, with separate counsel representing each category.<sup>67</sup> The controversy continues.

#### IV. RECOMMENDATIONS

Returning to NARBLA, did the editors of the *Business Law Review* violate copyright law by placing past volumes of professors' papers on the Husson University website without each professor's permission? Based on *Tasini* and *Greenberg*, especially *Greenberg*, the editors did not violate copyright law. The papers on the Husson website appear exactly

<sup>60</sup> 352 Fed. Appx. 508 (2<sup>nd</sup> Cir. 2009).

<sup>61</sup> In re Literary Works in Electronic Databases Copyright Litigation, 509 F.3d 116, 119 (2<sup>nd</sup> Cir. 2007).

<sup>62</sup> *Id.* at 118.

<sup>63</sup> 130 S.Ct. 1237 (2010).

<sup>64</sup> *Id.* at 1243-49.

<sup>65</sup> *Id.* at 1249.

<sup>66</sup> In re Literary Works in Electronic Databases Copyright Litigation, 654 F.3d 242, 245 (2<sup>nd</sup> Cir. 2011).

<sup>67</sup> *Id.* at 257.



as they are in the print volumes, in the same form and context. One cannot search for an article in isolation, such as by author, subject, headline, key terms, or words in text.

What might the editors do to further protect themselves and NARBLA? One suggestion is to add in the guidelines for the *Business Law Review* that authors or professors whose papers are published in the *Business Law Review* give the editors permission to republish the papers on the Internet at the Husson website, as well as to assign all rights to republish the papers on any electronic medium.<sup>68</sup> Unless a professor specifically reserves all rights of republication, the editors may make contracts with an electronic medium such as LEXIS/NEXIS provided the republished papers appear in the same context and form as they did in the original print volumes. If republished articles can be found in isolation, not appearing in the same context and form as the original print volumes, the editors may risk liability as contributory or vicarious infringers.<sup>69</sup>

What can freelancers (including professors) do to empower themselves? Freelancers must remember, that under current copyright law, in the absence of an express transfer of the copyright, when the freelancer submits a contribution to a collective work, the freelancer retains a copyright in the contribution, while the owner of the copyright in the collective work acquires only three privileges, two of which are to reproduce and distribute the contribution as part of that particular work or as any revision of that collective work.<sup>70</sup> If there is a market for a particular copyrighted work, professors are free to sell or assign publication rights to any other publishing medium, such as a journal, magazine, or newspaper. Generally, professors are not concerned with financial gain. They write and submit articles to journals for prestige, to keep up to date in their field, and to maintain a record of continuing research and publication. However, if freelancers or professors wish to profit from their creative works, they are free to negotiate with publishers. Some publishers, such as *The New York Times*, have the power to insist freelancers sign contracts giving *The Times* electronic republication rights in return for a syndication fee.<sup>71</sup> Other publishers

<sup>68</sup> See Michael N. Widener, *Safeguarding "The Precious": Counsel on Law Journal Publication Agreements in Digital Times*, 28 J. MARSHALL J. COMPUTER & INFO. L. 217, 227 (2010) (stating "the assignee or licensee fares best when the agreement recites that it may publish 'by any method,' 'in any medium,' or words with like effect").

<sup>69</sup> See *Metro-Goldwyn-Mayer Studios v. Grokster, Ltd.*, 545 U.S. 913, 928-42 (2005) (holding that "one who distributes a device with object of promoting its use to infringe copyright, as shown by clear expression or other affirmative steps taken to foster infringement, is liable for the resulting acts of infringement by third parties").

<sup>70</sup> 17 U.S.C. § 201 (c) (2012).

<sup>71</sup> See Amy Terry, *Tasini Aftermath: The Consequences of the Freelancer's Victory*, 14

may not have the same take-it-or-leave-it bargaining power, tipping the scales in favor of freelancers who can negotiate royalties. Freelancers can also take advantage of royalty collection services, such as the Author's Guild's Registry which collects royalty fees from publishers, and then distributes funds to authors.<sup>72</sup>

## V. CONCLUSION

The decisions in *Tasini* and *Greenberg* give great flexibility to publishers to reproduce their collective works on electronic databases. At the same time, individual authors or freelancers have the opportunity to negotiate the rights and privileges they are giving to publishers. The public benefits from the wealth of information that is so easily accessible on the Internet. While courts continue to grapple with interpreting the respective rights of authors and publishers in an environment of continuing advances in electronic reproduction technology, the best advice for both authors and publishers is to negotiate electronic reproduction rights in great detail before either party signs a licensing or transfer of copyright agreement.<sup>73</sup>

DEPAUL-LCA J. ART & ENT. L. 231, 253-54 (2004) (showing an excerpt from *The Times* agreement).

<sup>72</sup> *Id.* at 254-55 (explaining how the "Registry" acts as a clearance house for authors).

<sup>73</sup> See Michael L. Rustad, *Copyright in Cyberspace: A Roundup of Recent Cases*, 12 J. HIGH TECH. L. 106, 108 (2011) (concluding that "the complexity of the electronic database litigation is emblematic of new legal dilemmas for copyright law in responding to the digital world").

## IS THERE A CONSTITUTIONAL RIGHT TO BRING AN OBJECTIVELY BASELESS SUIT?

by Anne-Marie Hakstian\* and Craig Sergeant\*\*

### INTRODUCTION

Leadscope, a start-up company founded by three former employees of the American Chemical Society (ACS), launched its flagship product in 2001 after approximately five years of development. The new software tool met a critical need in pharmaceutical research and, very quickly, Leadscope secured contracts with eight out of ten major pharmaceutical companies. The hard work of the three scientists seemed to be paying off as they "began to enjoy acclaim as a successful, emerging Central Ohio technology company" with then Ohio Governor Taft mentioning the company in his 2002 State of the State Address and even visiting Leadscope.<sup>1</sup> However, within a few months, Leadscope and its founders found themselves in federal court defending against the ACS's allegations of misappropriation of proprietary information among other claims. The timing of the lawsuit as well as the ACS's vicious publicity campaign against Leadscope suggested that the prestigious professional organization pursued litigation as a strategy for dealing with its new business competitor. In addition to the absence of facts to support the

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<sup>1</sup> Rich Apodaca, *ACS Versus Leadscope – Leadscope Tells its Story in Court*, Depth-First (Nov. 4, 2011), <http://www.depth-first.com/articles/2010/11/04/acs-versus-leadscope-leadscope-tells-its-story-in-court-document/>; Laura Newpoff, *Leadscope, its founders sued by former employer*, Columbus Business First (May 13, 2002), available at <http://www.bizjournals.com/columbus/stories/2002/05/13/story8.html?page=2>

allegations in the ACS's complaint, the lawsuit was filed just as Leadscope was expecting a second round of venture capital to ensure its progress.<sup>2</sup>

The type of litigation at issue in *American Chemical Society v. Leadscope Inc.* can have "a profound impact on our competition-based economy."<sup>3</sup> In this article, we examine Leadscope's challenge to the validity of the ACS's lawsuit as a springboard to discuss broadly the Sherman Act, First Amendment rights, and selected Supreme Court cases. We begin by describing in detail the dispute over intellectual property rights between the American Chemical Society, the world's largest scientific society with 163,000 members including chemists, chemical engineers, and academics, and Leadscope, Inc., a small start-up high-tech company. Although Leadscope and its founders believe the case is an example of malicious litigation, the ACS's actions may be protected by the First Amendment which guarantees the right to "petition the government for the redress of grievances." Therefore, in the next part, we discuss the development of the Noerr-Pennington doctrine, an exception to the antitrust laws that has been interpreted to immunize plaintiffs from claims of malicious litigation. Based on our belief in free market competition in this context, we conclude by arguing that the Supreme Court of Ohio ought to adopt a narrow reading of the Noerr Pennington doctrine and a broad reading of the "sham exception" to affirm the lower courts' decisions that the American Chemical Society engaged in unfair competition when it brought suit against Leadscope.

#### BACKGROUND OF THE ACS CASE

The American Chemical Society (ACS) is a non-profit institution located in Columbus, Ohio, established for the purpose of supporting the advancement and promotion of chemistry and all sciences that contribute to chemistry. It seeks to accomplish this mission through its various journals, local, sectional, and national meetings, employment services, and various other functions.<sup>4</sup> The Chemical Abstracts Service (CAS) is a division of the ACS which compiles research and information on various chemicals and the reactions which are undertaken in order to synthesize such chemicals.<sup>5</sup> Access to this information is then provided to interested chemists at a fee. The CAS division provides to the ACS what amounts to 60 percent of the entire organization's gross revenues.<sup>6</sup>

<sup>2</sup> *Id.*

<sup>3</sup> Marina Lao, *Reforming the Noerr-Pennington Antitrust Immunity Doctrine*, 55 RUTGERS L. REV. 965, 979 (2003).

<sup>4</sup> American Chemical Society website, <http://www.acs.org>.

<sup>5</sup> *Am. Chem. Soc'y v. Leadscope*, 2010 WL 2396544, at \*1 (Ohio Ct. App. June 15, 2010).

<sup>6</sup> *Id.*

Beginning in 1995, two employees of the CAS division, Paul Blower and Glenn Myatt, were assigned to work on a new software tool called "PathFinder" which was intended to help chemists to "access, organize, and visualize information about chemical compounds and reactions."<sup>7</sup> A third employee, Wayne Johnson, became involved in the CAS's effort to broaden the scope of the project and possibly include it on Toshiba's new tablet device. In 1997, the division decided to suspend the project.<sup>8</sup> The suspension of the PathFinder project led to the resignation of Blower, Myatt, and Johnson from the CAS division, as they felt the project was of great commercial value and could still be fully realized with further project development. Soon after their resignations, Blower, Myatt, and Johnson founded a new company, called Leadscope, whose goals were to develop and market a software tool similar in capability to that of PathFinder. By 1999, the Leadscope founders were presenting their new software tool to the public and discussing its potential uses for chemical research.<sup>9</sup>

Meanwhile, the ACS was paying close attention to the efforts of its former employees to develop a similar product and commercialize it. Because this software tool was so similar to the PathFinder project, CAS division president Robert Massie "personally expressed concern to his colleagues that the individual [former employees] may have appropriated some software code or other intellectual property developed during their employment with ACS."<sup>10</sup> Although the ACS was concerned, it did not take any informal or legal action concerning this matter until after Leadscope obtained a patent for its new software tool on November 27, 2001 and had acquired \$10 million in venture capital.<sup>11</sup> Subsequently, in April 2002, the ACS's chief counsel contacted Leadscope regarding the ACS's concerns about the possible theft of intellectual property demanding that Leadscope hand over ownership of the patent for its new software tool, pay the ACS one million dollars, and execute an agreement to cease any further sales of its software tool.<sup>12</sup> The ACS followed up this conversation with a draft complaint in case the matter was not resolved amicably.<sup>13</sup> The two organizations had subsequent discussions which did not lead to an agreement.

The ACS eventually filed a lawsuit against Leadscope in the Franklin County Court of Common Pleas based on various claims including

<sup>7</sup> Brief of Appellant at 2 (Feb. 28, 2011).

<sup>8</sup> *American Chemical Society*, 2010 WL 2396544, at \*1.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> Brief of Appellee at 9 (Apr. 19, 2011).

<sup>13</sup> *American Chemical Society*, 2010 WL 2396544, at \*2.

misappropriation of trade secrets. Leadscope and its three founders counter-sued based on various claims including unfair competition. An eight-week trial concluded with the jury finding in favor of Leadscope, Blower, Myatt, and Johnson on most of their claims, awarding them a total of \$26.5 million in compensatory and punitive damages.<sup>14</sup>

On appeal, the ACS argued that the Noerr-Pennington doctrine should apply in this area as it shields from antitrust liability parties who petition the government for redress unless the petition is found to be "objectively baseless".<sup>15</sup> On June 15, 2010, the Court of Appeals of Ohio for the Tenth Appellate District rendered its decision.<sup>16</sup> Stating that the state of Ohio "recognizes malicious litigation as a basis for an unfair competition claim," it disagreed that the trial court should have dismissed Leadscope's claim of unfair competition.<sup>17</sup> The appeals court applied the bad faith standard to the case because it is well-suited to reveal the malicious nature of the claim and, concluding that the ACS did indeed litigate in bad faith, affirmed the lower court's decision in favor of Leadscope.<sup>18</sup> The ACS appealed to the Supreme Court of Ohio based on the argument that there has never existed a tort of malicious litigation in the state of Ohio and that a standard of "objective baselessness" is much more suitable in this case.<sup>19</sup> Oral arguments have been heard but the decision of the Court has not yet been handed down.<sup>20</sup>

The ACS claims immunity from liability for unfair competition by asserting that its lawsuit against Leadscope amounted to a petition to the government which is protected under the First Amendment due to the Noerr-Pennington doctrine. To determine whether the ACS is correct in its assertion that the Noerr-Pennington doctrine applies to this case, we begin by describing the development of the doctrine.

#### DEVELOPMENT OF THE NOERR-PENNINGTON DOCTRINE

The Noerr-Pennington doctrine is defined by one textbook as the legal immunity from antitrust law "under which competitors are permitted to work together for the purpose of governmental lobbying and other

<sup>14</sup> *Id.*

<sup>15</sup> *California Motor Transport Co. v. Trucking Unlimited.*, 404 U.S. 508 (1972); *Professional Real Estate Investors, Inc. v. Columbia Pictures Ind., Inc.*, 508 U.S. 49, 51, 56 (1993).

<sup>16</sup> *American Chemical Society*, 2010 WL 2396544.

<sup>17</sup> *Id.* at \*7.

<sup>18</sup> *Id.*

<sup>19</sup> Brief of Appellant (Feb. 28, 2011).

<sup>20</sup> The Supreme Court of Ohio and the Ohio Judicial System website, status of case available at <http://www.supremecourt.ohio.gov/Clerk/ecms/resultsbycasenumber.asp?year=2010&number=1335> (last accessed May 9, 2012).



political action.”<sup>21</sup> The impetus for the doctrine was the introduction and increasing enforcement of the Sherman Act which was passed in 1890 to prevent the creation of “trade restraints and monopolizations . . . , by the acts of individuals or combinations of individuals or corporations.”<sup>22</sup> The two relevant sections of the Sherman Act provide: “Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal . . . ” and “every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony . . . .”<sup>23</sup> The concern with this legislation, expressed first in the case of *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.*, was that companies would not be allowed to associate in order to petition the government without facing sanctions under the Sherman Act for engaging in anticompetitive behavior.<sup>24</sup>

*Right to petition the legislature*

In the *Noerr* case, a group of trucking companies and their trade association sued a group of railroads, a railroad association, and their public relations firm, claiming that the railroad companies had violated the provisions of the Sherman Act.<sup>25</sup> The main charge was that the railroad group had undertaken a “vicious” publicity campaign against the trucking companies with the intent of influencing the general public and subsequently the state government, and with the express desire of eliminating the competition presented by the trucking group.<sup>26</sup> Another charge against the railroad group was of having influenced the governor of Pennsylvania to veto legislation which would have favored the trucking business in that state.<sup>27</sup> The lower courts found in favor of the trucking companies based on their judgment that the publicity campaign was “malicious and fraudulent” in its methods of influencing government officials, and was undertaken with the express desire of denigrating the trucking group’s reputation among the general public.<sup>28</sup>

<sup>21</sup> MARIANNE M. JENNINGS, *BUSINESS: ITS LEGAL, ETHICAL, AND GLOBAL ENVIRONMENT* 542 (9th ed. 2012).

<sup>22</sup> *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U. S. 127, 136 (1961) (internal quotation marks omitted).

<sup>23</sup> 15 U.S.C. §§ 1 and 2 (1890).

<sup>24</sup> *Noerr*, 365 U.S. at 127.

<sup>25</sup> *Id.* at 129.

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at 130.

<sup>28</sup> *Id.* at 133.

The Supreme Court, in its reversal of the lower courts' judgment, expressed concern that such a broad application of the antitrust law would prevent businesses from collectively informing the government of their concerns and desires and would effectively regulate the political actions of the business community which was not the original intention of the Sherman Act. Furthermore, such regulation would violate businesses' First Amendment rights.<sup>29</sup> In its decision, the Supreme Court stated that "it is neither unusual nor illegal for people to seek action on laws in the hope that they may bring about an advantage to themselves and a disadvantage to their competitors."<sup>30</sup> According to the Court, some direct injury to a competitor is to be expected during a publicity campaign and is lawful as long as it occurs in the course of actually influencing government policy.<sup>31</sup> However, the Court indicated that immunity from antitrust laws ought not to apply in cases where actions undertaken by businesses are a "mere sham" in an attempt to get away with directly interfering with business competition.<sup>32</sup>

*Right to petition the executive branch*

Having provided immunity to companies that petitioned the legislative branch of the government, the Supreme Court then broadened this immunity to encompass petitions to the executive branch in the case of *United Mine Workers of America v. James M. Pennington*.<sup>33</sup> This case involved a dispute between unionized coal mine workers, as represented by the trustees of the United Mine Workers of America Welfare and Retirement Fund, and small coal mine operators, a partnership, individually and as owners of the Phillips Brothers Coal Mining Company. The small coal mine operators charged that the United Mine Workers union (UMW), in cooperation with large coal mine companies, had improperly influenced the Secretary of Labor concerning the establishment of a minimum wage for employees of contractors selling coal to the Tennessee Valley Authority (TVA).<sup>34</sup> In addition, they charged that the UMW, in cooperation with large coal mine companies, had asked the TVA to change how it purchased coal to the detriment of smaller operators.<sup>35</sup> The case was tried in the U.S. District Court for the Eastern District of Tennessee. The trial court had instructed the jury that it was acceptable for the UMW and large coal mine operators,

<sup>29</sup> *Id.* at 137, 138.

<sup>30</sup> *Id.* at 139.

<sup>31</sup> *Id.* at 143.

<sup>32</sup> *Id.* at 144.

<sup>33</sup> *United Mine Workers of America v. James M. Pennington*, 381 U.S. 657 (1965).

<sup>34</sup> *Id.* at 660.

<sup>35</sup> *Id.* at 660, 661.

together, to attempt to influence the Secretary of Labor and the TVA as long as it was not part of an overall attempt to eliminate the competition represented by the small coal mine operators.<sup>36</sup> The jury returned a verdict in favor of the small coal mine operators which included fines against the UMW in the amount of \$90,000. The judgment against the trustees of the Welfare and Retirement Fund was set aside by the presiding judge, but the verdict and fines against the UMW (as co-defendant in this lower court case) were allowed to stand. The Sixth Circuit, agreeing with the instructions to the jury, upheld the decision.<sup>37</sup>

In reversing that decision, the Supreme Court stated that: "Joint efforts to influence public officials do not violate the antitrust laws even though intended to eliminate competition. Such conduct is not illegal, either standing alone or as part of a broader scheme itself violative of the Sherman Act. The jury should have been so instructed . . . ."<sup>38</sup> Thus, in *Pennington*, the Court provided immunity from antitrust laws to companies or organizations working together in attempting to influence officials in administrative agencies.

#### *Right to petition the courts*

The final case establishing the Noerr-Pennington doctrine is *California Motor Transport Co. v. Trucking Unlimited*.<sup>39</sup> The two trucking companies were operating as competitors in California. The claim was that California Motor Transport (CMT) violated the antitrust laws by attempting to prevent Trucking Unlimited from doing its regular business through extensive use of the federal and state court systems. CMT routinely opposed in administrative and judicial proceedings their competitors' applications for operating rights regardless of the merits of those applications. The U.S. District Court for the Northern District of California dismissed the complaint and the Ninth Circuit reversed the dismissal.

In *California Motor Transport Co.* the Supreme Court explicitly extended the Noerr-Pennington doctrine to apply to petitions to the judicial branch stating that "the right of access to the courts is indeed but one aspect of the right of petition."<sup>40</sup> The Court wrote that while petitioners have the right to access the adjudicatory process, they cannot claim immunity from the antitrust laws when filing a series of repetitive and baseless claims simply to harass and to "bar their competitors from

<sup>36</sup> *Id.* at 670.

<sup>37</sup> *Id.* at 661.

<sup>38</sup> *Id.* at 670.

<sup>39</sup> *California Motor Transport Co. v. Trucking Unlimited*, 404 U.S. 508 (1972) [hereinafter *CMT*].

<sup>40</sup> *Id.* at 510.

meaningful access to adjudicatory tribunals.”<sup>41</sup> Therefore, for the first time, the Court applied the sham exception to deny immunity stating that: “First Amendment rights may not be used as the means or the pretext for achieving substantive evils.”<sup>42</sup>

These three cases comprise the Noerr-Pennington doctrine as it is commonly understood. Still, there was some ambiguity left as to when petitioning activity may fall under the category of a “mere sham” and thus lose immunity from antitrust laws. In the intervening years since the *California Motor Transport Co.* case, the lower courts have applied different standards. While some courts held that any lawsuit with a reasonable chance of succeeding is not a sham, other courts found that cases simply brought to harass the competition, even though the particular case had some substantive basis, should be considered a sham.<sup>43</sup> These inconsistencies were directly addressed by the Supreme Court in a trilogy of cases that narrowed the meaning of “sham” lawsuits as we describe below.<sup>44</sup>

### THE SHAM EXCEPTION

According to legal commentators, the first two decisions in the trilogy that narrowed the meaning of “sham” lawsuits resulted in providing absolute immunity from antitrust scrutiny to petitioners in the legislative arena.<sup>45</sup> The final case, *Professional Real Estate Investors, Inc. v. Columbia Pictures Ind., Inc.*, involves litigation tainted by blatant fraud and misrepresentation.<sup>46</sup> As in *American Chemical Society v. Leadscope, Inc.*, the defendant, PRE, filed an antitrust counterclaim in response to Columbia Pictures’ copyright infringement suit alleging that the plaintiff, Columbia Pictures, “did not honestly believe that the infringement claim was meritorious” but had used the suit as an anticompetitive weapon against PRE.

<sup>41</sup> *Id.* at 511-513.

<sup>42</sup> *Id.* at 513-515. Due to the original dismissal of the complaint in the district court the evidence against CMT was not presented, but the Supreme Court stated that based on the allegations alone there appears to be some basis for a “sham” being perpetrated by CMT; the case was therefore remanded for trial. *CMT*, 404 U.S. 508 at 516.

<sup>43</sup> Charles C. Hsieh, *Professional Real Estate: The Line Between Patent and Antitrust*, 7 HARV. J.L. & TECH. 173, 175-76 (1993).

<sup>44</sup> This trilogy consists of *Allied Tube and Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492 (1988), *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365 (1991), and *Professional Real Estate Investors, Inc. v. Columbia Pictures Industries, Inc.*, 508 U.S. 49 (1993).

<sup>45</sup> Lao, *supra* note 3, at 983.

<sup>46</sup> *Professional Real Estate Investors, Inc.*, 508 U.S. 49 (1993).

*Professional Real Estate Investors, Inc. v. Columbia Pictures*

The *Professional Real Estate Investors, Inc.* case involved an organization known as Professional Real Investors, Inc. and Kenneth F. Irwin (together, PRE) who owned and operated a hotel in California. In the early 1980s, they placed a type of media player using "videodiscs" in each hotel room and allowed guests of the hotel to rent these videodiscs for private viewing. PRE also marketed this type of rental arrangement to other hotel operators who might be interested in its commercial possibilities. Columbia Pictures Industries, Inc. and seven other movie companies (together, Columbia Pictures) owned the copyrights for many of these rental videodiscs and also had a competing system for directly offering their films to hotel guests through a cable system.<sup>47</sup> In 1983, Columbia Pictures brought suit against PRE, alleging the PRE rental movie activities constituted a breach of copyright laws. PRE countersued, claiming that Columbia Pictures was violating the Sherman Act among other infractions. More explicitly, PRE claimed that Columbia Pictures' lawsuit for copyright infringement against PRE "was a mere sham that cloaked underlying acts of monopolization and conspiracy to restrain trade."<sup>48</sup>

Both parties filed for summary judgment on the copyright infringement claims, delaying the antitrust claims for later consideration. The U.S. District Court for the Central District of California found for PRE and the Ninth Circuit Court of Appeals affirmed. The Ninth Circuit also remanded the case concerning the antitrust claims made by PRE against Columbia Pictures. On remand, Columbia Pictures argued that the copyright infringement lawsuit was not a sham and therefore fell under the Noerr-Pennington doctrine. The district court agreed, finding that the copyright infringement lawsuit "was clearly a legitimate effort," and granted Columbia Pictures summary judgment.<sup>49</sup> The Ninth Circuit affirmed the district court's decision.<sup>50</sup>

The Supreme Court granted certiorari in 1992 stating that the Courts of Appeals have described a sham lawsuit in "inconsistent and contradictory ways."<sup>51</sup> Prefacing its decision with a statement that individuals or organizations seeking to petition the government are generally immune from Sherman Act prosecution under the Noerr-Pennington doctrine, the Court then addressed the question left open by

<sup>47</sup> *Professional Real Estate Investors, Inc.*, 508 U.S. at 51, 52.

<sup>48</sup> *Id.* at 52.

<sup>49</sup> *Id.* at 53 (internal quotation marks omitted).

<sup>50</sup> *Id.*

<sup>51</sup> *Id.* at 55.



the *California Motor Transport* case: whether the subjective intent of the plaintiff is important when considering whether a lawsuit is a sham.<sup>52</sup> It held that, so long as the merits of the lawsuit allowed it to have a reasonable chance of succeeding in court, it did not matter whether the party bringing suit expected to win or not.<sup>53</sup> "[E]vidence of anticompetitive intent or purpose alone cannot transform otherwise legitimate activity into a sham,"<sup>54</sup> the court stated. The Court justified its decision based on earlier decisions in which it had recently "refused to let antitrust defendants immunize otherwise unlawful restraints of trade by pleading a subjective intent to seek favorable legislation or to influence governmental action,"<sup>55</sup> and decided "that challenges to allegedly sham petitioning activity must be resolved according to objective criteria."<sup>56</sup>

*The "objectively baseless" test*

In *Professional Real Estate Investors, Inc.*, the Court articulated a two-part definition of sham lawsuits. First, a lawsuit "must be objectively baseless," that is, it must have no reasonable hope of succeeding.<sup>57</sup> If the lawsuit has a plausible chance of success, then it qualifies for immunity under the Noerr-Pennington doctrine.<sup>58</sup> If the lawsuit fails the objectively baseless test, then the court must examine the subjective intent of the litigant and determine whether the lawsuit was nothing but "an attempt to interfere directly" with the business competition by using litigation simply as a means to interfere without any real interest in the ultimate outcome of the litigation.<sup>59</sup> Lastly, the Court noted that even if these two parts are met and the defendant loses its antitrust immunity, the plaintiff must still prove that the defendant has violated the antitrust statutes.

In deciding whether the lawsuit brought by Columbia Pictures against PRE was a sham, the Court essentially equated "objective baselessness" with "lack of probable cause" for bringing the lawsuit. Probable cause in this context is the "reasonable belief" of litigatory success necessary to justify bringing what was, ultimately, an unsuccessful lawsuit by the antitrust defendant against the plaintiff and

<sup>52</sup> *Id.* at 57.

<sup>53</sup> *Id.*

<sup>54</sup> *Id.* at 59.

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

<sup>58</sup> The Supreme Court warns against the tendency of judges to see a lawsuit as not being reasonable, after the lawsuit has already been lost in court, hindsight being 20/20. *Professional Real Estate Investors, Inc.*, 508 U.S. 49 at 60.

<sup>59</sup> *Id.* at 61.



not simply for the purpose of harassing the plaintiff. Applying this standard, the Supreme Court determined that Columbia Pictures had probable cause to sue PRE for renting out videodiscs due to possible copyright infringement thereby demonstrating that Columbia Pictures claim against PRE was not objectively baseless.<sup>60</sup> Because the first part of the definition of a sham lawsuit was not met, the Court held that the Ninth Circuit Court of Appeals was correct in denying PRE's request to examine the subjective intent of Columbia Pictures in bringing its lawsuit against PRE.<sup>61</sup> Therefore, the Court affirmed the Ninth Circuit's decision.

The *Professional Real Estate Investors, Inc.* decision provoked some controversy among legal scholars. Since the year it was decided, various authors have expressed concern about the case's implications.<sup>62</sup> It was described as making "the task of overcoming Noerr-Pennington immunity in cases claiming violations of the Sherman Act nearly insurmountable."<sup>63</sup> In the next part, using the ACS case as an illustration, we detail some of the concerns raised in attempting to determine whether the lawsuit is a "sham" and therefore not deserving of immunity from the antitrust laws.

#### THE IMPLICATIONS OF NOERR-PENNINGTON AND ITS "SHAM" EXCEPTION

Although the Supreme Court has not definitively ruled on the applicability of the doctrine in non-antitrust cases, federal and state courts have applied Noerr-Pennington immunity in tort law cases such as tortious interference with contract and with business relations, defamation, violation of civil rights, abuse of process, and intentional infliction of emotional distress.<sup>64</sup> The Noerr-Pennington doctrine has been found to protect a person's right to complain and to seek action from public agencies with authority over the conduct charged.<sup>65</sup> Given the importance of encouraging private citizens to assist government officials charged with investigating misconduct, courts have provided

<sup>60</sup> *Id.* at 62-64.

<sup>61</sup> *Id.* at 65.

<sup>62</sup> Raymond Ku, *Antitrust Immunity, The First Amendment and Settlements: Defining the Boundaries of the Right to Petition*, 33 IND. L. REV. 385, 385-86 (2000); see also, Marina Lao, *supra* note 3; Carson H. Barylak, *Reducing Uncertainty in Anti-SLAPP Protection*, 71 OHIO ST. L.J. 845 (2010).

<sup>63</sup> Zachary T. Jones, "Gangster Government:" *The Louisiana Supreme Court's Decision in Astoria v. DeBartolo on the Application of the Noerr-Pennington Doctrine to State Law Tort Claims*, 55 LOY. L. REV. 895, 907 (2009).

<sup>64</sup> Aaron R. Gary, *First Amendment Petition Clause Immunity from Tort Suits: In Search of a Consistent Doctrinal Framework*, 33 IDAHO L. REV. 67, 96-97 (1996).

<sup>65</sup> *Id.* at 100.

immunity to individuals and businesses reporting possible violations of law to all manner of regulatory agencies including law enforcement agencies, state and federal securities commissions, local zoning and land use boards, state attorney licensing bodies, and local and state business regulatory bodies.<sup>66</sup>

With the *American Chemical Society* case now before the Supreme Court of Ohio, we believe that the Court ought to affirm the appeals court's decision against applying the objectively baseless standard to determine whether the ACS's lawsuit against Leadscope was a sham. It characterized the objectively baseless standard as a "bare requirement that at the time litigation commenced no possible combination of yet-to-be-disproved facts could support the claims asserted" and refused to apply it. The fact that the ACS would almost certainly be immune from liability for engaging in predatory behavior makes the application of Noerr-Pennington and the objectively baseless standard inadvisable.

*Applying the "objectively baseless" standard to  
American Chemical Society v. Leadscope, Inc.*

Patent infringement plaintiffs who may not have a reasonable belief that they could prevail may nevertheless be able to prove that there was probable cause to bring suit against the defendant thereby immunizing themselves against antitrust liability. As mentioned earlier, the three former employees of the ACS left the organization and eventually developed a product similar to one they had worked on while in the ACS's employ. It is quite likely that a court applying the "objectively baseless" standard would find that the ACS had probable cause to sue Leadscope for the misappropriation of trade secrets given that most reasonable employers worry about the theft of intellectual property whenever a highly knowledgeable and important employee leaves the business.<sup>67</sup> Although ACS executives testified at trial that there was no credible evidence to support the ACS's allegations of theft of proprietary information, the subjective reasons for initiating the lawsuit need not be examined if the ACS had probable cause to file suit against Leadscope.

If a court applying the "objectively baseless" standard found that the ACS did not have probable cause to sue Leadscope, the court would be required to determine whether the ACS had hoped to interfere with Leadscope's business through the process of bringing the infringement suit against it. In the words of one legal scholar: "By definition, a patent . . . infringement suit is a suit for the exclusion of a competitor."<sup>68</sup> In other words, the subjective intent of the plaintiff is to reach a successful

<sup>66</sup> *Id.* at 100-101.

<sup>67</sup> *Am. Chem. Soc'y v. Leadscope*, 2010 WL 2396544, at \*1 (Ohio Ct. App. June 15, 2010).

<sup>68</sup> Lao, *supra* note 3, at 987.

outcome in “petitioning” the court. Because the subjective intent of the ACS is to prevail on its misappropriation claim, its suit against Leadscope would not be considered a “sham.” Therein lies the problem with the Noerr-Pennington doctrine and its sham exception: what was meant as a way to ensure access to the courts without the threat of antitrust penalties has morphed into a broad immunity from counterclaims of malicious litigation or tortious interference for all types of potentially anticompetitive behavior. The result is that a business may bury its competitors under litigation with impunity.<sup>69</sup>

Despite the legitimate concern that businesses may fear counterclaims of unfair competition or tortious interference for pressing a lawsuit, it is more appropriate to allow these cases to be decided on their individual merits and the particular facts and motives therein, rather than relying on the objectively baseless standard that involves looking only at the simple facade of a particular case. Under Ohio state jurisprudence, a claim of unfair competition can be established by proving that a party was engaged in malicious litigation.<sup>70</sup> The case of *Henry Gehring Co. v. McCue* is considered the seminal case, establishing malicious litigation as a basis for the tort of unfair competition.<sup>71</sup> In *Gehring*, the appeals court explicitly stated that “[t]here are numerous cases of successful recoveries because of malicious acts by way of litigation in the courts, where it appears that the litigation was not founded upon good faith, but was instituted with the intent and purpose of harassing and injuring a rival . . . .”<sup>72</sup> To determine whether a party has engaged in unfair competition, the courts rely on the bad faith standard which “encompasses the elements of scope, context, timing, and intent.”<sup>73</sup>

With respect to the *American Chemical Society* case, much of the evidence presented to the jury supported Leadscope’s assertions that the ACS was attempting to drive it out of business.<sup>74</sup> For example, the CAS division president, Robert Massie, “had taken the situation very personally” and contacted the governor of Ohio to dissuade him from visiting Leadscope to promote it as an example of a new high-tech start-up business in that state.<sup>75</sup> As mentioned earlier, the ACS initially demanded that Leadscope hand over the patent, pay \$1 million, and stop all attempts to sell the software tool; this also included threats of

<sup>69</sup> *Id.* at 985-86.

<sup>70</sup> *Water Mgt. Inc. v. Stayanchi*, 472 N.E.2d 715 (Ohio 1984); *Henry Gehring Co. v. McCue*, 154 N.E. 171 (Ohio Ct. App. 1926).

<sup>71</sup> See *American Chemical Society*, 2010 WL 2396544, at \*7.

<sup>72</sup> *Henry Gehring Co. v. McCue*, 154 N.E. at 171.

<sup>73</sup> *American Chemical Society*, 2010 WL 2396544, at \*7.

<sup>74</sup> *Id.*

<sup>75</sup> *Id.* at \*8, 9.

extensive negative publicity if discussions concerning these demands did not start immediately.<sup>76</sup> Finally, the record shows the harm suffered by Leadscope and its founders as a result of the ACS's litigation against it. For example, Leadscope's expert testified that the company lost \$36.6 million in profits and goodwill due to the publicity surrounding the litigation and that consequently Leadscope had downsized from thirty-nine to thirteen employees.<sup>77</sup> Based on these facts, the court of appeals found that sufficient evidence was presented to the jury for it to draw permissible inferences from the "chronology, course, and scope of the litigation ACS undertook and to conclude ACS's civil action constituted malicious litigation undertaken in bad faith" and upheld the jury's award of compensatory and punitive damages to Leadscope.<sup>78</sup>

While predatory activities of the kind the ACS engaged in to suppress Leadscope's growth are unlawful under the anti-trust laws, it is also true that efforts to influence the government, including efforts undertaken through litigation, are protected under the First Amendment right of petition. In the next part, we discuss the purpose of the Noerr-Pennington doctrine "to resolve the inherent tension between anti-trust law and the First Amendment in these situations."<sup>79</sup>

#### *The Future of the Doctrine*

The Noerr-Pennington doctrine is based on both statutory and constitutional principles, stemming from the Sherman Act and the First Amendment right to petition the government for the redress of grievances.<sup>80</sup> While access to the courts is protected under the First Amendment, the right of petition does not require protection for all lawsuits regardless of the nature of a litigant's conduct.<sup>81</sup> Similarly, the Sherman Act should not be used to undermine the values of a democratic system of government by allowing the indiscriminate filing of lawsuits without consideration of the merits of the cases. Professor Marina Lao, an expert in antitrust law, points to the many rules currently in existence that govern the adjudicatory processes and that restrict, through sanctions, different forms of improper litigation conduct.<sup>82</sup> Therefore, in proposing reforms to the Noerr-Pennington doctrine, she argues that "an antitrust rule providing that material misrepresentations will not be protected under Noerr, even if the

<sup>76</sup> *Id.* at \* 9.

<sup>77</sup> *Id.* at \*10.

<sup>78</sup> *Id.* at \*9.

<sup>79</sup> Lao, *supra* note 3, at 1001.

<sup>80</sup> *Id.* at 1002. See also Raymond Ku, *supra* note 62, at 385-386.

<sup>81</sup> Lao, *supra* note 3, at 1012.

<sup>82</sup> *Id.* at 1010-11.



litigant is genuinely seeking a favorable outcome in litigation, is no more offensive to the Constitution than the existing rules.”<sup>83</sup> Among Professor Lao’s suggestions for reforming the doctrine, she advocates easing the requirements of “sham.”

Should the Ohio Supreme Court follow Professor Lao’s proposal, its analysis would result in upholding the appeals court’s decision to affirm the jury’s verdict for Leadscope. With regards to the first prong, Lao recommends a two-part inquiry: 1) is the suit such that no reasonable litigant could realistically expect success on the merits and 2) is the suit being used as an anti-competitive tactic.<sup>84</sup> Based on the evidence presented at trial, the jury could have determined that no reasonable litigant could realistically expect success on the merits of the ACS’s case and that the ACS used the lawsuit as an anti-competitive tactic against Leadscope. Lao suggests eliminating the subjective test because it is redundant in the litigation context so the inquiry would end there.<sup>85</sup>

That the ACS’s suit against Leadscope may have some validity does not change the fact that its purpose in pursuing the litigation was improper. As former Judge Robert Bork has cautioned, sham litigation is particularly effective in terms of inflicting tremendous costs on a competitor including delaying the competitor’s entry into the market.<sup>86</sup> With the number of patents granted by the U.S. Patent and Trademark Office growing considerably in the past decade, it is likely that the number of cases arising from patent disputes will also increase.<sup>87</sup> If the sham exception continues to be interpreted as it has been, it is also likely that innovation in this country will slow down. Given that competition spurs innovation, the law ought not immunize the predatory and abusive business practices that can prevent entrepreneurs from succeeding.

<sup>83</sup> *Id.* at 1011-12.

<sup>84</sup> *Id.* at 1025.

<sup>85</sup> *Id.*

<sup>86</sup> *Id.* at 992.

<sup>87</sup> In the year 1997, over 124,000 patents were granted in the United States. More recently in the year 2010, over 244,000 patents were granted in the United States. Calendar Year Patent Statistics (January 1 to December 31) General Patent Statistics, Patent Technology Monitoring Team Report, US Patent and Trademark Office, Alexandria, VA <http://www.uspto.gov/web/offices/ac/ido/oeip/taf/reports.htm> .

## SELECTED CASES IN THE STUDENT T-SHIRT WARS

by John O. Hayward\*

I may disagree with what you say, but I will  
defend to the death your right to say it.

— Voltaire (1694 – 1778)

### I. INTRODUCTION

Although students have passionately seized on the latest forms of social media to communicate with each other and stay connected, they have also embraced another medium to express themselves: the lowly T-shirt. They have brazenly been using this lowly article of clothing to express their views and opinions on politics,<sup>1</sup> social trends, support or criticism of public officials, as well as the occasional offensive or off-color remark. Those of us with long memories can recall the infamous “F\*\*k the Draft” T-shirt of *Cohen v. California*<sup>2</sup> and marvel how far haberdashery political and social comment has come since the turbulent draft card and bra burning days of the 1960s. However, not everyone is amused. The targets of T-shirt barbs are increasingly joining forces with school officials to censor and remove what they perceive to be their “offensive” or “disruptive” messages, often shredding the First Amendment rights of the wearers in the process. This brief article reviews several prominent cases in the latest skirmishes in what can be termed the “T-Shirt Wars.”

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<sup>1</sup> See *Marineau v. Guiles*, 461 F.3d 320 (2d Cir. 2006) (school can't censor student T-shirt criticizing President Bush). See *infra* Section IIIA.

<sup>2</sup> 403 U.S. 15 (1971) (criminal conviction for wearing obscene T-shirt reversed).

II. STUDENT FREE SPEECH RIGHTS<sup>3</sup>A. *Protected vs. Unprotected Speech*

Not all speech is protected under the First Amendment. Obscenity,<sup>4</sup> defamation,<sup>5</sup> public safety,<sup>6</sup> inciting to riot,<sup>7</sup> and so-called "fighting words"<sup>8</sup> are areas of unprotected speech. The rationale usually given for unprotected speech is that it contains no ideas or viewpoints and doesn't advance any socially worthwhile goal.<sup>9</sup> In examining the constitutionality

<sup>3</sup> This section previously appeared in the author's article on anti-cyber bullying legislation. See John O. Hayward, *Anti-Cyber Bullying Statutes: Threat to Student Free Speech*, 59 CLEV. ST. L. REV. 85, 102-107 (2011).

<sup>4</sup> See *Miller v. California*, 413 U.S. 15 (1973) (First Amendment does not protect obscene material; test for obscenity is whether the average person, applying contemporary community standards, would find the material appealed to prurient interest, whether the work depicted sexual conduct defined by state law, and whether the work lacked serious literary, artistic, or scientific value). Accord: *U.S. v. Stevens*, 130 S. Ct. 1577 (2010) (Court declines to create new class of unprotected speech and invalidates animal cruelty law because it criminalized depictions of ordinary and lawful activities); See *Ashcroft v. ACLU*, 542 U.S. 656 (2004); *United States v. Playboy Entertainment Group, Inc.*, 529 U.S. 803 (2000).

<sup>5</sup> See *New York Times v. Sullivan*, 376 U.S. 254 (1964) (First Amendment prohibits a public official from recovering damages for a defamatory statement unless the statement was made knowing it was false or with actual malice, i.e., reckless disregard for whether it was true or false). Accord: *BE&K Constr. Co. v. NLRB*, 536 U.S. 516 (2002); *Masson v. New Yorker Magazine*, 501 U.S. 496 (1991).

<sup>6</sup> See *Gillow v. New York*, 268 U.S. 652 (1925) (held freedom of speech and the press not absolute rights, but subject to reasonable limitations by the states, and thus state could punish utterances endangering the foundation of lawful government that threatened to overthrow it by unlawful means). Accord: *People v. Epton*, 227 N.E.2d 829 (NY 1967) (defendant's words and actions created a "clear and present danger" of intensifying riots; conviction for conspiracy to incite riot upheld).

<sup>7</sup> See *Schenck v. United States*, 249 U.S. 47 (1919) (words created a clear and present danger, and as they would not protect shouting fire in a theatre, conviction for conspiracy upheld). Accord: *Members of City Council v. Taxpayers for Vincent*, 466 U.S. 789 (1984).

<sup>8</sup> See *Chaplinsky v. New Hampshire*, 315 U.S. 568 (1942) (upholding a conviction under a statute prohibiting use of "offensive" words, not as defined by what the addressee thought, but by what reasonable men of common intelligence understood as words likely to cause an average addressee to fight, i.e. "fighting words"). Accord: *United States v. Stevens*, 130 S. Ct. 1577 (2010) (Court declines to create new class of unprotected speech and invalidates animal cruelty law because it criminalized depictions of ordinary and lawful activities). See also *Cohen v. Calif.*, 403 U.S. 15 (1971) (conviction reversed for wearing jacket imprinted with four letter expletive in courthouse). See also *R.A.V. v. City of St. Paul*, 505 U.S. 377 (1992) (striking down municipal hate-speech ordinance prohibiting fighting words that aroused "anger, alarm or resentment on the basis of race, color, creed, religion or gender." p. 377). While recognizing that fighting words generally are unprotected by the First Amendment, the Court nevertheless found that the ordinance unconstitutionally discriminated on the basis of content and viewpoint.

<sup>9</sup> *Id.* at 572.

of student T-shirt censorship we must begin with four cases the Supreme Court has handed down over the past four decades that set out the nature and extent of student free speech rights.

### B. *The Tinker Tetralogy*

Beginning in 1969, the U.S. Supreme Court addressed student free speech rights in four decisions. The first, *Tinker v. Des Moines Independent Community School District*,<sup>10</sup> concerned the right of high school students to wear black armbands to protest American involvement in the Vietnam War. The second, *Bethel School Dist. No. 403 v. Fraser*,<sup>11</sup> found the Court being asked to decide whether a school could suspend a student for a lewd and suggestive speech given at a school function. The third arose a year later in 1987. *Hazelwood School District v. Kuhlmeier*<sup>12</sup> found the Court confronted with censorship of a high school newspaper. The last case was handed down in 2007. In *Morse v. Frederick*,<sup>13</sup> the high court was confronted with suspension of a student who, during school hours, unfurled a banner promoting illegal drug use. The unfurling took place not on school premises but across the street. At present the box score stands at Students 1, School Officials 3. Let's briefly examine these cases.

#### 1. *Tinker – The Black Arm Band Saga*

Two high school students and a third in junior high in Des Moines, Iowa, were suspended from school for wearing black armbands to protest U.S. policy in Vietnam. They sought nominal damages and an injunction against a regulation that the respondents had promulgated banning the wearing of armbands. The District Court dismissed the complaint on the ground that the regulation was within the Board's power, despite the absence of any finding of substantial interference with the conduct of school activities. The Court of Appeals, sitting en banc, affirmed by an equally divided court.<sup>14</sup>

The Supreme Court reversed. It held that when wearing armbands the petitioners were quiet and passive. They were not disruptive, and did not impinge upon the rights of others. In these circumstances, it found that their conduct was within the protection of the Free Speech Clause of the First Amendment and the Due Process Clause of the Fourteenth.<sup>15</sup> It held further that First Amendment rights are available to teachers and

<sup>10</sup> 393 U.S. 503 (1969).

<sup>11</sup> 478 U.S. 675 (1986).

<sup>12</sup> 484 U.S. 260 (1987).

<sup>13</sup> 551 U.S. 393 (2007).

<sup>14</sup> *Tinker*, 393 U.S. at 503.

<sup>15</sup> *Id.* at 505-506.



students, subject to application in light of the special characteristics of the school environment.<sup>16</sup> Lastly, it ruled that prohibitions against expression of opinion, without any evidence that the rule is necessary to avoid substantial interference with school discipline or the rights of others are not permissible under the First and Fourteenth Amendments.<sup>17</sup>

In addressing the fear of potential disruption of school activities, the Court remarked that mere concern that student comments or opinions could lead to a disturbance was not enough to overcome the right to freedom of expression because the Constitution requires we take that risk.<sup>18</sup> Where school officials prohibit speech, they must be able to show that the prohibition results from more than a mere desire to avoid the discomfort that accompanies unpopular viewpoints.<sup>19</sup> Rather, they must demonstrate that the forbidden conduct would "materially and substantially interfere with the requirements of appropriate discipline in the operation of the school."<sup>20</sup>

Thus the Court laid the foundation for the "substantial disruption" test that has become the touchstone for all cases dealing with student free speech rights. In so doing, the Supreme Court gave students the right to express unpopular opinions and viewpoints without fear of reprisal or censorship from school officials as long as school decorum is maintained.

## 2. *Fraser - A Certain Kind of Man*

In 1986, the Supreme Court was asked to decide if a student's free speech rights extended to making lewd and suggestive remarks at a voluntary assembly held during school hours and attended by about six hundred students, many only fourteen years old.<sup>21</sup> The Justices declined. In a 7-2 decision, the high court held that though under the First Amendment the use of an offensive form of expression may not be prohibited to adults making what the speaker considers a political point, it does not follow that the same latitude must be permitted to children in a

<sup>16</sup> *Id.* at 506-507.

<sup>17</sup> *Id.* at 508-509.

<sup>18</sup> *Id.* at 508-509.

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* at 509.

<sup>21</sup> *Fraser*, 478 U.S. at 677. The entire speech was as follows:

I know a man who is firm - he's firm in his pants, he's firm in his shirt, his character is firm - but most . . . of all, his belief in you, the students of Bethel, is firm. Jeff Kuhlman is a man who takes his point and pounds it in. If necessary, he'll take an issue and nail it to the wall. He doesn't attack things in spurts — he drives hard, pushing and pushing until finally — he succeeds. Jeff is a man who will go to the very end — even the climax, for each and every one of you. So vote for Jeff for A.S.B. vice-president - he'll never come between you and the best our high school can be. *Id.* at 677-678.

public school.<sup>22</sup> Citing the role of public schools in preparing students for citizenship in a democracy, the Court commented that it is an appropriate function of public school education to prohibit the use of vulgar and offensive terms in public discourse, and that even Thomas Jefferson in drafting the *Manual of Parliamentary Practice* prohibited “impertinent” speech in the House of Representatives.<sup>23</sup> Since Fraser’s audience included minors, the Court added that the law has long recognized an interest in protecting minors and children from exposure to vulgar and offensive language.<sup>24</sup>

Given that obscenity has never enjoyed First Amendment protection,<sup>25</sup> the result in *Fraser* is not surprising. Whereas in *Tinker* the students were making a political statement, Matthew Fraser was simply indulging in lewd and offensive speech as adolescents often do. The next case in the tetralogy, however, is more troublesome. The students in *Hazelwood*<sup>26</sup> sought to write about a timely though disturbing topic and were prohibited from doing so.

### 3. Hazelwood – *What’s Fit to Print*

If school officials can suspend students for lewd and offensive speech at a school function during school hours without violating their First Amendment rights, can they delete pages from a school newspaper that is part of a journalism course if they find the subject matter inappropriate for younger pupils? Using a forum-based analysis, the Court answered in the affirmative.

Former high school students who were staff members of the school’s newspaper sued the school district and school officials in federal district court alleging that their First Amendment rights were violated by the deletion of two pages that included an article describing school students’ experiences with pregnancy and another article discussing the impact of divorce on students at the school. The newspaper was written and edited in a journalism class, as part of the school’s curriculum. The principal deleted the pages where the articles appeared. The District Court held

<sup>22</sup> *Supra* note 11 at 682.

<sup>23</sup> *Id.* at 681-682.

<sup>24</sup> *Id.* at 684, citing *Ginsberg v. New York*, 390 U.S. 629 (1968) (upholding constitutionality of a statute prohibiting sale of obscene material to minors) and *FCC v. Pacifica Foundation*, 438 U.S. 726 (1978) (the “seven dirty words” case; held FCC can sanction radio station for broadcasting content that, although not obscene, is nevertheless vulgar, offensive, and shocking and not entitled to absolute protection under the First Amendment). The *Pacifica* case has been “explained” and criticized in *FCC v. Fox TV Stations, Inc.*, 129 S. Ct. 1800 (2009).

<sup>25</sup> *Supra* note 4.

<sup>26</sup> *Supra* note 12.

that no First Amendment violation had occurred. The Court of Appeals reversed.<sup>27</sup>

Reversing the Appellate Court and declaring that First Amendment rights of students in the public schools are not automatically coextensive with the rights of adults in other settings, and must be applied in light of the special characteristics of the school environment, the Supreme Court ruled that a school need not tolerate student speech that is inconsistent with its basic educational mission, even though the government could not censor similar speech outside the school.<sup>28</sup> Holding that the school newspaper as part of a journalism course and the school itself were not public forums, the Court declared that school officials could impose "reasonable restrictions" on the speech of students, teachers, and other members of the school community.<sup>29</sup> Hence "reasonable restrictions" were added to *Tinker's* "substantial disruption test" as a restraint on student speech.

The Court also pointed out that editorial control of the student paper was in the hands of the journalism teacher who exercised substantial control over the publication.<sup>30</sup> Finally the Court concluded that:

educators do not offend the First Amendment by exercising editorial control over the style and content of student speech in school-sponsored expressive activities, so long as their actions are reasonably related to legitimate pedagogical concerns.<sup>31</sup>

The Court did not elaborate on what constitutes "legitimate pedagogical concerns" but in *Morse v. Frederick*,<sup>32</sup> the last case in the tetralogy, it held that conformity with official school policy is one of them.

#### 4. *Morse – The Wrong Student Message*

In January 2002, at a school-sponsored and school supervised event, a student unfurled a 14ft. banner that read "BONG HiTS 4 JESUS."<sup>33</sup> The school principal interpreted it as advocating illegal drug use which was contrary to official school policy. She told the student to take it down.<sup>34</sup> He refused. The principal confiscated the banner and suspended the student.<sup>35</sup> After the suspension was upheld by the school superintendent and school board, the student, Joseph Frederick, sued the principal.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at 266.

<sup>29</sup> *Id.* at 267.

<sup>30</sup> *Id.* at 268.

<sup>31</sup> *Id.* at 273.

<sup>32</sup> 551 U.S. 393 (2007).

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

Deborah Morse, and the school board for violating his First Amendment rights.<sup>36</sup> The District Court agreed with Morse that a reasonable interpretation of the banner was advocacy of illegal drug use and found no violation of Frederick's First Amendment rights.<sup>37</sup> The Ninth Circuit Court of Appeals reversed. The Supreme Court agreed with the District Court and upheld the suspension.<sup>38</sup>

The Court ruled that because schools may take steps to safeguard those entrusted to their care from speech that can reasonably be regarded as encouraging illegal drug use, the school officials in this case did not violate the First Amendment by confiscating the pro-drug banner and suspending Frederick.<sup>39</sup> The Court rejected Frederick's argument that his case was not a school speech case because the event occurred during school hours and was sanctioned by the school principal as an approved social event where the district's student-conduct rules expressly applied. Teachers and administrators were among the students and were charged with supervising them. Frederick stood among other students across the street from the school and directed his banner toward the school, making it plainly visible to most students. Under these circumstances, the Court said that Frederick cannot claim he wasn't at school.<sup>40</sup> After reviewing *Tinker*,<sup>41</sup> *Fraser*,<sup>42</sup> and *Veronia School Dist. 47J v. Acton*,<sup>43</sup> the Court concluded that deterring illegal drug use by school children is a compelling government interest justifying restricting student speech that promotes such use at a school-sponsored event during school hours.<sup>44</sup>

### C. The *Tinker* Legacy

Clearly the most enduring consequence of *Tinker* is the litmus test of "substantial disruption" of school activities, though as the *Morse* Court points out, in *Fraser* that approach was jettisoned.<sup>45</sup> So what precepts can

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> *Id.* at 394.

<sup>40</sup> *Id.*

<sup>41</sup> *Supra* note 10.

<sup>42</sup> *Supra* note 11.

<sup>43</sup> 515 U.S. 646 (1995) (upholding the constitutionality of mandatory drug testing of high school athletes in the face of a Fourth Amendment challenge). *Accord: Bd. of Education v. Earls*, 536 U.S. 822 (2002) (school policy requiring drug tests for all students participating in extracurricular activities held constitutional because it reasonably served the school's important interest in detecting and preventing drug use among its students).

<sup>44</sup> 551 U.S. at 407. It is noteworthy that Thomas, J. in his concurrence argues that *Tinker* has no constitutional basis. *Id.* at 410.

<sup>45</sup> *Id.* at 404.



we extract from the *Tinker* tetralogy? Based on holdings as summarized in *Morse*<sup>46</sup>, we can glean the following:

1. Students do not shed their constitutional rights to freedom of speech or expression at the schoolhouse gate; [*Tinker*]<sup>47</sup>
2. First Amendment rights, applied in light of the special characteristics of the school environment, are available to teachers and students. [*Tinker*]<sup>48</sup>
3. Student expression may not be suppressed unless school officials reasonably conclude that it will materially and substantially disrupt the work and discipline of the school; [*Tinker*]<sup>49</sup>
4. Constitutional rights of students in public school are not automatically coextensive with the rights of adults in other settings; [*Fraser*]<sup>50</sup>
5. School officials may control student speech in school-sponsored expressive activities so long as their actions are reasonably related to legitimate pedagogical concerns. [*Hazelwood*]<sup>51</sup>

With the above propositions in mind, let's briefly review several cases where school officials have found student T-shirts to be "disruptive" or "offensive."

### III. STUDENT T-SHIRTS & THE FIRST AMENDMENT

#### A. Criticism of Political Figures<sup>52</sup>

In *Marineau v. Guiles*,<sup>53</sup> a 13-year-old student at a middle school in Williamstown, Vermont, claimed he had a right under the First Amendment to wear a T-shirt depicting President George W. Bush in an uncharitable light.<sup>54</sup> The school administration disagreed. The T-shirt, through an amalgam of images and text, criticized the President as a

<sup>46</sup> *Id.* at 403-406.

<sup>47</sup> *Supra* note 10 at 506.

<sup>48</sup> *Id.*

<sup>49</sup> *Id.* at 513.

<sup>50</sup> *Supra* note 11 at 782.

<sup>51</sup> *Supra* note 12 at 273.

<sup>52</sup> For a case involving criticism of school officials where students referred to some of them as "douche bags" and "dirty whores," see *Donninger v. Niehoff*, 642 F.3d 334 (2d Cir. 2011) (affirming summary judgment for school authorities where they forbade wearing T-shirts with a political message and refused to permit one student to run for school office because her conduct did not reflect "good citizenship").

<sup>53</sup> 461 F.3d 320 (2d Cir. 2006), *cert. denied* 551 U.S. 1162 (2007).

<sup>54</sup> *Id.* at 321. The district court opinion appears at 349 F. Supp. 2d 871 (D. Vt. 2004) *sub nom. Guiles ex rel. Lucas v. Marineau*.

chicken-hawk president and accused him of being a former alcohol and cocaine abuser.<sup>55</sup> To make its point, the shirt displayed images of drugs and alcohol. When a fellow student complained about the T-shirt, school officials made the student, Zachary Guiles, put duct tape over the alcohol- and drug-related pictures because they allegedly violated a school policy prohibiting any display of such images.<sup>56</sup> Guiles' parents sued to enjoin the school's application of the policy to their son's T-shirt, arguing that the policy violated his freedom to engage in political speech.<sup>57</sup> The District Court held that the school could censor the T-shirt consistent with the First Amendment.<sup>58</sup> The student's parents appealed.

The U.S. Court of Appeals for the Second Circuit reviewed the Supreme Court's standards for speech in public schools finding that: (1) schools have wide discretion to prohibit speech that is less than obscene—to wit, vulgar, lewd, indecent or plainly offensive speech; (2) if the speech at issue is "school-sponsored," educators may censor student speech so long as the censorship is "reasonably related to legitimate pedagogical concerns;" and (3) for all other speech, meaning speech that is neither vulgar, lewd, indecent or plainly offensive under *Fraser*, nor school-sponsored under *Hazelwood*, the rule of *Tinker* applies. Schools may not regulate such student speech unless it would materially and substantially disrupt class work and discipline in the school.<sup>59</sup> When speech in school falls within the lewd, vulgar, and plainly offensive rubric, it can be said that *Fraser* limits the form and manner of speech, but does not address the content of the message. The Court held that the terms "vulgar" and "offensive" in *Fraser* refer to words and phrases that are themselves coarse and crude, regardless of whether one disagrees with the overall message that the speaker is trying to convey.<sup>60</sup> It held further that while the images in *Guiles* of a martini glass, alcohol, and lines of cocaine, like the banner in *Frederick*, could cause school administrators displeasure and could be construed as insulting or in poor taste, it could not say that these images, by themselves, were as plainly offensive as the sexually charged speech considered in *Fraser* nor as offensive as profanity used to make a political point.<sup>61</sup> Thus they declined to rule that the images on Guiles' T-shirt were plainly offensive, especially when considering that they were part of an anti-drug political message.<sup>62</sup> Lastly, under *Tinker*, the Court held that Guiles' T-Shirt caused no disruption in school and thus, consistent with

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

<sup>58</sup> *Id.*

<sup>59</sup> *Id.* at 325.

<sup>60</sup> *Id.* at 329.

<sup>61</sup> *Id.*

<sup>62</sup> *Id.*



the First Amendment, could be worn free of any blotting out of its pictorial messages.<sup>63</sup>

### B. The "Disruptive" T-Shirt

The students in *Barr v. LaFon*,<sup>64</sup> however, did not do as well, though in all fairness, their situation was quite different. They wanted to express their Southern heritage by wearing clothing depicting the Confederate flag, but in an environment rift with racial tensions and altercations, racist graffiti violent in character, and "hit lists" of specific student names, the Sixth Circuit Court of Appeals, utilizing the rationale in *Tinker*, upheld the district court's granting of the School Board's motion for summary judgment banning display of the flag.<sup>65</sup>

The District Court heard testimony of the conditions at a Knoxville, Tennessee high school where incidents included racist graffiti that made general threats against the lives of African-Americans, graffiti containing "hit lists" of specific students' names, physical altercations between African-American and white students, and a police lockdown at the school.<sup>66</sup> It was against this racially charged background that the school's dress code was adopted, prohibiting "clothing which exhibits written, pictorial, or implied references to illegal substances, drugs or alcohol, negative slogans, vulgarities, or causes disruption to the educational process; wearing apparel that is sexually suggestive or that features crude or vulgar commercial lettering or printing and/or pictures that depict drugs, tobacco, alcoholic beverages, racial/ethnic slurs or gang affiliation."<sup>67</sup> The district court granted the Board's motion for summary judgment on the students' First Amendment and Equal Protection claims because the Confederate flag did not need to have caused a disruption in the past in order for school officials to ban it when (1) there were racially motivated incidents at the school that caused tension among the student body and (2) such a ban was not implemented in a viewpoint-discriminatory manner.<sup>68</sup> The Appeals Court reasoned that "*Tinker* does not require disruption to have actually occurred."<sup>69</sup> Rather than evaluating competing claims about whether disruption occurred in the past, the court concluded that it "must evaluate the circumstances to determine if [the school's] forecast of substantial disruption was

<sup>63</sup> *Id.* at 331.

<sup>64</sup> 538 F.3d 554 (6th Cir 2008), *cert denied* 2009 U.S. LEXIS 6984 (2009).

<sup>65</sup> *Id.* at 557.

<sup>66</sup> *Id.*

<sup>67</sup> *Id.* at 556-557.

<sup>68</sup> *Id.* at 562.

<sup>69</sup> *Id.* at 565, citing *Lowery v. Euverard*, 497 F.3d 584, 593 (6th Cir. 2007).

reasonable,"<sup>70</sup> pointing out that the rationale for this standard lies in the fact that requiring evidence of disruption caused by the banned speech would place "school officials ... between the proverbial rock and hard place: either they allow disruption to occur, or they are guilty of a constitutional violation."<sup>71</sup>

Recognizing that the *Tinker* decision does not require that the banned form of expression itself actually have been the source of past disruptions, subsequent appellate court decisions considering school bans on expression have focused on whether the banned conduct would likely trigger disturbances such as those experienced in the past.<sup>72</sup>

After evaluating all the circumstances, the Court concluded that their inquiry should be whether the school reasonably forecast that the Confederate flag would cause material and substantial disruption to schoolwork and school discipline.<sup>73</sup> Stressing that there is no requirement that disruption under *Tinker* be violent, the Court concluded that disruption of classes was sufficient to ban the images.<sup>74</sup>

Finally, the Court noted that its decision showed greater sensitivity to the effect of the regulated speech on its student audience than that ordinarily accorded to the targets of speech in First Amendment jurisprudence because standards applicable to student speech in public schools are unique, and courts accord more weight in the school setting to the educational authority of the school in attending to all students' psychological and developmental needs.<sup>75</sup> The court stressed that its decision did not establish a precedent justifying a school's ban on student speech *merely* because other students find the speech offensive.<sup>76</sup> Rather its holding was simply that the school's dress code as applied to ban the Confederate flag was constitutional because of the disruptive potential of the flag in a school where racial tension was high and serious racially motivated incidents, such as physical altercations or threats of violence, had occurred.<sup>77</sup>

<sup>70</sup> *Id.*

<sup>71</sup> *Id.* citing *Lowery* at 596.

<sup>72</sup> *Id.* citing *Brogdon*, 217 F. App'x at 525 (citing *Castorina*, 246 F.3d at 542; *Melton v. Young*, 465 F.2d 1332 (6th Cir. 1972), *cert. denied*, 411 U.S. 951 (1973)).

<sup>73</sup> *Id.* at 565.

<sup>74</sup> *Id.* at 566.

<sup>75</sup> *Id.* at 567-568.

<sup>76</sup> *Id.* at 568.

<sup>77</sup> *Id.* The Court commented that the decision would be different if the speech took place among adults in a public forum. "If there is a bedrock principle underlying the First Amendment, it is that the government may not prohibit the expression of an idea simply because society finds the idea itself offensive or disagreeable." *Id.*, citing *Texas v. Johnson*, 491 U.S. 397, 414 (1989) (holding that prosecution of defendant for burning an American flag during a protest rally violated the defendant's right to free expression under the First Amendment).

## C. The "Offensive" T-Shirt

Students' psychological and developmental needs appear to form the basis of the court's decision in *Harper v. Powry Unified School District*,<sup>78</sup> where a student challenged the decisions of several school officials to keep him out of class because he was wearing a T-shirt with a religious message condemning homosexuality.<sup>79</sup> The district court denied relief and he appealed.

Over a vigorous dissent stressing the importance of First Amendment rights, the appellate court, citing *Tinker*, ruled that "public schools may restrict student speech which 'intrudes upon . . . the rights of other students' or 'collides with the rights of other students to be secure and to be let alone.'"<sup>80</sup> It found that the "right to be let alone" encompassed ". . . not only freedom from physical assaults but from psychological attacks that cause young people to question their self-worth and their rightful place in society."<sup>81</sup> The court went further, holding that speech critical of high school minority students made them feel inferior, damaged their sense of security, and interfered with their opportunity to learn.<sup>82</sup> It stated that:

The demeaning of young gay and lesbian students in a school environment is detrimental not only to their psychological health and well-being, but also to their educational development.<sup>83</sup>

Quoting from a social report, it found that:

Indeed, studies demonstrate that 'academic underachievement, truancy, and dropout are prevalent among homosexual youth and are the probable consequences of violence and verbal and physical abuse at school.'<sup>84</sup>

Apparently holding that teenage self-esteem trumps free speech, at least in the classroom, it held further that school administrators "need not tolerate verbal assaults that may destroy the self-esteem of our most vulnerable teenagers and interfere with their educational development."<sup>85</sup>

<sup>78</sup> 445 F.3d 1166 (9th Cir. 2006). See Michael Kent Curtis, *Be Careful What You Wish For: Gays, Dueling High School T-Shirts, and the Perils of Suppression*, 44 WAKE FOREST L. REV. 431 (2009).

<sup>79</sup> Handwritten in front of the T-shirt was "BE ASHAMED, OUR SCHOOL EMBRACED WHAT GOD HAS CONDEMNED" and handwritten on the back "HOMOSEXUALITY IS SHAMEFUL." The T-shirt was worn in opposition to the "Day of Silence" promoting acceptance of homosexuality. *Id.* at 1171.

<sup>80</sup> *Id.* at 1177, citing 393 U.S. at 508.

<sup>81</sup> *Id.* at 1178.

<sup>82</sup> *Id.*

<sup>83</sup> *Id.* at 1178-1179.

<sup>84</sup> *Id.* at 1179, citing Susanne M. Stronski Huwiler and Gary Remafedi, *Adolescent Homosexuality*, 33 REV. JUR. U.I.P.R. 151, 164 (1999).

<sup>85</sup> *Id.* at 1179.

Then, as if to endorse First Amendment rights, the court went on to affirm student free speech rights dealing with controversial issues (citing *Tinker & Fraser*)<sup>86</sup> and commented that it was important that students engage in vigorous political debate, both in and out of the classroom, even if it was offensive to others.<sup>87</sup> The court then stressed that restrictions on student speech must be narrow and applied in a manner consistent with the First Amendment, while limiting its holding “to instances of derogatory and injurious remarks directed at students’ minority status such as race, religion, and sexual orientation.”<sup>88</sup>

Justice Koslowski’s compelling dissent, also citing *Tinker*, pointed out that the only way the T-shirt could be banned was that if it “materially disrupts class work or involves substantial disorder or invasion of the rights of others.”<sup>89</sup> He maintained there was scant evidence to support the court’s holding that Harper’s messages were so demeaning and offensive that they interfered with the ability of homosexual students to learn, and further, that this position was not briefed or argued by any of the parties nor had anyone introduced evidence to support or contradict it.<sup>90</sup> He criticized the majority’s “sua sponte lawmaking” as finding no support in the record, and argued that, while they could be correct, the only authority for their position were “a few law review articles, a couple of press releases by advocacy groups and some pop psychology.”<sup>91</sup>

He noted that given the strong views on both sides elicited by the “Day of Silence,” the school would have been justified in banning the subject altogether by denying everyone permission to express their views during the school day.<sup>92</sup> Addressing the issue of viewpoint discrimination, he quoted with approval Judge Rosen’s comment that “no matter how well-intentioned the stated objective, once schools get into the business of actively promoting one political or religious viewpoint over another, there is no end to the mischief that can be done in the name of good intentions.”<sup>93</sup> Clearly the decision takes sides by protecting gay and lesbian students from criticism of their sexual orientation in total disregard of the First Amendment rights of students who find their

<sup>86</sup> *Id.* at 1182.

<sup>87</sup> *Id.* at 1182-1183.

<sup>88</sup> *Id.* at 1183.

<sup>89</sup> *Id.* at 1193, citing 393 U.S. at 513.

<sup>90</sup> *Id.* at 1198.

<sup>91</sup> *Id.* at 1199.

<sup>92</sup> *Id.* at 1197. For a case upholding a school district’s content-neutral T-shirt policy banning all political messages, see *Palmer v. Waxahachie School District*, 579 F.3d 502 (5th Cir. 2009), cert. denied 130 S. Ct. 1055 (2010), discussed at 123 HARVARD L. REV. 2088 (2010).

<sup>93</sup> *Id.*, citing *Hansen v. Ann Arbor Public Schools*, 293 F. Supp. 780, 803 (E. D. Mich. 2003).



lifestyle morally objectionable. Apparently, the court found the criticism of homosexuality to be too condemnatory. Would a more soothing critique pass First Amendment muster? The answer is yes as the following case demonstrates.

*D. The "Offensive" T-Shirt, Part II: Sanitizing the Message*

Eschewing Biblical condemnation of homosexuality for a more upbeat message, students in *Zamecnik v. Indian Prairie School District*<sup>94</sup> on the "Day of Silence" sought to wear a T-Shirt that on the front read "My Day of Silence, Straight Alliance" and on the back "Be Happy, Not Gay." School officials inked out the phrase "Not Gay" as being derogatory and in violation of the school's policy forbidding "derogatory comments," spoken or written, "that refer to race, ethnicity, religion, gender, *sexual orientation*, or disability" (emphasis added).<sup>95</sup> Students seeking to wear the allegedly "derogatory" T-shirt sought injunctive relief that the district court granted. The school district appealed.

The appellate court affirmed, describing the phrase "Be Happy, Not Gay" as "only tepidly negative," saying that "derogatory" or "demeaning" were "too strong" a characterization.<sup>96</sup> The court thought it speculative that allowing the plaintiff to wear the T-shirt "would have even a slight tendency to provoke such [violent] incidents, or for that matter to poison the educational atmosphere. Speculation that it might is, under the ruling precedents, and on the scanty record compiled thus far in the litigation, too thin a reed on which to hang a prohibition of the exercise of a student's free speech."<sup>97</sup> Therefore, it ruled that:

a school that permits advocacy of the rights of homosexual students cannot be allowed to stifle criticism of homosexuality. The school argued (and still argues) that banning "Be Happy, Not Gay" was just a matter of protecting the "rights" of the students against whom derogatory comments are directed. But people in our society do not have a legal right to prevent criticism of their beliefs or even their way of life.<sup>98</sup>

The court rejected the "hurt feelings" defense seemingly embraced in *Harper* of school districts that violate the First Amendment rights of its students, commenting that "[a] particular form of harassment or intimidation can be regulated . . . only if . . . the speech at issue gives rise to a well-founded fear of disruption or interference with the rights of

<sup>94</sup> 636 F. 3d 874 (7th Cir. 2011).

<sup>95</sup> *Id.* at 875.

<sup>96</sup> *Id.* at 876-877.

<sup>97</sup> *Id.* at 877, citing its earlier decision in *Nuxoll v. Prairie School District*, 523 F. 3d 668, 676 (7th Cir. 2008) that allowed the students to wear the T-shirt.

<sup>98</sup> *Id.* at 876, citing *R.A.V. v. City of St. Paul*, 505 U.S. 377, *supra* note 8, and *Boos v. Barry*, 485 U.S. 312 (1988).

others.”<sup>99</sup> It declared that school officials could use their discretion to determine when student speech “crosses the line between hurt feelings and substantial disruption of the educational mission, because they have the relevant knowledge of and responsibility for the consequences.”<sup>100</sup> Referencing the district court’s opinion, it stated that no doubt the phrase “Be Happy. Not Gay” is disparaging but “it is not the kind of speech that would materially and substantially interfere with school activities.”<sup>101</sup> Finally, it echoed the warning that schools:

are educating the young for citizenship is reason for scrupulous protection of Constitutional freedoms of the individual, if we are not to strangle the free mind at its source . . . . The First Amendment . . . is consistent with the school’s mission to teach by encouraging debate on controversial topics while also allowing the school to limit the debate when it becomes substantially disruptive. *Nuxoll*’s slogan-adorned t-shirt comes nowhere near that standard.<sup>102</sup>

### *E. The Slippery Slope of Student T-Shirt Censorship*

One needs look no further than Judge Koslowski’s dissent in *Harper* to see the danger to free expression resulting from censorship of student T-shirts.<sup>103</sup> After excoriating the school’s hate speech policy as overbroad and stifling free expression on and off school premises, he commented:

Consider those who participate in the Day of Silence. They, of course, believe they are doing so to promote tolerance and equality. But others — like Harper — might view it as an effort to exalt homosexuality and denigrate their own sexual orientation and religious beliefs. Relying on the same overbroad policy that the school used to ban Harper’s t-shirt, the school could, if it chose, easily ban the Day of Silence activities as demeaning the sexual orientation of straight students, or the religious beliefs of Christians like Harper. All manner of other speech, from the innocuous to the laudable, could also be banned or punished under the school’s hate speech policy. May a student wear a Black Pride t-shirt, or does this denigrate white and Asian students? May a student wear a t-shirt saying “I love Jesus,” or will this make Jews, Muslims and Druids feel it’s an attack on their religions? May a student wear a t-shirt saying “Proud to be a Turk,” or will this cause bad vibrations for the Greeks and Armenians in the school? Will a student be disciplined for disruption if, during a lunch-time discussion, he argues forcefully that the State of Israel oppresses Palestinians and, when called on it, defends himself, saying: “I said it because I’m proud to be a Muslim.”?<sup>104</sup>

<sup>99</sup> *Id.* at 877, citing *Sypniewski v. Warren Hills Regional Bd. of Education*, 307 F.3d 243, 264-65 (3d Cir. 2002).

<sup>100</sup> *Id.* at 877-878.

<sup>101</sup> *Id.* at 878, citing *Nuxoll*, *supra* note 97, at 679.

<sup>102</sup> *Id.* at 679-680.

<sup>103</sup> *Harper*, *supra* note 78.

<sup>104</sup> *Id.* at 1206-1207.



One moment's reflection on the implications of these comments is enough to cause profound disquiet and concern among free speech advocates. Student T-shirt censorship has the potential to muzzle student opinion and obliterate First Amendment rights in the schoolhouse.

#### IV. CONCLUSION

Censorship of student T-shirts, like speech codes and many anti-cyber bullying policies, stifle free speech and independent thought, while insulating students from ideas and concepts some regard as "derogatory" or "demeaning" but which are nevertheless part of the universe of intellectual thought.<sup>105</sup> Instead of learning how to debate and argue various points of view, censorship in all its guises teaches students they need not confront hostile ideas and viewpoints with rational argument, but rather need only to complain to silence opposing views. Never having learned the give and take of intellectual argument, as adults they will seek to silence whoever disagrees with them. This can only endanger democracy and freedom in our society. It ought to be resisted.

<sup>105</sup> See Hayward, *supra* note 3.

## THE WTO DECISION ON CHINA'S EXPORT RESTRICTIONS FOR RAW MATERIALS

by Ruth Jebe\* and Don Mayer\*\*

### INTRODUCTION

The January 2012 decision by the World Trade Organization (WTO) in the matter of Chinese export restrictions on raw materials is notable in several respects.<sup>1</sup> First, China has recently restricted exports of rare earth elements, causing considerable anxiety for many clean-tech and high-tech manufacturers in Japan, Taiwan, the United States and the European Union. Chinese rare earth elements account for ninety-seven percent of the world's supply, and these elements are essential for wind power, hybrid automobile technology, and many electronic products. Second, the WTO decision determines, for the first time, a crucial question under Article XI:2 of the GATT 1994 regarding "critical shortages." Third, the WTO decision confirms and strengthens several critical concepts in Article XX, which provides WTO member states with some leeway in pursuing environmental goals while maintaining GATT-consistent import and export policies. This article will review the WTO Dispute Panel decision as well as the confirming Appellate Body report.

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<sup>1</sup> Panel Report, *China – Measures Related to the Exportation of Various Raw Materials*, WT/DS394/R, WT/DS395/R, and WT/DS398/R (July 5, 2011) [hereinafter Panel Report]. Reports of the Appellate Body, *China – Measures Related to the Exportation of Various Raw Materials*, WT/DS394/SB/R, WT/DS395/AB/R, and WT/DS398/AB/R (January 30, 2012) [hereinafter Appellate Body Report].

In brief, China's export restrictions were found to be inconsistent with its obligations as a member of the WTO.

#### THE WTO DISPUTE OVER RAW MATERIAL EXPORTS

China has large deposits of many important raw materials. Historically, much of China's raw material wealth has been exported to developed economies, either in its raw state or with minimal initial processing. More recently, the Chinese government has pursued developing more complex economy that adds value to those raw materials by manufacture and assembly.

China has also awakened to the environmental consequences of the extraction of raw materials and has instituted measures directed to reducing the environmental degradation associated with mining. Ostensibly to such ends, China in 2009 instituted export restrictions on a variety of raw materials, including bauxite, coke, and manganese.<sup>2</sup> The export restrictions included both temporary and special export duties on certain raw materials and export quotas on other raw materials.<sup>3</sup> Restrictions on rare earth elements were introduced after the U.S., the E.U., and other WTO member nations complained about the 2009 export restrictions.

On June 23, 2009, the United States and the European Communities and on August 21, 2009 Mexico (the Complainants) each requested consultations under the relevant provisions of the World Trade Organization Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) with the People's Republic of China. The issues focused on China's export restraints (duties and quotas) on nine raw materials.<sup>4</sup> On November 4, 2009, the Complainants requested the Dispute Settlement Body to establish a panel pursuant to Article 6 of the DSU and in March 2010 a panel was constituted.<sup>5</sup>

<sup>2</sup> The nine minerals were bauxite, coke, fluorspar, magnesium, manganese, silicon carbide, silicon metal, yellow phosphorus, and zinc. Panel Report at ¶¶2.1-2.2.

<sup>3</sup> Export duties applied to bauxite, coke, fluorspar, magnesium, manganese, silicon metal, yellow phosphorus, and zinc. Export quotas applied to bauxite, coke, fluorspar, and silicon carbide. *Id.* at ¶¶2.3-3.2.

<sup>4</sup> The U.S., the EU, and Mexico had each brought separate complaints against China, the U.S. in WT/DS394/, the EU in WT/DS395/, and Mexico in WT/DS398. The three complainants requested that the WTO Dispute Settlement Body establish a single panel to hear the claims against China. The Panel to hear the combined complaints of the three parties was established in March 2010. *Id.* ¶¶1.3-1.4.

<sup>5</sup> A number of other WTO members reserved their rights to participate in the Panel proceedings as third parties. These countries were Argentina, Brazil, Canada, Chile, Colombia, Ecuador, India, Japan, Korea, Norway, Chinese Taipei, Turkey, and the Kingdom of Saudi Arabia. *Id.* ¶1.6.

The Complainants argued that the Chinese export quotas were contrary to Article XI:1 of the GATT 1994. That article prohibits WTO members from imposing quantitative restrictions on the import or export of any product to or from another WTO member.<sup>6</sup> The Complainants also claimed that the export duties violated China's obligations under paragraph 11.3 of its Accession Protocol.<sup>7</sup> China sought to defend its export restraints by invoking both Article XI:2(a) and provisions from Article XX of the GATT 1994.

#### ARTICLE XI ISSUES AND DEFENSES

China had established an export quota regime for refractory grade bauxite (bauxite).<sup>8</sup> This quota was administered by the Chinese Ministry of Commerce (MOFCOM) through a system involving both direct allocation of quotas and through a quota bidding system.<sup>9</sup> MOFCOM determines and announces the total amount of annual export quota for bauxite by October 31 of each year.<sup>10</sup> Parties then apply to MOFCOM for a portion of the export quota for the following year.<sup>11</sup> Thus, China's export quota regime involved annual review both of the total amount of export quota and of the allocation of that quota.

Article XI:1 of the GATT 1994 forbids import and export restrictions or prohibitions, including those "made effective through...quotas...on the exportation...of any product."<sup>12</sup> Article XI:2(a), however, allows certain restrictions as measures "temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential" to the exporting country.<sup>13</sup> The Complainants argued (and the Panel came to agree) that the provisions of Article XI:2 are affirmative defenses and that the burden was therefore on China, as the respondent, to

<sup>6</sup> General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, THE LEGAL TEXTS: THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS 17 (1999), 1867 U.N.T.S. 187, 33 I.L.M. 1153 (1994) [hereinafter GATT 1994], Article XI.

<sup>7</sup> Paragraph 11.3 of China's Accession Protocol requires China to eliminate "all taxes and charges applied to exports unless specifically provided in Annex 6 of this Protocol..." None of the raw materials that were the subject of this dispute were included in Annex 6 of the Accession Protocol. World Trade Organization, Protocol on the Accession of the People's Republic of China to the Marrakesh Agreement Establishing the World Trade Organization, WT/L/432 (Nov. 10, 2001), ¶11.3 and Annex 6, available at [http://www.wto.org/english/thewto\\_e/acc\\_e/completeacc\\_e.htm](http://www.wto.org/english/thewto_e/acc_e/completeacc_e.htm).

<sup>8</sup> Panel Report at ¶ 7.201.

<sup>9</sup> *Id.* at ¶¶ 7.172, 7.173, and 7.176.

<sup>10</sup> *Id.* at ¶ 7.173.

<sup>11</sup> *Id.* at ¶ 7.174.

<sup>12</sup> *Id.* at ¶¶ 7.161, 7.205.

<sup>13</sup> *Id.* at ¶ 7.163.

demonstrate that Article XI:2 was applicable.<sup>14</sup> The Panel then found that China's export quota regime for raw materials was inconsistent with China's Article XI:1 obligations.<sup>15</sup>

Article XI:2 contains three principal terms important to understanding its scope. It permits restrictions that are (1) "temporarily applied" to (2) prevent or relieve "critical shortages" of food stuffs or (3) other products "essential" to the country imposing the restrictions. This dispute was the first opportunity for a panel to consider Article XI:2 in terms of a mineral resource. The Panel determined that bauxite was an "essential" product for China within the meaning of Article XI:2. China had proposed a broad interpretation of the concept of "essential products," arguing that the Article did not limit the types of "other products" that may be subject to restrictions, except that the products must be "essential." Thus, the phrase "other products essential to the exporting [Member]" could include "minerals, metals, and other commodities, as well as initial processed downstream products thereof."<sup>16</sup>

The Panel found the ordinary understanding of the term "essential" to mean "important" or "necessary" or "indispensable," and concluded that a product could fall within the scope of Article XI:2(a) when it was important or necessary or indispensable to a particular country.<sup>17</sup> Further, the Panel found nothing in the terms of the Article that excluded products that might be an "input" to a product or industry, such as bauxite or other raw materials. On the facts presented by China as to the importance of bauxite to its economy, the Panel found that bauxite was an "essential product" for China within the meaning of Article XI:2(a).<sup>18</sup>

The Panel determined, however, that the restrictions were not "temporarily applied." Complainants had argued that there could be no such thing as temporary measures to remedy shortages of finite resources. The Complainants stated, "Given that the availability of such a good would keep decreasing until the exhaustion of the good's reserves," this type of shortage could not be remedied or prevented through measures of limited time duration.<sup>19</sup> Thus, restrictions with regard to finite resources could not be "temporarily applied," as required by Article XI:2, according to the Complainants.

<sup>14</sup> *Id.* at ¶ 7.210.

<sup>15</sup> *Id.* at ¶ 7.224.

<sup>16</sup> *Id.* at ¶¶ 7.261-262.

<sup>17</sup> *Id.* at ¶ 7.275.

<sup>18</sup> *Id.* at ¶ 7.340.

<sup>19</sup> *Id.* at ¶ 7.253.

The Complainants' interpretation implies a connection between the words "temporary" and "critical shortage." The Complainants argued that the term "critical shortage" must be read within the context of the entire provision of Article XI:2(a), including reference to the limited time element. Thus, for a shortage to be "critical" the shortage must be *temporary*, with availability of the good returning to normal at some point in time. By definition, Article XI:2(a) would not apply if the shortage will never cease to exist because, under that circumstance, it would not be possible to "relieve or prevent" the shortage through export restrictions of limited time duration.<sup>20</sup>

The Panel agreed with the Complainants' reading of these two requirements, concluding that the term "critical shortage" in Article XI:2(a) refers to situations or events that may be "relieved or prevented through the application of measures on a temporary, and not indefinite or permanent, basis"<sup>21</sup> Article XI:2(a) would not permit the imposition of long-term measures imposed to address an "inevitable depletion of a finite resource."<sup>22</sup> Under the facts of the case, it appeared to the Panel that the restrictions on the export of bauxite had been in place for a decade and did not seem likely to be withdrawn. In fact, the indications were that the quota system would remain in place until China's bauxite reserves had been exhausted. Such measures could not be considered to be "temporarily applied" within the meaning of Article XI:2(a).<sup>23</sup> Moreover, the Panel did not agree that China faced a "critical shortage" of bauxite. China estimated a 16-year remaining lifespan for its bauxite reserves and this, in the Panel's view, would not demonstrate a situation rising to the level of a "crisis."<sup>24</sup> Based on these conclusions, the Panel determined that China's export quota was not consistent with Article XI:2(a). While finding that bauxite was an "essential" product for China, China had failed to demonstrate that its export quota for bauxite was "temporarily applied" to prevent or relieve a "critical shortage."<sup>25</sup>

#### ARTICLE XX ISSUES AND DEFENSES

Article XX of the GATT allows WTO members to take measures that would otherwise violate the GATT, so long as those measures fit within one of the enumerated exceptions.<sup>26</sup> Measures that fit within one of the

<sup>20</sup> *Id.* at ¶ 7.290.

<sup>21</sup> *Id.* at ¶ 7.306.

<sup>22</sup> *Id.* at ¶ 7.305.

<sup>23</sup> *Id.* at ¶ 7.350.

<sup>24</sup> *Id.* at ¶ 7.351.

<sup>25</sup> *Id.* at ¶ 7.355.

<sup>26</sup> Article XX provides that "[s]ubject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised



exceptions are further subject to the general requirement of the introductory clause (chapeau) of Article XX: measures must not be applied in a manner that would constitute "arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade . . . ." <sup>27</sup>

The two exceptions most relevant for environmental measures are contained in paragraphs (b) and (g) of Article XX, which cover measures that are:

(b) necessary to protect human, animal, or plant life or health; . . . or

(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption. <sup>28</sup>

China invoked each of these paragraphs in its defense of its export restrictions. While the two paragraphs are both related to environmental issues, the legal requirements of each differ significantly. We will first consider China's claimed defenses under Article XX(b), which related to the protection of human health, defenses which the Panel rejected.

#### *China's Article XX(b) defense*

China invoked Article XX(b) with respect to two different types of export restrictions. China had imposed export duties on "scrap" products (magnesium scrap, manganese scrap, and zinc scrap), which are inputs for secondary production/recycled materials. China had also imposed duties and quotas on a variety of what it termed "energy-intensive, highly polluting, resource-based products" (EPR products). <sup>29</sup> EPR products are unprocessed raw materials, such as zinc ore. Both sets of restrictions dealt with what were essentially raw materials as opposed to any finished products or goods. <sup>30</sup> China contended that these export restrictions were part of a comprehensive environmental framework of measures intended to reduce pollution to protect the health of the Chinese population. <sup>31</sup> The restrictions on the export of scrap products

restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures" otherwise contrary to GATT 1994 obligations. The Article lists ten specific categories of exceptions. GATT 1994, *supra* note 6, Article XX. See also NATHALIE BERNASCONI-OSTERWALDER, DANIEL MAGRAW, MARCOS ORELLANA & ELISABETH TUEK, *ENVIRONMENT AND TRADE: A GUIDE TO WTO JURISPRUDENCE* 76-78 (2006).

<sup>27</sup> GATT 1994, *supra* note 4, at Article XX.

<sup>28</sup> *Id.*

<sup>29</sup> Panel Report, *supra* note 1, at ¶7.470.

<sup>30</sup> *Id.* at ¶¶ 7.470 – 7.471.

<sup>31</sup> *Id.* at ¶7.471.

were necessary to ensure a steady supply of scrap to China's recycling industry, facilitating a shift from primary production to secondary production.<sup>32</sup> Since the production of metals from scrap (secondary production) is less environmentally harmful than the production of EPRs (primary production), this shift in production would reduce pollution overall.<sup>33</sup> China claimed that its export restrictions on EPRs by reducing the amount of EPRs exported would reduce the production of EPRs, thus reducing the pollution associated with their production.<sup>34</sup>

In reviewing China's claims, the Panel turned first to the legal interpretation of Article XX(b), which involves a two-step process. In making a legal interpretation under Article XX(b), the Panel first had to determine whether the challenged measure "falls within the range of policies designed to protect human, animal or plant life or health." A wide range of policies have been recognized as meeting this requirement, and deference is generally accorded to countries' policies by panels and the Appellate Body.<sup>35</sup> The second step for Panels has focused on the "necessity requirement" of Article XX(b), as the language of Article XX(b) permits measures that are "necessary" to protect human, animal, and/or plant life or health. An assessment of necessity involves "a process of weighing and balancing a series of factors . . ."<sup>36</sup> In delineating the relevant factors, the Panel recognized the Appellate Body report in *Brazil – Retreaded Tyres*,<sup>37</sup> where three factors were deemed particularly relevant to a determination of "necessity." These were "the importance of the interests or values at stake, the extent of the contribution to the achievement of the measure's objective, and its [the measure's] trade restrictiveness."<sup>38</sup>

As to the first factor, the *Brazil* Appellate Body had stated that "[t]he more vital or important [the] common interests or values" behind the policies pursued, "the easier it would be to accept as 'necessary' a measure designed as an enforcement instrument." This factor looks at the objective of the challenged measures. Previous Appellate Body reports had noted the heightened importance of protecting human health and the environment.<sup>39</sup>

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.* at ¶7.479. Previous cases on the issue have included policies to reduce air pollution resulting from the consumption of gasoline and the reduction of risks arising from the accumulation of waste tires.

<sup>36</sup> *Id.* at para.¶ 7.480.

<sup>37</sup> Appellate Body Report, *Brazil – Measures Affecting Imports of Retreaded Tyres*, WT/DS332/AB/R, (Dec. 3, 2007) [hereinafter *Brazil – Retreaded Tyres*].

<sup>38</sup> Panel Report at ¶ 7.481 (quoting *Brazil – Retreaded Tyres*, *supra* note 37, at ¶178).

<sup>39</sup> *Id.* at ¶7.482 (citing *Brazil – Retreaded Tyres*, *supra* note 37, at ¶¶144, 179 ("few

instance, where the alternative imposes prohibitive costs or technical difficulties on the defending country, is not a "reasonably available" alternative.<sup>47</sup>

Having reviewed prior WTO disputes interpreting Article XX(b), and relying upon the *Brazil* Appellate Body determinations, the Panel looked at whether the objective of the challenged measures was the protection of health and the environment. China claimed that the objective of its export restrictions on EPRs was to reduce pollution caused by the production of the restricted exports, which would lead to better health for the Chinese population. China pointed to a number of laws, regulations, and policy statements that the country claimed were part of a comprehensive environmental protection framework whose objectives were "pollution reduction for the protection of health of the Chinese population, energy conservation, and transformation into a 'circular economy' . . . ." <sup>48</sup>

The Complainants challenged China's declared objective, arguing that the true goal of the export restrictions had nothing to do with public health or protection of the environment. Rather, Complainants argued, the export restrictions were designed to promote increased production of high value-added downstream products that use the EPRs as inputs. The export restrictions served to lower the price of these inputs in China, which facilitates increased production of downstream products by Chinese domestic producers. For the Complainants, China's invocation of environmental and health concerns was merely a *post hoc* rationalization of its export restrictions.<sup>49</sup>

In assessing the objective of China's export restrictions, the Panel undertook a textual review of the export restrictions themselves, as well as the other laws, regulations, and policy statements which China claimed constituted its comprehensive policy framework for environmental protection.<sup>50</sup> While acknowledging that these measures were evidence of China's efforts to regulate in the interest of protecting the environment, the Panel failed to "discern in this array of measures a comprehensive framework" addressing public health and environmental protection.<sup>51</sup> The Panel noted that the proffered documents referred to the environment, but also referred to energy, transportation, and economic development. More importantly, the Panel noted, "we do not

<sup>47</sup> *Id.* at ¶7.490.

<sup>48</sup> *Id.* at ¶7.498.

<sup>49</sup> *Id.* at ¶7.499.

<sup>50</sup> These other documents included, among others, China's *Eleventh Five-Year Plan for Environmental Protection (2006-2010)*, a *Circular on the Measures to Control the Export of EPR Products*, and the announcements of export tariffs for EPR products for the years 2006 through 2009. *Id.* at ¶¶7.501-7.506.

<sup>51</sup> *Id.* at ¶7.511.

As to the second factor, the *Brazil* Appellate Body distinguished between two different types of contribution. A measure can "bring about" a material contribution to the achievement of its objective, or a measure can be "apt to produce" a material contribution to the objective pursued.<sup>40</sup> Further, a measure can be considered "necessary" even where the contribution the measure makes is not "immediately observable."<sup>41</sup> Specifically, the *Brazil* Appellate Body recognized that certain public health or environmental problems can only be addressed through a comprehensive policy, comprised of multiple interacting measures, and a "necessary" measure might be just one piece of a larger policy framework. The *Brazil* Appellate Body noted that the contribution of the measure could be demonstrated quantitatively and/or qualitatively. "Quantitative demonstration" could include data pertaining to the past or the present, as well as future projections establishing that the measure at issue makes or will make a material contribution to the public health or the environmental objectives pursued. Qualitative demonstration can consist of "reasoning based on a set of hypotheses that are tested and support by sufficient evidence."<sup>42</sup>

The third and final factor in assessing the "necessity" of a challenged measure is the trade restrictiveness of the measure. One key inquiry is gauging the measure's effect on "international commerce."<sup>43</sup> Generally, "[t]he less restrictive the effects of the measure, the more likely it is to be characterized as 'necessary.'" A very restrictive measure calls for a "cost-benefit" analysis; the country defending the measure must show that the importance of the interest protected by the measure and the contribution the measure makes to protecting that interest outweighs the trade restrictive effect of the measure.<sup>44</sup>

If analysis of a measure under these three factors indicates that the measure is indeed "necessary" within the meaning of Article XX(b), a panel must then consider whether there are alternatives to the challenged measure. These alternatives must be "WTO-consistent while providing an equivalent contribution to the achievement of the objective pursued by the challenged measure."<sup>45</sup> Alternative measures must be "practically and financially feasible" for the country defending the measure.<sup>46</sup> A measure that is "merely theoretical in nature," for

interests are more 'vital' and 'important' than protecting human beings from health risks, and protecting the environment is no less important.")).

<sup>40</sup> *Id.* at ¶7.484.

<sup>41</sup> *Id.* at ¶7.485.

<sup>42</sup> *Id.* (citing *Brazil – Retreaded Tyres*, *supra* note 37, at ¶151).

<sup>43</sup> *Id.* at ¶7.487.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.* at ¶¶7.489-7.490.

<sup>46</sup> *Id.* at ¶7.492.

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<sup>51</sup> *Id.* at ¶7.511.



find evidence that the export measures at issue in this dispute form part of any such framework.”<sup>52</sup> China failed to produce persuasive evidence of the connection between the challenged export restrictions and the achievement of China’s environmental and public health goals. The Panel stated to justify a measure under Article XX(b), a country “must do more than produce a list of measures referring, *inter alia*, to environmental protection and polluting products.” The defending country must show *how* these measures fulfill the objective they claim to address.<sup>53</sup> According to the Panel, the documents China submitted did not sufficiently demonstrate that the subject export restrictions were intended to reduce pollution from the production of EPR products<sup>54</sup>. The Panel found that China had not substantiated its claim that its export restrictions were part of a comprehensive environmental program.<sup>55</sup>

The Panel specifically noted what it called the “systemic implications” of China’s arguments under Article XX(b). If China’s position were accepted, Article XX(b) could then “be interpreted to allow the use of export restrictions on any polluting products on the ground that export restrictions reduce the production of these products and thus pollution,” the Panel stated. Further, China’s argument, if accepted, would permit restrictions on any raw materials “simply because they help increase growth” and eventually reduce pollution. The Panel reiterated the importance of the requirement that “only those export restrictions that bring about a material contribution to the environmental policy goal” be accepted as WTO-compliant.<sup>56</sup>

The Panel moved on to the second factor in determining whether the measures were “necessary” and examined whether the imposition of export restrictions was apt to materially contribute to the reduction of pollution and consequently the improvement of the health of the Chinese population.<sup>57</sup> China offered evidence both as to the present contribution of the export restrictions to pollution reduction and to projected future reduction. To support its claim of the measures’ current contribution to pollution reduction, China submitted two empirical studies estimating the effect of certain of the challenged duties and quotas on China’s domestic production.<sup>58</sup> China also put forth a

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> *Id.* at ¶7.512.

<sup>55</sup> *Id.* at ¶7.516.

<sup>56</sup> *Id.*

<sup>57</sup> *Id.* at ¶7.518.

<sup>58</sup> One study estimated the effect of an export duty on manganese metal and magnesium metal and of an export quota on silicon carbide, using a simulation model of demand and supply. The second study used a regression model to estimate the effects of imposing an export duty and a quota on coke. *Id.* at ¶7.519.

qualitative argument based on standard economic theory of the effects of an export restriction:

[A]n export restriction on polluting raw materials, by reducing foreign demand for the good on which it is imposed, shifts supply of the good to the domestic market, thus putting downward pressure on the domestic price of the product. The reduction of the domestic price of the good will decrease production and this, in turn, will lower pollution.<sup>59</sup>

The Panel was not convinced by either China's quantitative or its qualitative arguments. The Panel expressed reservations about the quality of the data used in the demand-supply study<sup>60</sup> and with the methodology of the regression analysis in the second study.<sup>61</sup> Further, the Panel was unconvinced by China's qualitative argument because it did not account for important "upstream-downstream interactions."<sup>62</sup> Given the vertical integration of the metals industries in China, the Panel found it critical to look at the downstream effect of an upstream export restriction to determine the total effect on production and, therefore, pollution.

Specifically, the Panel noted that an export restriction reduces overall production of a raw material, but also makes available additional amounts of the raw material for use by the domestic downstream industry. In industries where vertical linkages are important, such as China's mining and minerals industry, the test for material contribution to the stated objective "must account for those policies that may offset the alleged effect of the policy in place."<sup>63</sup> That is, even an overall reduction in production of a raw material in China because of reduced exports may result in domestic use of those materials that more than offset the pollution reduction benefits claimed for the export reductions. Thus, to assess whether an export restriction reduces pollution, the Panel needed information not only on the reduction of pollution

<sup>59</sup> *Id.* at ¶7.526.

<sup>60</sup> The Panel noted that this study applied estimated supply and demand elasticities for coke to its analysis of manganese metal, magnesium metal and silicon carbide. Standard economic theory provides that supply and demand elasticities are generally specific to specific products. China had not produced evidence to show that the demand elasticities of the raw materials that were the subject of the study were the same as the elasticities for coke. *Id.* at ¶7.529.

<sup>61</sup> The Panel's concerns with this study were two-fold. First, it noted that China's regression model included inappropriate control variables and periodic data, either of which would alter the results shown by the model. *Id.* at ¶7.532 n.842. Second, the regression model methodology failed to distinguish which of the export restrictions – duty or quota – was the "biting" constraint. This distinction is important since a change in an export duty, for example, will only affect production if the duty is the biting constraint. *Id.* at ¶7.532 n.844.

<sup>62</sup> *Id.* at ¶7.533.

<sup>63</sup> *Id.* at ¶7.536.

generated by the lower level of raw material production, but also on "the increased pollution generated by the amount of steel and iron that are produced using the additional units of EPRs available as domestic consumption." China had failed to produce this second piece of information for the Panel's consideration.<sup>64</sup> Thus, the Panel was not persuaded that the export restrictions imposed by China currently made a material contribution to the objective of protecting public health and the environment.<sup>65</sup>

China's second economic argument claimed that its export restrictions would make a material contribution to its environmental protection objectives because export restrictions on raw materials would "facilitate[e] China's economic growth which, in turn leads to substantial environmental protection." This argument is based on two interdependent assumptions: first, that export restrictions on upstream raw materials will promote faster economic growth in China and, second, that greater national income will lead to environmental gains.<sup>66</sup>

In support of the first assumption, China asserted that there are strong links between export restrictions and economic growth. China referred to a study identifying the existence of "export sophistication externalities" in support of this argument. This study suggested that "if countries consume, rather than export, raw and basic materials and make efforts to produce and export 'sophisticated' bundles of goods, they can achieve higher growth."<sup>67</sup> The Panel was unconvinced by this argument, finding that China's export restrictions were not the type of policy suggested by the study.<sup>68</sup> The Panel also rejected China's claims regarding the link between higher economic growth and environmental benefits. China pointed to the empirical evidence of the "Environmental Kuznets Curve" (EKC), an empirical correlation between income per capita and environmental degradation. This correlation shows that, at relatively low levels of income, pollution increases with income, but beyond a certain income level, pollution declines.<sup>69</sup> The Panel found that the connection between growth and environmental protection

<sup>64</sup> China asserted that it did not include additional downstream pollution in its calculations because it believed downstream pollution to be relatively minor compared to pollution caused by upstream production of the raw materials. The Panel noted that it did not have the evidence required to evaluate this contention. *Id.* at ¶7.534.

<sup>65</sup> *Id.* at ¶7.538.

<sup>66</sup> *Id.*

<sup>67</sup> *Id.* at ¶7.543 n.854. The study was Ricardo Hausmann, Jason Hwang & Dani Rodrik, *What You Export Matters*, 12 J. ECON. GROWTH 1 (2007).

<sup>68</sup> *Id.* at ¶7.545.

<sup>69</sup> *Id.* at ¶7.551.

underlying the EKC did not prove that export restrictions were necessary for environmental gains.<sup>70</sup>

The Panel interpreted the third factor of the "necessity" test, the trade restrictiveness of the measures, in a fairly straightforward way. Specifically, the Panel observed that the impact of the export restrictions at issue on the world market did not depend on the global availability of the raw natural resources.<sup>71</sup> Rather, the test of restrictiveness is the country's export market share in the world market.<sup>72</sup> Where a country's global share of a product is "quite significant," even modest export restrictions can have an important worldwide impact, the Panel reasoned.<sup>73</sup> China argued that its measures were not overly trade restrictive in the long term because the high world market prices occasioned by its restrictions would drive new producers to enter the market, returning world prices to their initial level.<sup>74</sup> The Panel flatly rejected this reasoning, stating that long term effects do not counterbalance short term effects in determining the trade restrictiveness of a challenged measure.<sup>75</sup>

At this point in its analysis, the Panel had not made a finding on whether China's export restrictions were "necessary" within the meaning of Article XX(b). The Panel specifically shelved that finding, while it undertook an *arguendo* analysis of the availability of WTO-consistent less trade restrictive alternative measures.<sup>76</sup> The Complainants submitted six types of alternative measures which they argued were WTO-consistent and more efficient for ensuring the reduction of pollution and the protection of the health of the Chinese people.<sup>77</sup> China argued that all of the alternative measures suggested were already in place in China and that the export restrictions complemented the existing measures as part of a comprehensive framework to minimize the environmental and health consequences of

<sup>70</sup> *Id.* at ¶7.553.

<sup>71</sup> *Id.* at ¶7.558.

<sup>72</sup> *Id.*

<sup>73</sup> *Id.* For example, China's global share of coke exports was 43.5%, its share of manganese exports was 74.2%, and its share of magnesium exports was 74.2%, at the time of the dispute.

<sup>74</sup> *Id.* at ¶7.561.

<sup>75</sup> *Id.* at ¶7.562.

<sup>76</sup> *Id.* at ¶7.565. The Panel specifically noted that it found it "useful to review the arguments and evidence submitted" with regard to the availability of alternatives and, therefore, would examine those arguments *arguendo*.

<sup>77</sup> *Id.* at ¶¶7.569 – 7.580. These six alternatives were: (1) investment in more environmentally friendly technologies; (2) recycling of consumer goods; (3) increasing environmental standards; (4) investing in infrastructure necessary to facilitate recycling of scrap; (5) stimulating greater local demand for scrap without discouraging local supply; and (6) introduction of production restrictions or pollution controls.



EPR production and through scrap recycling.<sup>78</sup> China submitted evidence relating to the alternative measures, consisting of Chinese laws and regulations, but the Panel was not convinced by this evidence. First, the Panel noted with regard to each of the six alternatives that the evidence China submitted as to its regulatory scheme did not show how and to what extent China had actually implemented the laws and regulations, nor did China produce any evidence showing the effects of the implementation of those laws.<sup>79</sup> Second, the Panel noted that China produced no evidence as to why the alternative measures could not be used in lieu of export duties and quotas. For example, several of the measures China offered as evidence appeared to be only guidelines or plans, and not obligatory.<sup>80</sup> Making these measures mandatory and more stringent could serve as an equally effective and less trade restrictive method for protection of the environment and health.<sup>81</sup>

Having applied the three factors required to determine whether China's measures were "necessary" within the meaning of Article XX(b) and having investigated the availability of alternative measures, the Panel concluded that China had not carried its burden of demonstrating that the export restrictions on EPRs were justified under Article XX(b).<sup>82</sup>

*China's Article XX(g) defense claims*

China cited Article XX(g) in defense of its export restrictions on refractory-grade bauxite and fluor spar. Article XX(g) permits measures "relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption."<sup>83</sup> China claimed that bauxite and fluor spar were scarce, exhaustible natural resources for which substitutes were difficult to find, and thus needed to be managed and protected. China

<sup>78</sup> *Id.* at ¶7.567.

<sup>79</sup> E.g., with regard to investment in environmentally friendly technologies, China submitted the *Law on the Prevention and Control of Atmospheric Pollution*, the *Law on Promoting Clean Production*, the *Law on the Prevention and Control of Environmental Pollution by Solid Wastes*, and the *Law on the Prevention and Control of Water Pollution*, to support its contention that the country had this alternative type of measure already in place. Each of these laws the Panel found to contain general statements about adopting general policies and encouraging research, but found nothing to explain how these broad statements would, in fact, encourage investment in environmentally friendly technologies. *Id.* at ¶7.569.

<sup>80</sup> This appeared to be true of the *Law on Promoting Clean Production*, the *Law on the Prevention and Control of Environmental Pollution by Solid Wastes*, as well as a host of Chinese environmental laws submitted to show that China had implemented production restrictions and pollution controls. *Id.* at ¶¶7.570, 7.581 n.924.

<sup>81</sup> *Id.* at ¶¶7.589 - 7.590.

<sup>82</sup> *Id.* at ¶7.591.

<sup>83</sup> GATT 1994, *supra* note 6, at Article XX(g).



also argued that nothing should interfere with its sovereignty over its natural resources.<sup>84</sup> Related to this argument, China referred to the “need for developing countries to make optimum use of **their resources** for their development, as they deem appropriate, **including** the processing of their raw material.”<sup>85</sup> The Complainants countered that China could not use the “flexibilities” of Article XX to support an export regime that otherwise violated its WTO obligations.<sup>86</sup>

The Panel began its legal interpretation of Article XX(g) by parsing the provision into two components. For a measure to be justified under the Article, it must (1) “relate to the conservation of an exhaustible natural resource,” and (2) must be “made effective in conjunction with restrictions on domestic production or consumption.”<sup>87</sup> With regard to the first component, China argued, and the Complainants did not contest, that the raw materials at issue were “exhaustible natural resources” within the meaning of Article XX(g).<sup>88</sup>

*Relating to the conservation of an exhaustible natural resource:*

Based on a review of the WTO cases construing Article XX(g), the Panel concluded that a measure “relates to” conservation if there is a substantial relationship between the export measure and conservation, and “that a measure must be ‘*primarily aimed at*’ the conservation of exhaustible natural resources to fall within the scope of Article XX(g).<sup>89</sup> The Appellate Body in *US – Shrimp* described this relationship as “a close and genuine relationship of ends and means” requiring an examination of the relationship between the general structure and design of a measure and the policy goal it purports to serve.<sup>90</sup>

In interpreting the concept of “conservation,” the Panel considered both the ordinary meaning of the word and the context of this provision. The Panel found the ordinary meaning of conservation to be “the act of preserving and maintaining the existing state of something,” which in this case was natural resources.<sup>91</sup> The Panel reviewed the “immediate context” of Article XX(g) by looking at paragraph (i) of Article XX. Article XX(i) deals with situations where exports of domestic materials can be restricted to assist domestic downstream industries under certain circumstances.<sup>92</sup> However, the provision explicitly states that such

<sup>84</sup> Panel report, *supra* note 1, at ¶7.356.

<sup>85</sup> *Id.*

<sup>86</sup> *Id.*

<sup>87</sup> *Id.* at ¶7.361.

<sup>88</sup> *Id.* at ¶7.363.

<sup>89</sup> *Id.* at ¶7.370 (citation omitted).

<sup>90</sup> *Id.* at n.587.

<sup>91</sup> *Id.* at ¶7.372.

<sup>92</sup> Article XX(i) provides an exception for measures “involving restrictions on exports of

restrictions cannot be imposed to increase the protection of the domestic industry; the restrictions remain subject to the basic GATT principle of non-discrimination.<sup>93</sup> In the Panels' view, Article XX(g) ought not to be interpreted in such a way as to contradict article XX(i)'s prohibition of discrimination. According to the Panel, "WTO Members cannot rely on Article XX(g) to excuse export restrictions adopted in aid of economic development if they operate to increase protection of the domestic industry."<sup>94</sup>

*What is "effective in conjunction with domestic restrictions"?:*

The second requirement for a measure to be permitted under Article XX(g) is that it be "made effective in conjunction with restrictions on domestic production or consumption."<sup>95</sup> The Panel took the ordinary meaning of the term "restriction" to be that which has a "limiting effect"<sup>96</sup> and then examined what it means for a measure to be "made effective in conjunction with" domestic restrictions. A measure is "made effective" where it is "operative," "in force," or has "come into effect."<sup>97</sup> For a measure to be made effective "in conjunction with" domestic restrictions, both the export restriction and the related domestic restriction must operate at the same time.<sup>98</sup> Further, the measure must be "primarily aimed at rendering effective" those domestic restrictions.<sup>99</sup> "[T]he purpose of [the] export restrictions must be to ensure the effectiveness of [the] domestic restrictions."<sup>100</sup>

*The broader context of Article XX(g): sovereignty over natural resources:*

China also contended that its Article XX(g) claim was bolstered by a broader context of its sovereignty over natural resources, in keeping with international law. This contention mirrors some basic concepts and principles forwarded in both the Stockholm Declaration of 1972 and

domestic materials necessary to ensure essential quantities of such materials to a domestic processing industry during periods when the domestic price of such materials is held below the world price as part of a governmental stabilization plan;..." *Id.* at ¶7.385.

<sup>93</sup> *Id.* at ¶¶7.384, 7.386.

<sup>94</sup> *Id.* at ¶7.386.

<sup>95</sup> GATT 1994, , *supra* note 6, at Article XX(g).

<sup>96</sup> Panel Report, *supra* note 1, at ¶7.394.

<sup>97</sup> *Id.* at ¶7.396.

<sup>98</sup> *Id.* at ¶7.398.

<sup>99</sup> *Id.* at ¶7. 395 (quoting Report of the Panel, *Canada – Measures Affecting Exports of Unprocessed Herring and Salmon*, ¶4.6, L/6268 (Nov. 20, 1987), GATT B.I.S.D. (35<sup>th</sup> Supp.) at 98 (1988)).

<sup>100</sup> *Id.* at ¶7.397.

principles articulated at the 1992 "Earth Summit" in Rio de Janeiro. In 1972, the Stockholm Declaration's Principle 21 affirmed that

States have, in accordance with the Charter of the United Nations and the principles of international law, the sovereign right to exploit their own resources pursuant to their own environmental policies, and the responsibility to ensure that activities within their jurisdiction or control do not cause damage to the environment of other States or of areas beyond the limits of national jurisdiction.<sup>101</sup>

Twenty years later, at Rio de Janeiro, parts of Principle 21 were included in Principle 2 of the Rio Declaration on Environment and Development, and re-affirmed the basic concept of state sovereignty in exploiting its own resources.<sup>102</sup> In addressing China's sovereignty argument in terms of the Preamble to the WTO agreement, the Panel found that the Preamble to the WTO Agreement was relevant as giving "colour, texture, and shading" to the interpretation of the GATT 1994.<sup>103</sup> The Preamble specifically recognized that WTO members' trade relations should allow for the use of resources in accordance with the objective of sustainable development, to protect the environment, but to do so in a manner consistent with needs and concerns of members at different levels of economic development.<sup>104</sup> According to the Panel, a proper reading of Article XX(g) must take into account "the challenge of using and managing resources in a sustainable manner that ensures the protection and conservation of the environment while promoting economic development."<sup>105</sup>

Second, the Panel found principles of general international law applicable to its interpretation, specifically the principle of state sovereignty.<sup>106</sup> According to the Panel, the principle of state sovereignty includes the principle of sovereignty over natural resources and the ability to enter into international agreements.<sup>107</sup> Sovereignty over natural resources allows states to "freely use and exploit their natural wealth and resources wherever deemed desirable by them for their own

<sup>101</sup> Report of the U.N. Conference on the Human Env't, Stockholm, Swed., June 5-16, 1972, Declaration of Principles [Stockholm Declaration], principle 21, U.N. Doc.A/CONF.48/14, reprinted in 11 I.L.M. 1416 (1972).

<sup>102</sup> Rio Declaration on Environment and Development, principle 2, U.N. Doc. A/CONF.151/5, reprinted in 31 I.L.M. 874, 877 (1992).

<sup>103</sup> Panel Report at ¶7.373 (citation omitted). The Panel also noted that Article 31(2) of the *Vienna Convention on the Law of Treaties* makes clear that the context of a treaty includes its "text, including its preamble and annexes." *Id.*

<sup>104</sup> *Id.* at ¶7.374, quoting Preamble, Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, 1867 U.N.T.S. 154.

<sup>105</sup> *Id.* at ¶7.375.

<sup>106</sup> *Id.* at ¶¶7.377 – 7.379.

<sup>107</sup> *Id.* at ¶¶7.380, 7.382.

progress and economic development," the Panel stated.<sup>108</sup> The Panel noted that the sovereignty principle would afford WTO members the opportunity to "use their natural resources to promote their own development while regulating the use of these resources to ensure sustainable development."<sup>109</sup> But by exercising its sovereignty and becoming a WTO member, a country commits itself to abide by the obligations embodied in the WTO agreements, including the GATT 1994, the Panel reasoned.<sup>110</sup>

*The "even-handedness" requirement:*

Finally, Article XX(g) has also been interpreted to impose a requirement of "even-handedness" between the export restriction and the domestic restriction.<sup>111</sup> This "even-handedness" requirement does not mean that the export restriction and the domestic restriction must be identical or that they must have an identical effect.<sup>112</sup> But if there are no restrictions placed on domestic production or consumption, and all limitations are imposed on exports, the challenged measure cannot be construed as designed for conservationist goals.<sup>113</sup> China argued that this requirement was satisfied so long as some restriction was imposed on domestic supply, and that Article XX(g) does not require resource-endowed countries to ensure that user-countries benefit equally or identically from the resources of the exporting countries. The Complainants urged the Panel to adopt a more restrictive view, arguing that "evenhandedness" required that the domestic restrictions must "fix definitely" the limitations on domestic supply and that domestic interests must suffer some negative impact from the restrictions.<sup>114</sup> The Panel agreed with the essence of the Complainants' argument, noting that "if a WTO Member is not taking steps to manage the supply of natural resources domestically, it is not entitled to seek the cover of Article XX(g) for the measures it claims are helping to conserve the resource . . . ."<sup>115</sup> Article XX the Panel reasoned, justifies GATT-inconsistent measures if those measures, along with parallel domestic restrictions, related to the conservation of natural resources and were

<sup>108</sup> *Id.* at ¶7.380, citing U.N. G.A. Resolution 626 (VII), *Right to Exploit Freely Natural Wealth and Resources* (21 December 1952).

<sup>109</sup> *Id.* at ¶7.381.

<sup>110</sup> *Id.* at ¶7.382.

<sup>111</sup> *Id.* at ¶7.402.

<sup>112</sup> *Id.* (quoting Appellate Body Report, *US - Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R (April 29, 1996)) [hereinafter *US - Reformulated Gasoline*].

<sup>113</sup> *Id.*

<sup>114</sup> *Id.* at ¶¶7.390 - 7.391.

<sup>115</sup> *Id.*, at ¶7.406.

primarily aimed at making the domestic measures effective for such conservation.<sup>116</sup>

*Rejecting China's Article XX(g) defenses*

Applying all of these interpretations to the challenged export restrictions, the Panel concluded that China had failed to demonstrate that its measures met the requirements of the Article. First, the Panel addressed whether China's export restrictions "relate to the conservation" of bauxite and/or fluorspar. China argued that it had adopted a "comprehensive set of measures" relating to the conservation of bauxite and fluorspar, listing thirteen measures in all that it claimed were relevant to its conservation framework.<sup>117</sup> The Panel reviewed the measures that had been in effect before the dispute was brought in 2009.<sup>118</sup> Looking at the text of these various measures, the Panel noted that none of them mentions conservation of natural resources as an objective. The National Mineral Resources Plan (2008-2015), for example, mentions the restriction of extraction of minerals as a useful policy tool and references possible future extraction restrictions, but does not contain any current restrictions on extraction or production.<sup>119</sup> Based on this textual review, the Panel concluded that none of the measures sufficiently connected any restrictions to conservation objectives.<sup>120</sup>

In support of its contention that these export quotas and duties were related to conservation, China argued that the measures "contribute to its [China's] stated objective of conservation" of the resources at issue by reducing foreign demand for the minerals, which will reduce domestic production and, therefore, the extraction of the minerals. The export restrictions were necessary because domestic restrictions alone would undermine China's sustainable development, it argued.<sup>121</sup> The Panel was not convinced that the restrictions were related to conservation, stating that, if China wished to conserve these minerals, a policy

<sup>116</sup> *Id.* at ¶7.408.

<sup>117</sup> *Id.* at ¶¶7.419 – 7.420.

<sup>118</sup> These measures were: Mineral Resources Laws of 1986, Environmental Protection Law of 1989, Provisional regulations on Resource Tax of 1994 and Detailed Rules for the Implementation of the Provisional Regulations on Resource Tax of 1994, Administration of Collection of the Mineral Resources Compensation Fees of 1997, National Mineral Resources Plan of 2001, Notice of Opinions of Authorities on the Integration of Exploitation of Mineral Resources of 2006, and National Mineral Resources Plan (2008-2015). *Id.* at ¶7.421.

<sup>119</sup> *Id.* at ¶7.422.

<sup>120</sup> *See id.* at ¶¶7.422 – 7.426.

<sup>121</sup> *Id.* at ¶7.427.



restricting *extraction* would be more effective than one restricting *exports*.<sup>122</sup>

The Panel also had before it evidence showing that there had been a “substantial” increase in Chinese domestic consumption of bauxite and fluorspar, while exports of the minerals grew at a much slower pace. For example, Chinese consumption of fluorspar increased 124 percent from 2000 to 2009.<sup>123</sup> The Panel also considered evidence of increased exports of fluorspar in the form of downstream products containing fluorspar.<sup>124</sup> “[G]iven that domestic extraction has in fact increased,” the Panel found that the evidence did not support China’s claim that it had in place a comprehensive regime to conserve bauxite and fluorspar.<sup>125</sup> In addition, China had failed to show any clear link between the way the duties and quotas were structured and any conservation objective. The Panel noted, for example, that China had not explained how the fifteen percent duty on fluorspar would extend the lifespan of fluorspar reserves and, in fact, did not argue that this was the objective of the export duty.<sup>126</sup> Rather, the Panel noted that China itself maintained that the duty was designed to limit exports of fluorspar – not the extraction of fluorspar – because otherwise China would be “compelled to share [its] resources according to nothing more than the demands of foreign markets.”<sup>127</sup> A mechanism that would increase the cost of bauxite and fluorspar to foreign consumers, but reduce their costs to domestic users, could not be reconciled with the claimed objective of conservation, the Panel concluded.<sup>128</sup>

In light of the absence of textual references to any conservation objectives for the measures and the empirical evidence that China’s consumption of the minerals at issue had increased, the Panel determined that the subject export restrictions did not “relate to the conservation” of the minerals, within the meaning of Article XX(g).

Although China’s defense failed as to this first requirement of Article XX(g), the Panel went on to assess whether the restrictions at issue were “made effective in conjunction with restrictions on domestic production or consumption.” The Panel noted that it must investigate the *actual* effect the measures had on domestic production or consumption, not just

<sup>122</sup> *Id.* at ¶¶7.427 - 7.428.

<sup>123</sup> *Id.* at ¶7.429.

<sup>124</sup> The United States had urged that, in assessing the amount of exported mineral, the Panel look not only at raw and processed fluorspar and bauxite, but that it also consider the amount of these minerals contained in finished products exported by the Chinese. *Id.*

<sup>125</sup> *Id.*

<sup>126</sup> *Id.* at ¶7.433

<sup>127</sup> *Id.* at ¶7.433 (citation omitted).

<sup>128</sup> *Id.* at ¶7.434.

the theoretical or potential effect.<sup>129</sup> Reviewing the thirteen measures China claimed as its “comprehensive set of measures” for conserving bauxite and fluorspar, the Panel was unconvinced that they actually restricted Chinese domestic production or consumption. None of the measures contained provisions setting limits or restrictions on domestic supply.<sup>130</sup> While two of the measures ostensibly imposed a tax or fee on the extraction of the minerals, the Panel found the amounts of the taxes to be so low as to create no actual restriction on domestic supply.<sup>131</sup> Further, China had produced no evidence that the tax or fee restricted extraction or production.<sup>132</sup>

The Panel also reviewed measures that China had adopted after the dispute was brought in 2009 to evaluate China's claim that domestic restrictions on production and consumption were being introduced.<sup>133</sup> Several of these laws set no restrictions on domestic supply, while others set production caps for 2010 that exceeded the caps from prior years or exceeded the actual production of prior years.<sup>134</sup> China argued that these measures were intended to provide a “transition period” and that it was foreseen that the level of permitted extraction would be reduced year by year.<sup>135</sup> The Panel took issue with these future restrictions, noting that to meet the requirements of Article XX(g), the export restrictions and domestic restrictions must operate concurrently.<sup>136</sup> Thus, the Panel concluded that China had not demonstrated that its export restrictions on bauxite and fluorspar were “made effective in

<sup>129</sup> *Id.* at ¶7.437.

<sup>130</sup> *Id.* at ¶7.440.

<sup>131</sup> Through its Provisional Regulations on Resource Tax, China imposes a resource tax on entities exploiting mineral products. This tax was set at 3 RMB per metric ton (or approximately 0.45 USD per metric ton), which was equivalent to about 0.1% of bauxite or fluorspar prices in China at the time. As of June 1, 2010, the tax was raised to 1% of the respective prices of bauxite and fluorspar. *Id.* at ¶¶7.443 – 7.444. China also subjects extraction of bauxite or fluorspar ores to a “compensation fee” which is a fee calculated based on a company's sales income. The Panel found that the rate of this fee could be so low that it would be unlikely to limit mineral production. *Id.* at ¶¶7.446 – 7.447.

<sup>132</sup> *Id.* at ¶7.447.

<sup>133</sup> These measures included 2010 Measures to Control the Extraction and Production of Refractory-grade Bauxite and Fluorspar, 2010 Public Notice on Refractory-grade Bauxite (High Alumina Bauxite) Industry Entrance Standards, 2010 Circular on Passing Down the 2010 Controlling Quota on Total Extraction Quantity of High-alumina Bauxite Ores and Fluorspar Ores, 2010 Circular on Passing Down the Controlling Quota of the 2010 Total Production Quantity of High-Alumina Refractory-Grade Bauxite and Fluorspar, and 2010 Catalogue of Good Subject to Export Licensing Administration and Notice on Announcement of the 2010 Export Quota Amounts for Agricultural and Industrial Products. *Id.* at ¶7.448.

<sup>134</sup> *Id.* at ¶¶7.450 – 7.453.

<sup>135</sup> *Id.* at ¶7.454.

<sup>136</sup> *Id.* at ¶7.455.

conjunction with restrictions on domestic production or consumption" because the domestic restrictions in place were not enforcing a reduction of domestic production or consumption.<sup>137</sup>

The final portion of the Panel's analysis of China's defense under Article XX(g) looked at whether China's export restrictions were "even-handed" within the meaning of the Article. The Complainants argued that China's restrictions were not even-handed because, while China's domestic regulations and taxes applied to both domestic and foreign companies, the export restrictions affected only foreign companies. China imposed a burden on foreign producers that was not imposed on domestic producers or users; this added burden, Complainants argued, was not consistent with Article XX(g).<sup>138</sup> China countered that "even-handed" treatment has not been interpreted to mean identical treatment and that the export restrictions would burden domestic consumption, when combined with China's production restrictions. China's quota system allocated a certain number of units of production for export. Production caps, when combined with the export quota, would leave a reduced amount of minerals for domestic consumption. Thus, the export restrictions, China argued, created a burden for China as well as for foreign users.<sup>139</sup>

The Panel noted that the Appellate Body had not previously addressed the relative treatment of domestic and foreign interests that would qualify as "even-handed."<sup>140</sup> However, the Appellate Body had said that if there is no restriction on domestic production or consumption, the export restrictions cannot be said to be even-handed.<sup>141</sup>

The Panel rejected China's argument that its export restrictions acted as a burden on its domestic production. "[D]omestic consumption is limited by a production cap only when the domestic demand is greater than the quantity available to the domestic economy through the application of the production and the export caps."<sup>142</sup> China had produced no evidence that China's production cap system guaranteed this result. Thus, China had not demonstrated that its domestic and export regime for bauxite and fluorspar would not lead to an "uneven-handed imposition on foreigners."<sup>143</sup> Identical treatment of domestic and foreign users is not required by the Article, but if no parallel restrictions are imposed on domestic users or on domestic consumption,

<sup>137</sup> *Id.* at ¶7.458.

<sup>138</sup> *Id.* at ¶7.460.

<sup>139</sup> *Id.* at ¶7.463.

<sup>140</sup> *Id.* at ¶7.462.

<sup>141</sup> *Id.* (citing *US - Reformulated Gasoline*, *supra* note 112, at 21).

<sup>142</sup> *Id.* at ¶7.464.

<sup>143</sup> *Id.* at ¶7.465.

and all limits are borne by foreign users, the export restrictions cannot be considered to be evenhanded.<sup>144</sup>

Because its exports restrictions did not "relate to the conservation" of bauxite or fluorspar, nor were they "made effective in conjunction with domestic restrictions on production or consumption," the Panel found that China's export restrictions were not justified under Article XX(g).<sup>145</sup>

#### THE APPELLATE BODY DECISION

Following the Panel's issuance of its final report in July 2011, China appealed certain issues of law and legal interpretation to the WTO Appellate Body. Specifically, China asked the Appellate Body to reverse the Panel's interpretation of Article XI:2(a) of the GATT 1994, alleging that the Panel erred in its interpretation of the term "temporarily" and in its interpretation of the term "critical shortages."<sup>146</sup> China also asked the Appellate Body to find that the Panel erred in its interpretation of the requirements of Article XX(g). The Appellate Body agreed with the Panel's ultimate conclusions that China had failed to demonstrate that its export restrictions were justified under either Article XI:2(a) or Article XX(g), and agreed with its interpretation of Article XI:2(a). However, the Appellate Body took a different view from the Panel as to the correct interpretation of Article XX(g).

In reviewing China's appeal of the Panel's interpretation of Article XI:2(a), the Appellate Body defined the two key concepts of the provision. The Appellate Body defined a measure "temporarily applied" as a "measure applied for a limited time, a measure taken to bridge a 'passing need.'"<sup>147</sup> "Critical shortages," the Appellate Body noted, are "deficiencies in quantity that are crucial, . . . or that reach a vitally important or decisive stage, or a turning point."<sup>148</sup> The crux of China's appeal was that the Panel used these definitions to exclude from the scope of Article XI:2(a) non-renewable exhaustible natural resources by presuming that a shortage of such a resource could not be "critical" within the meaning of the Article. The Appellate Body rejected China's understanding of the Panel's logic by noting that the "reach of Article XI:2(a) is not the same as that of Article XX(g), . . . these provisions are intended to address different situations and thus must mean different things." Article XI:2(a) addresses measures relating to "critical shortages" of resources while Article XX(g) addresses measures relating to conservation of resources. This difference the Panel had correctly

<sup>144</sup> *Id.* (citing *US – Reformulated Gasoline*, *supra* note 112, at 21).

<sup>145</sup> *Id.* at ¶¶7.466 – 7.468.

<sup>146</sup> Appellate Body Report at ¶40.

<sup>147</sup> *Id.* at ¶323.

<sup>148</sup> *Id.* at ¶324.



identified in interpreting Article XI:2(a) and applying it to China's export restrictions.<sup>149</sup>

China also appealed the Panel's interpretation of Article XX(g), arguing that it had erroneously interpreted the phrase "made effective in conjunction with" to mean that domestic production or consumption restrictions must be applied jointly with export restrictions, but also that the purpose of export restrictions must be to ensure the effectiveness of the domestic restrictions.<sup>150</sup> China contended that this expansive interpretation of Article XX(g) was not warranted by either the text of the provision or previous WTO decisions.<sup>151</sup> The Appellate Body noted that it had interpreted the "in conjunction with" term in *US - Reformulated Gasoline* to mean that domestic and export measures must exist jointly, but expressly refused to impose a requirement that the export measures ensure the effectiveness of the domestic measures.<sup>152</sup> The Appellate Body found nothing in the text of Article XX(g) to impose this additional requirement and found that the Panel erred in its interpretation of the phrase "made effective in conjunction with" in Article XX(g).<sup>153</sup>

The difference between the Panel's interpretation of this critical Article XX(g) requirement and the interpretation of the Appellate Body is significant for states defending their conservation measures under the provision. The Panel's interpretation essentially imposes the requirement of a causal connection between export or import restrictions and domestic restrictions. That is, the export /import restrictions must have an effect *on the domestic restrictions*, the effect being to make the domestic restrictions "effective."<sup>154</sup> This interpretation of the "in conjunction with" language arose from an early Panel's belief that the purpose of Article XX was to ensure that commitments under the GATT did not hinder policies that pursued the conservation of exhaustible natural resources, but not to increase the scope of measures available to member states.<sup>155</sup> Thus, the *Canada - Unprocessed Herring and*

<sup>149</sup> *Id.* at ¶337.

<sup>150</sup> *Id.* at ¶345. China did not appeal the Panel's ultimate conclusion that its export restrictions were not justified under Article XX(g). *Id.* at ¶350.

<sup>151</sup> *Id.* at ¶351.

<sup>152</sup> *Id.* at ¶358.

<sup>153</sup> *Id.* at ¶361.

<sup>154</sup> One commentator has referred to this as the "ends-means relationship," the export/import measures acting as the means by which the domestic measures are made effective. ERICH VRANES, *TRADE AND THE ENVIRONMENT: FUNDAMENTAL ISSUES IN INTERNATIONAL LAW, WTO LAW, AND LEGAL THEORY* 267 (2009).

<sup>155</sup> Panel Report, *Canada - Measures Affecting Exports of Unprocessed Herring and Salmon*, L/6268 - 35S/98, adopted March 22, 1988, ¶4.6 [hereinafter *Canada - Unprocessed Herring and Salmon*].



*Salmon* Panel, and several subsequent pre-WTO panels, narrowed the availability of Article XX(g) by their strict interpretation of this clause.<sup>156</sup> States defending under Article XX(g) would need to show proof of the causal connection between the export/import restrictions and the domestic measures.

In *US – Reformulated Gasoline*, the first case decided under the WTO dispute settlement procedure, the Appellate Body examined the interpretation of the “made effective in conjunction with” language of Article XX(g). The Appellate Body explicitly rejected the notion from prior panel reports that this language imposed what it called an empirical “effects test” for export/import restrictions.<sup>157</sup> Looking at the language of Article XX(g) and the chapeau, the Appellate Body reasoned that the ordinary meaning of the terms in the provision imposed no such requirement.<sup>158</sup> “Made effective,” when applied to a governmental regulation, means that the measures is “operative” or “in force,” the Appellate Body noted. Further, the phrase “in conjunction with” means “together with” or “jointly with,” according to the Appellate Body.<sup>159</sup> Taken together, this clause requires that states imposing export or import restrictions as part of a conservation effort must also have in place domestic restrictions as part of that program.<sup>160</sup> While the international and domestic restrictions would be in place at the same time, the Appellate Body found no basis in the provision to require that the two types of measures be connected to each other causally.<sup>161</sup> “[T]he problem of determining causation . . . is always a difficult one,” the Appellate Body stated.<sup>162</sup> The Appellate Body found this difficulty to be acute in the field of conservation of exhaustible natural resources, where a substantial period of time may have to elapse before the effects attributable to any conservation measure may be observable.<sup>163</sup> Under these circumstances, the Appellate Body held, the legality of such a measure cannot reasonably be made contingent on the occurrence of subsequent events.<sup>164</sup>

<sup>156</sup> The other panels following the reasoning of *Canada – Unprocessed Herring and Salmon* were *United States – Restrictions on Imports of Tuna (Tuna/Dolphin I)*, DS21/R-39/S/155 (Sept. 3, 1991), not adopted; and *United States – Restrictions on Imports of Tuna (Tuna/Dolphin II)*, DS29/R (June 16, 1994), not adopted.

<sup>157</sup> *US – Reformulated Gasoline*, *supra* note 112, at 21

<sup>158</sup> *Id.*

<sup>159</sup> *Id.*

<sup>160</sup> *Id.*

<sup>161</sup> *Id.*

<sup>162</sup> *Id.*

<sup>163</sup> *Id.*

<sup>164</sup> *Id.*

The effect of the *US – Reformulated Gasoline* Appellate Body's broader reading of Article XX(g) is to relieve states that are either creating or defending conservation regimes under Article XX(g) from the burden of showing that any import/export restrictions implemented are linked causally with domestic restrictions. The import/export restrictions must be causally related to the "conservation of exhaustible natural resources," but not necessarily to the domestic measures implemented. This interpretation of the Article gives states much more flexibility in crafting a conservation regime, allowing them to identify the most effective measures on each of the international and domestic sides to accomplish their objectives, without the burden of establishing a cause and effect relationship between the international and domestic measures.

#### SUMMARY OF THE RAW MATERIALS DISPUTE AND ITS CONTRIBUTION TO WTO - GATT JURISPRUDENCE

The *China Raw Materials* decision solidifies the WTO's approach to Article XX exceptions, and also rules for the first time that raw materials cannot be in critically short supply so as to justify export restrictions. For Article XI:2(a), while the Panel and the Appellate Body agreed that bauxite was an "essential" product for China, both bodies also found that China had failed to demonstrate that its export quota for bauxite was "temporarily applied" to prevent or relieve a "critical shortage."<sup>165</sup> The restrictions on the export of bauxite had been in place for a decade, and there were no plans to end the restrictions until all of China's bauxite reserves had been exhausted. Thus, any such measures could not be considered "temporarily applied" within the meaning of Article XI:2(a).<sup>166</sup> Further, given a sixteen year remaining lifespan for its bauxite reserves, China could not demonstrate a situation rising to the level of a "crisis."<sup>167</sup> The length of time that the quota system had been in place suggested to the Panel that the measures were, in fact, designed to address something other than a critical shortage.

The clear implication for WTO members is that any raw material resource cannot be kept primarily for domestic uses through export restrictions, whether by quotas or by some other method. A limited supply cannot mean a critical shortage, and no temporary measures can bring a limited supply back to a sustainable supply.

Article XI:2(a) was not China's only argument, as we have seen. Would export restrictions re-framed as "conservation measures" be more GATT-consistent? Instead of arguing that bauxite and other raw

<sup>165</sup> Panel Report, *supra* note 1, at ¶7.355.

<sup>166</sup> *Id.* at ¶7.350.

<sup>167</sup> *Id.* at ¶7.351.

materials were in critical shortage, perhaps the restrictions could be justified as "conservation" measures intended to protect the health of China's citizens? This argument fared no better. For the first time, the WTO had a chance to consider export restrictions under Article XX(b) and Article XX(g). In general, the GATT (and, subsequently, the WTO) puts the burden of proof on the member nation seeking to justify environmental protections. In all but one case out of nearly a dozen where some subpart of Article XX has been used as a defense,<sup>168</sup> the GATT or the WTO dispute bodies have rejected the member state practices as inconsistent with their obligations.<sup>169</sup> While *Raw Materials* is no different in that respect, it confirms a set of key concepts for nations that would restrict export of basic materials. These concepts include (1) the need for a member state to make sure that conservation measures are domestic, as well as international, (2) that the environmental or conservation objectives of regulations must be clear and embedded in the regulations, not an afterthought, and (3) that "necessary" measures may be just one part of that larger policy framework. Finally, to the extent that "raw materials" can be analogized to other basic items of global trade such as foodstuffs (wheat, soybeans, corn), other minerals (such as rare earth elements), or oil, the *Raw Materials* decision will be influential in future trade disputes.

<sup>168</sup> Report of the Appellate Body, *U.S. - Import Prohibitions of Certain Shrimp & Shrimp Products*, Recourse to Article 21.5 of the DSU by Malaysia, WT/DS58/AB/RW (Oct. 22, 2001).

<sup>169</sup> TRISH KELLY, *THE IMPACT OF THE WTO: THE ENVIRONMENT, PUBLIC HEALTH AND SOVEREIGNTY 1* (2007).

## PROPOSED PRIVACY REFORM LEGISLATION IN EUROPE AND ITS EFFECT ON INTERNATIONAL DATA TRANSFERS

by Carter Manny\*

### I. INTRODUCTION

In January, 2012, the European Commission released proposed privacy reform legislation, including a proposed regulation<sup>1</sup> that would replace the current data protection framework in the European Union under the 1995 Data Protection Directive.<sup>2</sup> If adopted in its current form, the Proposed Regulation would generally strengthen privacy protection for Europeans and require businesses both inside and outside the EU to make changes in how they collect and use personal information.<sup>3</sup> The revision retains much of the structure of the 1995 Data Protection Directive, but would greatly improve harmonization of law throughout most of Europe because as a regulation its provisions would take direct effect in all 27 EU Member States without the need for

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<sup>1</sup> EUR. PARL. DOC. (COM 2012) 11 (2012), available at [http://ed.europa.eu/justice/data-protection/document/review2012/com\\_2012\\_11\\_en.pdf](http://ed.europa.eu/justice/data-protection/document/review2012/com_2012_11_en.pdf) (visited 17 Mar. 2012) [hereinafter *Proposed Regulation*]. There are three parts to the Commission's Proposed Regulation: (1) an Explanatory Memorandum, (2) 139 Recitals, and (3) 91 Articles.

<sup>2</sup> Council Directive 95/46, 1995 O.J. (L281) 31 [hereinafter *1995 Data Protection Directive*].

<sup>3</sup> See generally *Opinion of the European Data Protection Supervisor on the Data Protection Reform Package*, available at [http://www.edps.europa.eu/EDPSWEB/webdav/site/mySite/shared/Documents/Consultation/opinions/2012/12-03-07\\_EDPS\\_Reform\\_package\\_EN.pdf](http://www.edps.europa.eu/EDPSWEB/webdav/site/mySite/shared/Documents/Consultation/opinions/2012/12-03-07_EDPS_Reform_package_EN.pdf) (visited Mar. 13, 2012) [hereinafter *EDPS Opinion*].



any implementing national legislation.<sup>4</sup> The Proposed Regulation updates the European data protection regime to take into account advances in technology since 1995.<sup>5</sup> It also establishes new legal rights for the benefit of individual data subjects.<sup>6</sup> For businesses outside the EU, it clarifies the extraterritorial reach of data protection law.<sup>7</sup> This paper examines these changes from the perspective of a business in the United States which is collecting and using personal information from Europe.

## II. GENERAL EU PRINCIPLES OF DATA PROTECTION

Many of the general data protection principles set forth in the 1995 Data Protection Directive are retained. The person to whom the data relate is known as a "data subject,"<sup>8</sup> anyone who decides how data will be collected or used is known as a "controller,"<sup>9</sup> and someone who merely follows the instructions of a controller and manipulates the data is known as a "processor."<sup>10</sup> The activities of a controller are closely regulated. It must inform the data subject of what it will be doing with the data.<sup>11</sup> Collection and use of the data must be for some purpose either permitted by data protection law or be pursuant to consent given by the data subject.<sup>12</sup> Data protection law is administered by government agencies, known as "supervisory authorities" or data protection authorities, established under national law in the 27 EU Member States.<sup>13</sup> Data subjects' remedies for violations of law include the right to file a complaint with a data protection authority<sup>14</sup> and the right to bring a judicial action before a court in a Member State.<sup>15</sup> A transfer of personal information from within the EU to a country outside the EU is restricted to one of several permitted categories or to a country whose legal protection for privacy is deemed to be "adequate" by the European Commission under EU standards.<sup>16</sup>

<sup>4</sup> See, e.g., *Proposed Regulation*, *supra* note 1, Explanatory Memorandum § 3.1.

<sup>5</sup> See, e.g., *Id.* Explanatory Memorandum § 2.

<sup>6</sup> Examples include a "right to be forgotten" through a demand that data be deleted, "data portability" through a request that one's personal data be transferred from one website to another, a ban on profiling, and a right to prompt notification of a data breach. See *Proposed Regulation*, *supra* note 1, Arts. 17, 18, 20, 31 & 32.

<sup>7</sup> See *Proposed Regulation*, *supra* note 1, Art. 3(2).

<sup>8</sup> See *Proposed Regulation*, *supra* note 1, Art. 4(1).

<sup>9</sup> See *Proposed Regulation*, *supra* note 1, Art. 4 (5).

<sup>10</sup> See *Proposed Regulation*, *supra* note 1, Art. 4 (6).

<sup>11</sup> See *Proposed Regulation*, *supra* note 1, Art. 11(2).

<sup>12</sup> See generally *Proposed Regulation*, *supra* note 1, Arts. 5 – 7.

<sup>13</sup> See generally *Proposed Regulation*, *supra* note 1, Arts. 44 – 54.

<sup>14</sup> See *Proposed Regulation*, *supra* note 1, Art. 73.

<sup>15</sup> See *Proposed Regulation*, *supra* note 1, Art. 75.

<sup>16</sup> See generally *Proposed Regulation*, *supra* note 1, Arts. 40 – 44.



Many of the general principles of the 1995 Data Protection Directive are updated by the Proposed Regulation. In addition, new rights and duties have been added. The changes which are most relevant to organizations involved in international transfers of data are examined in the following sections.

#### A. Expanded Definition of Personal Data

The definition of "personal data" is crucial to any data protection regime. The concept of "personal data" is expanded from the language in the 1995 Directive which reads: "any information relating to an identified or identifiable person"<sup>17</sup> (followed by a lengthy definition of "identifiable person,"<sup>18</sup>) to the much broader definition in the Proposed Regulation which reads: "any information relating to a data subject."<sup>19</sup> The expansive definition, however, is narrowed by two recitals. Recital 23 of the Proposed Regulation applies a reasonableness test stating that the question of whether data can be related to a person should be determined by taking account of "all the means likely reasonably to be used" to identify the individual.<sup>20</sup> Furthermore, Recital 24 introduces a flexible standard for data generated by online activity and mobile devices, by acknowledging that online identifiers and location data can be combined with other data to create profiles which identify people, but that such data "need not necessarily be considered personal data in all circumstances."<sup>21</sup> Thus, data becomes "personal" and therefore protected, depending upon whether "reasonable" means are likely to connect the information to a person, and whether the information can be combined in a way that enables the person to whom the data relate to be identified. Although both recitals raise the possibility that "de-identified" data is not "personal data" under the Proposed Regulation, it is potentially risky for a controller to make this assumption when "re-identification" is possible in a surprisingly large number of situations.<sup>22</sup>

<sup>17</sup> See 1995 Data Protection Directive, *supra* note 2, Art. 2(a).

<sup>18</sup> The definition reads: "an identifiable person is one who can be identified, directly or indirectly, in particular by reference to an identification number or to one or more factors specific to his physical, physiological, mental, economic, cultural or social identity." See 1995 Data Protection Directive, *supra* note 2, Art. 2(a).

<sup>19</sup> See Proposed Regulation, *supra* note 1, Art. 4(2).

<sup>20</sup> See Proposed Regulation, *supra* note 1, Recital 23.

<sup>21</sup> See Proposed Regulation, *supra* note 1, Recital 24.

<sup>22</sup> See generally Paul Ohm, *Broken Promises of Privacy: Responding to the Surprising Failure of Anonymization*, 57 UCLA L. REV. 1701 (2010) (explaining how privacy laws often rely on the erroneous assumption that data subjects can never be identified from supposedly "anonymized" data.)

*B. Expanded Territorial Scope*

For businesses located outside the EU which collect data online, the most significant change made by the Proposed Regulation is the addition of a provision clarifying the extraterritorial reach of EU data protection law.<sup>23</sup> Under the 1995 Data Protection Directive, EU law applies to a controller located outside the EU when it "makes use of equipment" located within the EU for the processing of personal data.<sup>24</sup> The language was drafted before the Internet became widely available, and online data collection became common. In many instances, however, when a website or online advertising company collects information from a person within the EU as she browses the Internet, the business is using equipment within the EU.<sup>25</sup> The Proposed Regulation abandons the focus on "equipment" and instead looks at how the data are being used, regardless of location. If the controller located outside the EU is processing personal data of people located within the EU, and the processing relates to either "(a) the offering of goods or services to such data subjects in the Union, or (b) the monitoring of their behavior" then EU law data protection law applies.<sup>26</sup> Thus, the Proposed Regulation makes clear that a U.S. direct merchant that uses information about a European in order to try to encourage that person to place an order, the U.S. business is subject to EU data protection law. This is true regardless of how the direct merchant acquired the information and how the business is attempting to offer its goods. For example, if the U.S. business obtained the name and postal address of a European consumer from a marketing company in Europe, and sent a printed catalog to the consumer by postal mail, EU data protection law would clearly apply to the U.S. direct merchant's use of the name and address. Similarly, when a U.S.-based Internet search engine or social media website assembles information about a computer user in Europe for the purpose of delivering targeted advertising, the U.S. company clearly is subject to EU data protection law because it is monitoring the person's behavior. Because so much of the content available over the Internet is supported

<sup>23</sup> See *Proposed Regulation*, *supra* note 1, Art. 3(2).

<sup>24</sup> See *1995 Data Protection Directive*, *supra* note 2, Art. 4(1)(c).

<sup>25</sup> See, e.g., Article 29 – Data Protection Working Party, *Working Document on Determining the International Application of EU Data Protection Law to Personal Data Processing On the Internet by Non-EU based Web Sites*, available at [http://ec.europa.eu/justice\\_home/fsj/privacy/docs/wpdocs/2002/wp56\\_en.pdf](http://ec.europa.eu/justice_home/fsj/privacy/docs/wpdocs/2002/wp56_en.pdf) (visited Mar. 28, 2002)(analyzing how placement of a cookie or java script on the hard drive of a personal computer in the EU by a web site outside the EU, can trigger applicability of EU data protection law pursuant to the "make use of equipment" language in Article 4(1)(c) of the 1995 Data Protection Directive.)

<sup>26</sup> See *Proposed Regulation*, *supra* note 1, Art. 3(2).

by targeted advertising that depends upon behavioral monitoring, the territorial scope provision in the Proposed Regulation has significant implications for Internet-based businesses worldwide.

### C. Freedom From Measures Based on Profiling

Although monitoring the behavior of someone inside the EU triggers applicability of EU data protection law to an organization outside of Europe, related activities, known as measures based on "profiling," are largely prohibited regardless of the controller's location.<sup>27</sup> The prohibited activity is defined in three ways: (1) by whether the measure produces "legal effects" concerning the person or "significantly affects" the person, (2) by whether the measure is based solely on automated processing, and (3) by whether the measure is intended to evaluate "certain personal aspects" or to "analyze or predict" a person's "performance at work, economic situation, location, health, personal preferences, reliability or behavior."<sup>28</sup> Measures based on "profiling" however, are allowed when suitable safeguards are in place and the processing is based on the data subject's consent, express authorization under EU or Member State law, or pursuant to certain contracts.<sup>29</sup> It is possible that activities associated with the U.S. online advertising industry could be prohibited by this provision. However, in order to be prohibited, the activity would need to produce a "legal effect" or would need to "significantly affect" a person, neither of which is defined in the Proposed Regulation. If, for example, a U.S. company used an automated system to collect online information about a person in Europe, and produced a report evaluating that person which could be sold to prospective employers, the U.S. business's activity would probably violate this provision of the Proposed Regulation. However, U.S. online behavioral advertising systems used by U.S. websites to target ads would not necessarily run afoul of this provision, because their activities might not be considered to produce a "legal" or "significant" effect.

### D. The "Right to Be Forgotten"

Although existing EU law gives a data subject the right to have data erased when it is inaccurate or incomplete, or where its processing is not legally permissible,<sup>30</sup> the Proposed Regulation expands that notion into a general "right to be forgotten."<sup>31</sup> Under the Proposed Regulation, data

<sup>27</sup> See *Proposed Regulation*, *supra* note 1, Art. 20.

<sup>28</sup> See *Proposed Regulation*, *supra* note 1, Art. 20(1).

<sup>29</sup> See *Proposed Regulation*, *supra* note 1, Art. 20(2).

<sup>30</sup> See *1995 Data Protection Directive*, *supra* note 2, Art. 12(b).

<sup>31</sup> See *Proposed Regulation*, *supra* note 1, Art. 17.

must be erased by the controller in response to a request by the data subject when (1) the data are no longer necessary in relation to the purposes for which they were collected, (2) when the data subject withdraws consent to processing, (3) when the storage period consented to by the data subject has expired, (4) when there is no longer a legal ground for the processing, or (5) when the data subject objects to the processing for direct marketing or certain other purposes.<sup>32</sup> If the controller has made the data public, it shall take "all reasonable steps" to inform third parties processing the data "that the data subject requests them to erase any links to, or copy or replication of that personal data."<sup>33</sup> The implications of this provision for some types of businesses are potentially huge. Presumably, Europeans would have the right to the erasure of all data relating to them in a U.S. online advertising company's database because all such information is used for direct marketing. An online direct merchant in the U.S. could be asked to erase all data relating to a European customer's purchase, once payment has been received and the product has been delivered. U.S. social media websites and search engines would need to develop systems to erase information about users in Europe. Once people in the U.S. learn that Europeans have a legal "right to be forgotten," they may demand the same benefit for themselves, thus fundamentally changing the current economic basis for much of the commercial activity on the Internet: the exchange of nominally free content and services for personal information which is used to target online advertising.

#### *E. Data "Portability"*

The Proposed Regulation would establish a new right for a data subject to obtain a copy of the data undergoing processing and the right to transmit such data from one automated processing system into another.<sup>34</sup> These rights of "portability" apply only to data processed electronically in a format "which is commonly used."<sup>35</sup> The right to transmit data from one automated system to another is limited to data processed pursuant to a contract or the data subject's consent.<sup>36</sup> Although portability depends upon the type of formatting used, it is possible that this right could be asserted by a European to transfer data between U.S. based social media services like LinkedIn and Facebook.

<sup>32</sup> See *Proposed Regulation*, *supra* note 1, Arts. 17(1) & 19.

<sup>33</sup> See *Proposed Regulation*, *supra* note 1, Art. 17(2).

<sup>34</sup> See *Proposed Regulation*, *supra* note 1, Art. 18.

<sup>35</sup> See *Proposed Regulation*, *supra* note 1, Arts. 18(1) & (2).

<sup>36</sup> See *Proposed Regulation*, *supra* note 1, Art. 18(2).

### F. Data Breach Notification

Although most U.S. States have statutes requiring database operators to notify consumers of data breaches,<sup>37</sup> the Proposed Regulation's data breach notification provision could impose additional burdens on U.S. businesses. One significant burden is the short time limit. Generally, the controller must notify the supervisory authority "without undue delay," and, "where feasible" the notification of the supervisory authority must be made within 24 hours of the time the controller has become aware of the breach.<sup>38</sup> The notice must (1) describe the nature of the breach including the number of data subjects and records concerned, (2) recommend mitigating measures, (3) describe the consequences of the breach, and (3) describe measures proposed or taken by the controller to address the breach.<sup>39</sup> Another potential burden is that the provision has no exception for very minor breaches, other than a general provision allowing the European Commission to further specify criteria for establishing a data breach.<sup>40</sup> Finally, the Proposed Regulation's provision differs significantly from U.S. State law in that EU law would put the duty to notify the data subject of the breach on the supervisory authority rather than on the controller.<sup>41</sup> Furthermore, because the supervisory authority is obligated to notify a data subject only of a breach when it "is likely to adversely affect the protection of the personal data or privacy of the data subject," the data subject will not be notified of a very minor breach.<sup>42</sup> Accordingly, under the Proposed Regulation the controller must notify the supervisory authority of all breaches and then the supervisory authority makes a determination of whether a breach is serious enough to warrant notification of data subjects.

### III. PROVISIONS EXPLICITLY ADDRESSING INTERNATIONAL DATA TRANSFERS

The Proposed Regulation retains and refines much of the existing law governing permissible transfers of personal data from within the 27 EU Member States to "third country" destinations outside the EU. Such

<sup>37</sup> See, e.g., National Conference of State Legislatures, State Security Breach Notification Laws, available at <http://www.ncsl.org/issues-research/telcom/security-breach-notification-laws.aspx> (visited Mar. 28, 2012)(reporting that as of February, 2012, forty-six states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands have enacted data breach notification laws.)

<sup>38</sup> See *Proposed Regulation*, *supra* note 1, Art. 31(1).

<sup>39</sup> See *Proposed Regulation*, *supra* note 1, Art. 31(3).

<sup>40</sup> See *Proposed Regulation*, *supra* note 1, Art. 31(5).

<sup>41</sup> See *Proposed Regulation*, *supra* note 1, Art. 32(1).

<sup>42</sup> See *Proposed Regulation*, *supra* note 1, Art. 32(1).



transfers are generally prohibited unless there is a legal basis for the transfer under a provision in the Proposed Regulation.<sup>43</sup>

#### *A. Transfers to Countries With "Adequate" Protection*

The Proposed Regulation retains the concept that a transfer may be made to a country outside the EU which the European Commission has found to ensure an "adequate" level of data protection.<sup>44</sup> However, the standards for making an adequacy determination have been made more specific than those contained in the 1995 Data Protection Directive. For example, while the Directive makes reference to "rules of law, both general and sectoral,"<sup>45</sup> the Proposed Regulation refines the language by stating that such laws include laws concerning public security, defense, national security and crimes.<sup>46</sup> Moreover, the Proposed Regulation directs the Commission to consider the extent to which data subjects in the EU have access to "effective administrative and judicial redress" within the third country,<sup>47</sup> and whether there is an "independent supervisory authority" there,<sup>48</sup> factors which are not explicitly mentioned in the Directive.

#### *B. Transfers With Appropriate Safeguards*

A transfer is also permitted under the Proposed Regulation if a controller or processor of personal data "has adduced appropriate safeguards with respect to the protection of personal data in a legally binding instrument."<sup>49</sup> Such safeguards can be provided through standard data protection clauses adopted by the Commission or a supervisory authority.<sup>50</sup> They can also be provided through contractual clauses between the transferor and recipient of the data, provided that the clauses have received prior approval of a supervisory authority.<sup>51</sup> It

<sup>43</sup> See *Proposed Regulation*, *supra* note 1, Art. 40.

<sup>44</sup> See *Proposed Regulation*, *supra* note 1, Art. 41(1). As of March 2012, only four countries (Switzerland, Canada, Argentina and Israel) and four dependencies (Guernsey, Jersey, the Isle of Man and the Faroe Islands) have been found by the Commission to provide adequate protection for personal data. The Commission has also found that adequate protection is provided by organizations in the U.S. that join the EU – U.S. Safe Harbor Agreement. See, e.g., *Commission Decisions on the Adequacy of Protection of Personal Data in Third Countries*, available at [http://ec.europa.eu/justice/data-protection/document/international-transfers/adequacy/index\\_en.htm#h2-4](http://ec.europa.eu/justice/data-protection/document/international-transfers/adequacy/index_en.htm#h2-4) (visited Mar. 28, 2012).

<sup>45</sup> See *1995 Data Protection Directive*, *supra* note 2, Art. 25(2).

<sup>46</sup> See *Proposed Regulation*, *supra* note 1, Art. 41(2)(a).

<sup>47</sup> See *Proposed Regulation*, *supra* note 1, Art. 41(2)(a).

<sup>48</sup> See *Proposed Regulation*, *supra* note 1, Art. 41(2)(b).

<sup>49</sup> See *Proposed Regulation*, *supra* note 1, Art. 42(1).

<sup>50</sup> See *Proposed Regulation*, *supra* note 1, Art. 42(2).

<sup>51</sup> See *Proposed Regulation*, *supra* note 1, Art. 42(4).

is also possible to transfer data if appropriate safeguards are contained in an instrument which is not legally binding, but only if the transfer, or set of transfers, has received prior authorization from a supervisory authority.<sup>52</sup>

### C. Binding Corporate Rules

Binding corporate rules are not mentioned in the 1995 Data Protection Directive, but evolved under the provision authorizing a transfer pursuant to a contractual clause with appropriate safeguards provided that the transfer has been authorized by a Member State.<sup>53</sup> In 2003, the Article 29 Working Party, which is comprised of officials or data protection authorities of the EU Member States, issued an opinion which supported the use of binding corporate rules.<sup>54</sup> Under the Proposed Regulation, binding corporate rules are explicitly authorized in detailed provisions. A transfer from a controller or processor to another entity within the transferor's family of companies is permitted when there are appropriate safeguards for the protection of personal data contained in binding corporate rules which apply to and are enforced by every entity within the group.<sup>55</sup> Binding corporate rules must also "expressly confer enforceable rights on data subjects."<sup>56</sup>

The detailed requirements for binding corporate rules are designed to produce the functional equivalence of most of the protection in the Proposed Regulation. The members of the group must be identified.<sup>57</sup> There must be a description of the data transfers, including categories of data, types of processing, types of data subjects, purposes of processing and identification of destination countries.<sup>58</sup> The rules must contain general data protection principles including a purpose limitation, a data quality provision, a legal basis for processing, data security measures and onward transfer limitations.<sup>59</sup> Rights of data subject must be specified, including rights of enforcement through a supervisory authority or court.<sup>60</sup> The rules must also identify a member of the group located within the EU which will accept liability for a breach of the

<sup>52</sup> See *Proposed Regulation*, *supra* note 1, Art 42(5).

<sup>53</sup> See *1995 Data Protection Directive*, *supra* note 2, Art. 26(2).

<sup>54</sup> See Article 29 Working Party, *Working Document: Transfers of Personal Data to Third Countries: Applying Article 26(2) of the EU Data Protection Directive to Binding Corporate Rules for International Data Transfers*, available at [http://ec.europa.eu/justice/policies/privacy/docs/wpdocs/2003/wp74\\_en.pdf](http://ec.europa.eu/justice/policies/privacy/docs/wpdocs/2003/wp74_en.pdf) (visited Mar. 28, 2012).

<sup>55</sup> See *Proposed Regulation*, *supra* note 1, Art 43(1)(a).

<sup>56</sup> See *Proposed Regulation*, *supra* note 1, Art. 43 (1)(b).

<sup>57</sup> See *Proposed Regulation*, *supra* note 1, Art. 43(2)(a).

<sup>58</sup> See *Proposed Regulation*, *supra* note 1, Art. 43(2)(b).

<sup>59</sup> See *Proposed Regulation*, *supra* note 1, Art. 43(2)(d).

<sup>60</sup> See *Proposed Regulation*, *supra* note 1, Art. 43(2)(e).

binding corporate rules by any member of the group.<sup>61</sup> There must be an explanation of how information regarding the rules will be provided to data subjects.<sup>62</sup> The rules must identify a data protection officer within the group and include mechanisms for verification of compliance.<sup>63</sup> Finally, the rules must include mechanisms for cooperating with the supervisory authority, including the reporting of changes in the group's policies.<sup>64</sup>

#### *D. Transfers Pursuant to Exceptions*

The Proposed Regulation adds a new exception to the list in the 1995 Data Protection Directive for a transfer necessary for the controller or processor's "legitimate interests," provided that the transferor has assessed all the circumstances surrounding the transfer and adduced appropriate safeguards.<sup>65</sup> The transferor must document the assessment and safeguards, and must inform the supervisory authority of the transfer.<sup>66</sup> This new exception could be useful for a single transfer of data when other legal mechanisms for a transfer are not cost-justified, for example when a subsidiary company needs to transfer a small quantity of data to a parent company outside the EU when the group of companies does not have binding corporate rules in place.

The remaining exceptions in the Proposed Regulations are refined versions of exceptions contained in the 1995 Data Protection Directive. The first of these is consent. The Proposed Regulation's exception for a transfer based on the data subject's consent requires that the data subject first be informed of the risks of the transfer because of "the absence of an adequacy decision and appropriate safeguards."<sup>67</sup> The general definition of "consent" in the Proposed Regulation has been narrowed to mean "freely given specific, informed and explicit indication of his or her wishes by which the data subject, either by a statement or by a clear affirmative action, signifies agreement. . . ."<sup>68</sup> Moreover, the controller "bears the burden of proof for the data subject's consent,"<sup>69</sup> and the validity of consent will not be recognized "where there is a significant imbalance between the position of the data subject and the controller."<sup>70</sup> Consequently, the standard for obtaining valid consent by

<sup>61</sup> See *Proposed Regulation*, *supra* note 1, Art. 43(2)(f).

<sup>62</sup> See *Proposed Regulation*, *supra* note 1, Art. 43(2)(g).

<sup>63</sup> See *Proposed Regulation*, *supra* note 1, Art. 43(2)(h) & Art. 43(2)(i).

<sup>64</sup> See *Proposed Regulation*, *supra* note 1, Art. 43(2)(j) & Art. 43(2)(k).

<sup>65</sup> See *Proposed Regulation*, *supra* note 1, Art. 44(1)(h).

<sup>66</sup> See *Proposed Regulation*, *supra* note 1, Art. 44(6).

<sup>67</sup> See *Proposed Regulation*, *supra* note 1, Art. 44(1)(b).

<sup>68</sup> See *Proposed Regulation*, *supra* note 1, Art. 4(8).

<sup>69</sup> See *Proposed Regulation*, *supra* note 1, Art. 7(1).

<sup>70</sup> See *Proposed Regulation*, *supra* note 1, Art. 7(4).

a data subject to an international transfer is difficult for the transferor to establish. Another exception which is unchanged in the Proposed Regulation is the one allowing a transfer for the establishment, exercise or defense of legal claims.<sup>71</sup>

Like the 1995 Data Protection Directive, the Proposed Regulation continues exceptions based on certain types of contracts. The first exception is for a transfer that is necessary for the performance of a contract between the data subject and controller.<sup>72</sup> For example, assume that a U.S. bank (the controller) has a contractual obligation to allow an individual depositor (the data subject) to withdraw cash from his account using an automatic teller machine. When the depositor travels to Europe and uses an ATM there to make a withdrawal, the account holder's personal information must be transferred from the EU to the U.S. in order to verify the customer's identity and perform the bank's contractual obligation to provide cash to the depositor through an ATM. The second exception is for a transfer is necessary for the conclusion or performance of a contract concluded in the interest of the data subject between the controller and a third party.<sup>73</sup> For example, a European insurance company (the controller) might enter into a reinsurance contract with a U.S. insurance company (the third party) for the purpose of transferring risk with respect to homeowner insurance policies the former insurance company has sold to European consumers (the third parties.) Following a natural disaster which destroys and damages insured homes, the European insurer would transfer policy holder information to the reinsurer in the U.S. for the purpose of establishing its right to be reimbursed for claims it pays. The contract of reinsurance between the two insurance companies is for the benefit of the policy holders in the EU, because it increases the financial resources available to pay their claims. Moreover, the transfer of policy holder information is necessary for the performance of the reinsurance agreement, because the U.S. reinsurer needs evidence of the losses in order to establish its obligation to pay the European insurance company.

Other exceptions are modified versions of exceptions in the 1995 Data Protection Directive. A transfer is allowed for important grounds of public interest, but public interest is limited to legal interests recognized in the EU.<sup>74</sup> A transfer is allowed to protect the vital interests of the data subject, but only where the data subject is physically or legally incapable of giving consent.<sup>75</sup> A transfer is allowed from a register

<sup>71</sup> See *Proposed Regulation*, *supra* note 1, Art. 44(1)(e).

<sup>72</sup> See *Proposed Regulation*, *supra* note 1, Art. 44(1)(b).

<sup>73</sup> See *Proposed Regulation*, *supra* note 1, Art. 44(1)(c).

<sup>74</sup> See *Proposed Regulation*, *supra* note 1, Art. 44(1)(d) & Art. 44(5).

<sup>75</sup> See *Proposed Regulation*, *supra* note 1, Art. 44(1)(f).



which is intended to provide information to the general public, but not when all, or entire categories, of the data are to be transferred.<sup>76</sup> This exception, for example, would allow a few listings of people from a publicly available telephone directory to be transferred, but not all personal listings.

#### IV. EFFECTS ON EXISTING APPROVALS OF INTERNATIONAL TRANSFERS

Because the Proposed Regulation would repeal the 1995 Data Protection Directive,<sup>77</sup> what effect will there be on existing approvals of international data transfers by the Commission and supervisory authorities in the EU Member States? In the short run, the adoption of the Proposed Regulation will not disturb prior approvals because it declares that such approvals shall "remain in force"<sup>78</sup> even though the Directive is repealed. In addition, the Proposed Regulation "is without prejudice to international agreements concluded between the Union and third countries regarding the transfer of personal data . . ."<sup>79</sup> Over time, however, it is possible that the additional rights afforded data subjects under the Proposed Regulation will put pressure on the Commission to urge countries with adequacy determinations to adopt data protection measures consistent with those additional rights, especially limits on profiling and the "right to be forgotten." With respect to organizations in the U.S., the Commission might seek modification of the EU - U.S. Safe Harbor agreement,<sup>80</sup> under which EU personal data may be transferred to companies that agree to a detailed set of privacy safeguards. The implications for U.S. organizations which currently are members of the Safe Harbor could be significant. In addition to increased restrictions on profiling and increased duties to delete information under the "right to be forgotten," U.S. organizations could be obligated to comply with data portability provisions and burdensome data breach notification requirements.

#### V. CONCLUSION

In many respects, the Proposed Regulation is "a huge step forward."<sup>81</sup> It would increase harmonization of data protection law within the 27 EU Member States and eliminate some of the ambiguities under current

<sup>76</sup> See *Proposed Regulation*, *supra* note 1, Art. 44(1)(g) & Art. 44(2).

<sup>77</sup> See *Proposed Regulation*, *supra* note 1, Art. 88.

<sup>78</sup> See *Proposed Regulation*, *supra* note 1, Recital 134.

<sup>79</sup> See *Proposed Regulation*, *supra* note 1, Recital 79.

<sup>80</sup> See *Issuance of Safe Harbor Principles and Transmission to European Commission*, 65 Fed. Reg. 45,666 (2000).

<sup>81</sup> See *EDPS Opinion*, *supra* note 3, at iv.



law. European data subjects would gain new protections including freedom from measures based on profiling, a "right to be forgotten" and a right to data "portability." For organizations in the U.S. that use personal data from the EU, the most significant change made by the Proposed Regulation is the expansion of territorial scope, which would eliminate ambiguity under the existing law's reliance on the outdated concept of the location of equipment. Unfortunately, however, the Proposed Regulation makes relatively minor changes to the international data transfer provisions under existing EU law, provisions which have been criticized as being cumbersome and outmoded.<sup>82</sup> Those provisions could be improved by augmenting the current system which relies both on an overly optimistic expectation that legal systems in other countries will conform to EU standards for privacy protection, and on an assumption that a transferor of data will not be unduly burdened by the need through contractual negotiations to obtain satisfactory privacy safeguards from a recipient located outside Europe. An alternative could be added to place the data protection burden on a party likely to benefit from the transfer: the recipient of the data outside Europe. Under the alternative, an organization outside the EU could qualify to receive data transfers by making data protection commitments directly to supervisory authorities in the 27 Member States. Like the EU - U.S. Safe Harbor, there could be a transparent registration process with a web site listing the names and contact information of qualified recipients. Allegations of violations of data protection commitments could initially be resolved through an online dispute resolution process using independent data protection experts in Europe as arbitrators. The registration and dispute resolution systems could be funded through an annual registration fee paid to a newly created European Union data protection secretariat which would administer the online dispute resolution process in cooperation with the supervisory authorities in the Member States. As with international commercial disputes, an arbitral award could be enforced by the appropriate supervisory authority through the court system in the offending data recipient's country, if need be. This alternative might be a useful way to facilitate a number of international data transfers while maintaining high standards of data protection.

<sup>82</sup> See, e.g., Neil Robinson, Hans Grauz, Maarten Botterman, Lorenzo Valeri, *Review of the European Data Protection Directive*, 33 - 35, available at [http://www.rand.org/content/dam/rand/pus/technical\\_reports/2009/RAND\\_TR710.pdf](http://www.rand.org/content/dam/rand/pus/technical_reports/2009/RAND_TR710.pdf) (visited Mar. 24, 2012).

## MOTIONS TO COMPEL ARBITRATION AND SUITS ON THE UNDERLYING MERITS

by John F. Robertson\* and Patricia Quinn Robertson\*\*

### INTRODUCTION

Disputing parties may resolve their differences without resorting to a formal trial through submission of their dispute to an arbitrator for a binding decision.<sup>1</sup> Many contracts and some statutes provide for mandatory arbitration between parties.

Benefits of arbitration as opposed to litigation may include: increased privacy, saving of attorney's fees and other costs expenses, less burden on the courts, an increased possibility that relationships may be preserved by avoiding prolonged litigation, avoidance of the formalities of court, an expedited resolution of the case, choice of decision-maker and forum, and the saving of judicial resources.

In spite of the benefits of arbitration, once a dispute arises, a party may wish to go to court rather than participate in the arbitration process. The next step for such a person would be to file a lawsuit. The defendant then has the choice to file a motion to compel arbitration or to defend the lawsuit.<sup>2</sup>

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<sup>1</sup> American Arbitration Association, Arbitration, <http://www.adr.org/aaa/faces/services/disputeresolutionservices/arbitration> (last visited March 21, 2012). According to the American Arbitration Association, "[a]rbitration is the submission of a dispute to one or more impartial persons for a final and binding decision..." *Id.*

<sup>2</sup> See 9 U.S.C. §§ 1-16 (2010).

Not all arbitration clauses will be enforced by the courts,<sup>3</sup> and it may take layers of appeals before the court system does enforce the arbitration agreement. This paper examines the next step for a trial court when the defendant appeals the denial of a motion to compel arbitration. Should the trial on the merits proceed before the appeal is decided? Proceeding with a trial on the merits would seem to be the fastest way to a resolution of the underlying dispute. It also seems that the trial court must have at least a colorable argument to deny the motion to compel arbitration, so the defendant's eventual success in the appeal is far from guaranteed. On the other hand, allowing the trial on the merits to proceed eliminates much of the value of arbitration. It also raises the possibility that the parties will be litigating the underlying merits in the trial court and the arbitration agreement in the appellate courts at the same time.<sup>4</sup>

U.S. Circuit Courts of Appeals are split about the issue about whether an automatic stay of the proceedings on the merits should arise pending the decision in an appeal of the denial of a motion to compel arbitration.

In 2011, the Fifth Circuit Court of Appeals joined the Second and Ninth Circuits in holding that the trial on the merits may continue while the appeal goes forward.<sup>5</sup> Also in 2011, the Fourth Circuit joined the Third, Seventh, Tenth and Eleventh Circuits in holding that an appeal of a motion to compel arbitration automatically stays the proceedings in the lower court.<sup>6</sup>

#### *GRIGGS v. PROVIDENT CONSUMER DISCOUNT CO.*<sup>7</sup>

The *Griggs v. Provident Consumer Discount Co.* case provides the simplest foundation for the split in the circuits. The Second, Fifth, and Ninth Circuits have narrowly interpreted the ruling in *Griggs*, while the other circuits use a broad interpretation.<sup>8</sup>

<sup>3</sup> Contractual arbitration clauses may be contested under traditional theories of contract law. See, e.g., *Ticknor v. Choice Hotels Int'l, Inc.*, 265 F.3d 931 (9th Cir. 2001) (holding that an arbitration provision in a franchise agreement was unconscionable under Montana state law).

<sup>4</sup> See, e.g., *Bradford-Scott Data Corp., Inc. v. Physician Computer Network, Inc.*, 128 F.3d 504 (7th Cir. 1997).

<sup>5</sup> See *Weingarten Realty Investors v. Miller*, 661 F.3d 904 (5th Cir. 2011); *Motorola Credit Corp. v. Uzan*, 388 F.3d 39 (2d Cir. 2004); *Britton v. Co-op Banking Group*, 916 F.2d 1405 (9th Cir. 1990).

<sup>6</sup> See *Levin v. Alms and Associates, Inc.*, 634 F.3d 260 (4th Cir. 2011); *Ehleiter v. Grapetree Shores, Inc.*, 482 F.3d 207 (3rd Cir. 2007); *McCauley v. Halliburton Energy Services, Inc.*, 413 F.3d 1158 (10th Cir. 2005); *Blinco v. Green Tree Servicing, LLC*, 366 F.3d 1249 (11th Cir. 2004); *Bradford-Scott Data Corp., Inc. v. Physician Computer Network, Inc.*, 128 F.3d 504 (7th Cir. 1997).

<sup>7</sup> 459 U.S. 56 (1982).

<sup>8</sup> See *Levin*, 634 F.3d 260; *Weingarten*, 661 F.3d 904; *Ehleiter*, 482 F.3d 207; *McCauley*, 413 F.3d 1158; *Motorola*, 388 F.3d 39; *Blinco*, 366 F.3d 1249; *Bradford-Scott*, 128 F.3d 504;



In *Griggs*, the U.S. Supreme Court decided whether a notice of appeal was valid, even though it was filed while a motion to amend the judgment was still pending in a district court.<sup>9</sup> Plaintiffs *Griggs* alleged that the defendants violated the Truth in Lending Act. The plaintiffs won in the District Court for the Eastern District of Pennsylvania. The defendants filed a motion to alter or amend the judgment in the district court, and, before that motion had been decided, the defendants also filed a notice of appeal. The Third Circuit Court of Appeals accepted the appeal and overturned the judgment of the district court. The plaintiffs argued that the appeal was premature, but the Third Circuit allowed the appeal since the plaintiffs could not show that their interests would be prejudiced by the premature filing.<sup>10</sup>

However, the Supreme Court relied on the plain language of Rule 4(a)(4) of the Federal Rules of Civil Procedure, and reversed the Third Circuit.<sup>11</sup> Under Rule 4, the time to appeal a court's denial of a motion began when the order denying the motion was entered.<sup>12</sup> Therefore, the

*Britton*, 916 F.2d 1405.

<sup>9</sup> *Griggs*, 459 U.S. at 56.

<sup>10</sup> *Id.* at 57.

<sup>11</sup> *Id.* at 58.

<sup>12</sup> Under Rule 4, as it read at the time,

If a timely motion under the Federal Rules of Civil Procedure is filed in the district court by any party . . . under Rule 59 . . . , the time for appeal for all parties shall run from the entry of the order denying . . . such motion. A notice of appeal filed before the disposition of [such motion] shall have no effect. A new notice of appeal must be filed within the prescribed time measured from the entry of the order disposing of the motion as provided above. No additional fees shall be required for such filing.

*Id.* at 59 (quoting the 1979 version of Fed. R. Civ. P. 4).

The current version of Rule 4 reads as follows:

(4) Effect of a Motion on a Notice of Appeal.

(A) If a party timely files in the district court any of the following motions under the Federal Rules of Civil Procedure, the time to file an appeal runs for all parties from the entry of the order disposing of the last such remaining motion:

(i) for judgment under Rule 50(b);

(ii) to amend or make additional factual findings under Rule 52(b), whether or not granting the motion would alter the judgment;

(iii) for attorney's fees under Rule 54 if the district court extends the time to appeal under Rule 58;

(iv) to alter or amend the judgment under Rule 59;

(v) for a new trial under Rule 59; or

(vi) for relief under Rule 60 if the motion is filed no later than 28 days after the judgment is entered.

(B)(i) If a party files a notice of appeal after the court announces or enters a judgment—but before it disposes of any motion listed in Rule 4(a)(4)(A)—the notice becomes effective to appeal a judgment or order, in whole or in part, when the order

U.S. Supreme Court held that the Court of Appeals had no jurisdiction in *Griggs* because the notice of appeal, filed before the decision on the motion to alter or amend the judgment, was filed too early, and was therefore a "nullity."<sup>13</sup>

The Supreme Court stated that the history of the Federal Rules of Civil Procedure indicates that a trial court and an appeals court cannot have jurisdiction over a case at the same time.<sup>14</sup> According to the Supreme Court in *Griggs*, filing of the notice of appeal removes "those aspects of the case involved in the appeal" from jurisdiction of the trial court.<sup>15</sup>

It is the statement that the district court is unable to proceed with "those aspects of the case involved in the appeal"<sup>16</sup> that fuels today's controversy. Rule 59 of the Federal Rules of Civil Procedure allows the parties to a civil suit to make a motion for a new trial, allows the court to initiate on its own a new trial, and allows a party to make a motion to alter or amend a judgment.<sup>17</sup> These are clearly aspects of the case involved in the appeal of the original verdict of the trial court.<sup>18</sup> It is not so clear that a trial dealing with the underlying merits of a dispute is an aspect of the case involved in the appeal of a motion to compel arbitration.<sup>19</sup>

disposing of the last such remaining motion is entered.

(ii) A party intending to challenge an order disposing of any motion listed in Rule 4(a)(4)(A), or a judgment's alteration or amendment upon such a motion, must file a notice of appeal, or an amended notice of appeal—in compliance with Rule 3(c)—within the time prescribed by this Rule measured from the entry of the order disposing of the last such remaining motion.

(iii) No additional fee is required to file an amended notice.

Fed. R. Civ. P. 4. The rule was amended in 1993 to allow a notice of appeal filed before the final ruling on a post-trial motion to become effective at the time of the disposition of the last remaining notice, effectively overruling *Griggs*. *Id.*

<sup>13</sup> *Griggs*, 459 U.S. at 61. The Supreme Court stated that "[t]he notice of appeal filed in this case...was not merely defective; it was a nullity...In short, it is as if no notice of appeal were filed at all. If no notice of appeal is filed at all, the Court of Appeals lacks jurisdiction to act." *Id.*

<sup>14</sup> *Id.* at 58. The *Griggs* court stated that:

[e]ven before 1979, it was generally understood that a federal district court and a federal court of appeals should not attempt to assert jurisdiction over a case simultaneously. The filing of a notice of appeal is an event of jurisdictional significance—it confers jurisdiction on the court of appeals and divests the district court of its control over those aspects of the case involved in the appeal.

*Id.*

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> Fed. R. Civ. P. 59.

<sup>18</sup> See *Griggs*, 459 U.S. 56.

<sup>19</sup> See *Levin*, 634 F.3d 260; *Ehleiter*, 482 F.3d 207; *McCauley*, 413 F.3d 1158; *Blinco*, 366



# THE MAJORITY OF CIRCUITS AND THEIR BROAD INTERPRETATION OF GRIGGS

The Third, Seventh, Tenth, and Eleventh Circuits have held that a stay arises when a party appeals from a district court's refusal to compel arbitration, and in 2011 the Fourth Circuit joined this group.<sup>20</sup> Therefore, the majority of the U.S. Circuit Courts of Appeals deciding this issue have held that the district court does not have jurisdiction to proceed with hearing the merits of the case until the circuit court decides the appeal of the arbitrability issue.<sup>21</sup> Although the Federal Arbitration Act<sup>22</sup> does not specifically state whether such a stay arises,<sup>23</sup> many of the courts who subscribe to this majority view rely in part upon the United States Supreme Court case of *Griggs*<sup>24</sup> to hold that proceedings in the district court should be stayed until the appeal of arbitrability is decided.<sup>25</sup>

In 1997, the Seventh Circuit addressed the issue of the stay pending appeal of arbitrability in *Bradford-Scott Data Corp., Inc. v. Physician Computer Network, Inc.*<sup>26</sup> The district court in *Bradford-Scott* considered conflicting arbitration clauses in two agreements, and held that the defendants were not entitled to arbitration.<sup>27</sup> The defendants appealed the district court's refusal to compel arbitration to the Seventh

F.3d 1249; *Bradford-Scott*, 128 F.3d 504.

<sup>20</sup> *Id.* See also *Bombardier Corp. v. National Railroad Passenger Corp.*, 2002 U.S. App. LEXIS 25858 (D.C. Cir. 2002) (unpublished opinion) (holding that "because a non-frivolous appeal from the district court's order divests the district court of jurisdiction over those aspects of the case on appeal, this court has exclusive jurisdiction to resolve the threshold issue whether the dispute is arbitrable, and the district court may not proceed until the appeal is resolved.").

<sup>21</sup> *Id.*

<sup>22</sup> 9 U.S.C. §§ 1-16.

<sup>23</sup> See 9 U.S.C. § 16(a)(1); *McCauley*, 413 F.3d 1158. 9 U.S.C. § 3 provides as follows: If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

However, this section does not provide for a stay upon appeal of arbitrability issues. 9 U.S.C. § 3.

<sup>24</sup> 459 U.S. 56.

<sup>25</sup> See, e.g., *Levin*, 634 F.3d 260; *Ehleiter*, 482 F.3d 207; *McCauley*, 413 F.3d 1158; *Blinco*, 366 F.3d 1249; *Bradford-Scott*, 128 F.3d 504.

<sup>26</sup> 128 F.3d 504 (7<sup>th</sup> Cir. 1997).

<sup>27</sup> *Id.* at 505.

Circuit.<sup>28</sup> In *Bradford-Scott*, the Seventh Circuit stayed all proceedings in the district court until the Seventh Circuit could decide the appeal about arbitrability.<sup>29</sup>

In *Bradford-Scott*, the Seventh Circuit broadly construed *Griggs*<sup>30</sup> to hold that a stay of the proceedings in district court arises upon the appeal requesting a reversal of the lower court's order denying arbitrability.<sup>31</sup> The Seventh Circuit did not permit the district court and the court of appeals to have jurisdiction over the case at the same time.<sup>32</sup>

Although the arbitrability issue may be separate from the other issues involved in the merits of the case, the Seventh Circuit held that an appeal of the arbitrability issue does affect the trial on the merits because the court of appeals is specifically deciding whether the trial on the merits may proceed.<sup>33</sup>

The Seventh Circuit analogized the *Bradford-Scott* case to other cases in which trial on the merits are stayed, such as cases involving the risk of double jeopardy, cases which involve questions of public officials' immunity from litigation, and cases where the district court may not have jurisdiction based upon the Eleventh Amendment to the Constitution.<sup>34</sup> In such cases, the hearing on the merits of the case is stayed until the court of appeals decides whether the district court should hear the case at all.<sup>35</sup> Similarly, in the 2005 decision in *McCauley v. Halliburton Energy Services, Inc.*,<sup>36</sup> the Tenth Circuit agreed with the reasoning of the *Bradford-Scott* case, analogizing the appeal of arbitrability to an appeal of qualified immunity.<sup>37</sup> Qualified

<sup>28</sup> *Id.*

<sup>29</sup> *Id.* at 507. The Seventh Circuit distinguished the appeal in *Bradford-Scott* from an appeal of an injunction. The Seventh Circuit held that it was important not to ask "whether appellants have shown a powerful reason why the district court must halt proceedings, but whether there is any good reason why the district court may carry on once an appeal has been filed." *Id.*

<sup>30</sup> 459 U.S. 56.

<sup>31</sup> *Bradford-Scott*, 128 F.3d at 504-5.

<sup>32</sup> *Bradford-Scott*, 128 F.3d at 505. The *Bradford-Scott* court quoted the U.S. Supreme Court as follows:

[A] federal district court and a federal court of appeals should not attempt to assert jurisdiction over a case simultaneously. The filing of a notice of appeal is an event of jurisdictional significance—it confers jurisdiction on the court of appeals and divests the district court of its control over those aspects of the case involved in the appeal. *Bradford-Scott*, 128 F.3d at 505 (quoting *Griggs*, 459 U.S. at 58).

<sup>33</sup> *Bradford-Scott*, 128 F.3d at 506.

<sup>34</sup> *Id.* (citing *Goshtasby V. Univ. of Ill.*, 123 F.3d 427 (7<sup>th</sup> Cir. 1997); *Apostol v. Gallion*, 870 F.2d 1335 (7<sup>th</sup> Cir. 1989); *Abney v. U.S.*, 431 U.S. 651, 662 n. 9 (1977)).

<sup>35</sup> *Bradford-Scott*, 128 F.3d at 506.

<sup>36</sup> 413 F.3d 1158 (10<sup>th</sup> Cir. 2005).

<sup>37</sup> *Id.*

immunity is a constitutional right to avoid litigation, and arbitration is the contractual right to avoid litigation.<sup>38</sup> In either case, if a party is forced to litigate the merits of a case during an appeal of qualified immunity or arbitrability, that party may be denied its constitutional or contractual right to avoid the litigation.<sup>39</sup>

This stay is an important safeguard, because, for example, the "defense of sovereign or qualified immunity protects government officials not only from having to stand trial, but from having to bear the burdens attendant to litigation, including pretrial discovery."<sup>40</sup> Similarly, an enforceable arbitration agreement should protect the parties from litigation and its attendant burdens.<sup>41</sup> In the 2004 case of *Blinco v. Green Tree Servicing, LLC*,<sup>42</sup> the Eleventh Circuit noted that parties have the right to a timely interlocutory appeal of the arbitrability under the Federal Arbitration Act, and this evidences Congress' intent that a stay of the proceedings in the lower court during the arbitrability appeal is desirable to preserve the time and cost savings that arbitration provides.<sup>43</sup>

The Third Circuit joined the majority of circuits to grant a stay pending appeal of arbitrability in the 2006 decision of *Ehleiter v. Grapetree Shores, Inc.*,<sup>44</sup> and, finally, in 2011, the Fourth Circuit joined

<sup>38</sup> *Id.*

<sup>39</sup> *Id.* at 1162.

<sup>40</sup> *Blinco* at 1252.

<sup>41</sup> *Id.*

<sup>42</sup> *Blinco*, 366 F.3d 1249. In *Blinco*, borrowers sued a debt servicer for violations of the Real Estate Settlement Procedures Act. *Id.*

<sup>43</sup> *Id.* at 1249-1251. According to *Blinco*,

Section 16 of the Federal Arbitration Act grants a party the right to file an interlocutory appeal from the denial of a motion to compel arbitration. ... By providing a party who seeks arbitration with swift access to appellate review, Congress acknowledged that one of the principal benefits of arbitration, avoiding the high costs and time involved in judicial dispute resolution, is lost if the case proceeds in both judicial and arbitral forums.

*Id.* at 1251. See 9 U.S.C. § 16(a)(1)(a). In *Blinco*, the Eleventh Circuit agreed with the reasoning of the *Bradford-Scott* court and also relied on *Griggs*. *Blinco*, 366 F.3d 1249 (citing *Griggs*, 459 U.S. 56; *Bradford-Scott*, 128 F.3d 504). The *Blinco* court held that the district court proceedings were stayed until the conclusion of the appeal by the debt servicer in connection with the denial of a motion to compel arbitration. *Blinco*, 366 F.3d 1249.

<sup>44</sup> *Ehleiter*, 482 F.3d 207 (3<sup>rd</sup> Cir. 2006). The *Ehleiter* court considered plaintiff's claim that by actively engaging in the litigation the defendant had waived its right to compel arbitration.<sup>44</sup> The Third Circuit noted its agreement with the Seventh, Tenth and Eleventh Circuit's position that an automatic stay of proceedings on the merits should arise pending the resolution of an appeal of a defendant's assertion that it was entitled to arbitration in a personal injury claim. *Id.* The *Ehleiter* court stated that

There is a circuit split on the question of whether the filing of an interlocutory appeal pursuant to Section 16(a) of the FAA automatically deprives the trial court of



the majority in *Levin v. Alms and Associates, Inc.*<sup>45</sup> The *Levin* district court held that a stay was not justified, because it would cause unnecessary delays.<sup>46</sup> In the district court's opinion, allowing discovery to continue pending the appeal of the denial of the motion to compel arbitration would do no harm, and it would reduce delays in the case.<sup>47</sup> However, the Fourth Circuit reversed this decision, and adopted the position of the Third, Seventh, Tenth and Eleventh Circuits.<sup>48</sup> The *Levin* court also noted the differences in discovery and privacy under arbitration and litigation, stating that a stay of proceedings pending the appeal of arbitrability prevents the disclosure of information that would not be disclosed in arbitration.<sup>49</sup> Once that disclosure has occurred, even if the appellate court later compels arbitration, the privacy and lessened discovery benefits of arbitration are forever lost.<sup>50</sup>

Circuits holding the majority view have answered the concern that granting the stay pending appeal of arbitrability will provide a tool for litigants to unnecessarily delay resolution of disputes. These circuits have provided an exception to the stay if the appeal of arbitrability is frivolous.<sup>51</sup> These circuits hold the position that the district court may continue with the case if an appeal from the denial of a motion to compel arbitration is frivolous.<sup>52</sup>

jurisdiction to proceed until such time as the appeal is fully litigated or determined to be frivolous or forfeited. ... In our order granting GSI's motion to stay, we expressed our agreement with the majority rule of automatic divestiture where the Section 16(a) appeal is neither frivolous nor forfeited.

*Ehleiter*, 482 F.3d 207, 215 n. 6.

<sup>45</sup> 634 F.3d 260 (4<sup>th</sup> Cir. 2011).

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> *Id.* at 264.

<sup>49</sup> *Id.* at 265. The *Levin* court stated as follows:

[A]llowing discovery to proceed could alter the nature of the dispute significantly by requiring parties to disclose sensitive information that could have a bearing on the resolution of the matter. If we later hold that the claims were indeed subject to mandatory arbitration, the parties will not be able to unring any bell rung by discovery, and they will be forced to endure the consequences of litigation discovery in the arbitration process.

*Id.*

<sup>50</sup> *Id.*

<sup>51</sup> See, e.g., *Bradford-Scott*, 128 F.3d at 506.

<sup>52</sup> *Id.* at 507. In addition, the *McCauley* court stated that a clear jurisdictional rule automatically granting the stay is preferable when the appeal of arbitrability is not frivolous. *McCauley*, 413 F.3d at 1162. The Tenth Circuit later held that the negligence and loss of consortium claims did not fall within the arbitration clause, so the plaintiffs were entitled to their day in court on these claims. *McCauley*, 161 Fed. Appx. 760 (10<sup>th</sup> Cir. 2005). See also *Ehleiter*, 482 F.3d 207.

## THE NARROW INTERPRETATIONS OF GRIGGS

The Ninth Circuit Court of Appeals was the first to adopt a narrow interpretation of *Griggs* in *Britton v. Co-op Banking Group*.<sup>53</sup> Joseph Britton represented a group of plaintiffs who alleged that Co-op Banking Group (Co-op); Gold Depository and Loan Company ("Gold Depository"), a subsidiary of Co-op; and other defendants had violated securities laws through the sale of a tax shelter.<sup>54</sup> Jeff Liebling was an individual defendant in this securities litigation.<sup>55</sup> He maintained that claims against him should be subject to arbitration under the terms of a contract between the plaintiffs and Gold Depository, although he was not a signatory to that contract.<sup>56</sup>

Liebling's motion to compel arbitration was denied by the District Court for the Eastern District of California.<sup>57</sup> The trial court held that he had waived his right to arbitration.<sup>58</sup> He appealed the denial, and refused to comply with discovery.<sup>59</sup> The trial court eventually entered a default judgment against him.<sup>60</sup>

The Britton group argued that Liebling's motion to appeal the denial of arbitration was rendered moot by the trial court's default judgment.<sup>61</sup> The Ninth Circuit held that the default judgment should be treated as any other decision on the merits, and did not render Liebling's appeal moot.<sup>62</sup> Liebling argued that the appeal transferred jurisdiction to the appellate court, and the trial court did not have jurisdiction to enter a default judgment against him.<sup>63</sup> The Ninth Circuit found that arbitration could be severed from the merits of the underlying dispute.<sup>64</sup> Thus, the district court retained jurisdiction to decide the underlying dispute.<sup>65</sup>

The Ninth Circuit noted that the automatic stay that Liebling proposed would allow defendants to delay a trial simply by making a meritless motion to compel arbitration.<sup>66</sup> The court concluded that the

<sup>53</sup> 916 F.2d 1405.

<sup>54</sup> *Id.* at 1407.

<sup>55</sup> *Id.*

<sup>56</sup> *Id.* at 1408.

<sup>57</sup> *Id.*

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

<sup>61</sup> *Id.* at 1409.

<sup>62</sup> *Id.* at 1410.

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *Id.* at 1411.

<sup>66</sup> *Id.*



trial courts have the discretion to grant a stay if they find that the appellant would suffer harm if the trial proceeded.<sup>67</sup>

The case was remanded to the trial court on the issue of Liebling's standing to compel arbitration.<sup>68</sup> The Ninth Circuit found that the trial court had bypassed the threshold issue when it concluded that Liebling had waived his right to arbitration.<sup>69</sup> The Ninth Circuit concluded that if Liebling had a right to arbitration, the default judgment would be vacated. If he had no right to arbitration, the default judgment against him would be allowed to stand.<sup>70</sup>

The Second Circuit followed the Ninth Circuit in *Motorola Credit Corp. v. Uzan*.<sup>71</sup> Motorola Credit Corporation and Nokia entered into loans with Telsim and Rumeli Telefon, Turkish telecommunications companies, for the acquisition of cellular telephone equipment and licenses.<sup>72</sup> The equipment purchased with the Motorola loan came from an affiliate of Motorola Credit.<sup>73</sup> Rumeli Telefon was the majority shareholder of Telsim, and pledged Telsim stock as security for the loans.<sup>74</sup> The defendants in this case were individual shareholders and affiliates of these companies as well as related corporations, but Telsim and Rumeli Telefon were not parties to the case.<sup>75</sup> The plaintiffs alleged that the defendants made false statements to induce them to make the loans and took steps to dilute the value of the stock pledged as collateral for the loans.<sup>76</sup> Although some payments were made over time, the plaintiffs alleged that they lost over \$2 billion.<sup>77</sup>

This case involved several procedural aspects, but the two important issues for this article were the appeal of the denial of the defendants' motion to compel arbitration and the issue of the trial court's jurisdiction over the subject matter of the case while the appeal was pending.

The defendants attempted to compel arbitration under the agreements signed between Motorola Credit and Nokia as lenders and Telsim and Rumeli Telefon as borrowers.<sup>78</sup> None of the defendants were

<sup>67</sup> *Id.* The Ninth Circuit cited *Moses H. Cone Memorial Hospital v. Mercury Construction*, 460 U.S. 1 (1983) for the proposition that arbitration may be separately litigated from the merits of the underlying dispute. *Britton*, 916 F.2d at 1412 n.7.

<sup>68</sup> 916 F.2d at 1414.

<sup>69</sup> *Id.* at 1413.

<sup>70</sup> *Id.* at 1414. The Ninth Circuit eventually concluded that Liebling lacked standing to compel arbitration in *Britton v. Co-op Banking Group*, 4 F.3d 742 (9th Cir. 1993).

<sup>71</sup> 388 F.3d 39 (2d Cir. 2004), *cert. denied*, 544 U.S. 1044 (2005).

<sup>72</sup> 388 F.3d at 43.

<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> *Id.* at 42.

<sup>78</sup> *Id.* at 49.

signatories to these documents.<sup>79</sup> The agreements included a choice of law clause that specified that disputes would be governed by Swiss law.<sup>80</sup> The court concluded that, under Swiss law, the defendants could not compel the plaintiffs who did sign the agreements to arbitrate their dispute.<sup>81</sup>

The district court refused to stay the trial pending the defendants' appeal from its decision to deny arbitration.<sup>82</sup> The Second Circuit cited earlier cases to support its decision.<sup>83</sup> The Second Circuit went on to adopt the Ninth Circuit's interpretation that trial court proceedings on the merits are not aspects of the case involved in the appeal.<sup>84</sup>

In 2011, the Fifth Circuit joined the minority with its decision in *Weingarten Realty Investors v. Miller*.<sup>85</sup> Weingarten Realty Investors ("WRI") made a \$75,000,000 loan to a joint venture that it formed with Miller Sheriden, LLC ("Miller Sheriden").<sup>86</sup> There were extensive documents related to the loan, including a promissory note, and the loan agreement listed these documents as "Loan Documents."<sup>87</sup> The loan agreement provided for mandatory arbitration.<sup>88</sup> Stewart A. Miller, the defendant in the proceedings, was a third-party guarantor of the Miller Sheriden loan.<sup>89</sup> Stewart did not sign the underlying loan agreement, and the guarantee did not include a clause requiring arbitration.<sup>90</sup>

The loan agreement was modified twice, and these modifications did refer to the guarantee as loan documents.<sup>91</sup> The modifications included

<sup>79</sup> *Id.*

<sup>80</sup> *Id.* at 50. The choice of law question was tied to the issue of arbitrability. The Second Circuit found that the choice of Swiss law meant that Swiss law governed the agreement to arbitrate. *Id.*

<sup>81</sup> *Id.* at 53. The Second Circuit discussed the defendants' claim that Chapter 2 of the Federal Arbitration Act (implementing the Convention on the Recognition and Enforcement of Foreign Arbitral Awards) required the district court to compel arbitration. The Second Circuit found that the FAA would require arbitration if the parties had agreed to arbitrate, but they had not. *Id.* at 49.

<sup>82</sup> *Id.* at 53. The district court found that the appeal was frivolous. The Second Circuit disagreed, but this had no impact on their eventual decision. *See Id.*

<sup>83</sup> *Id.* at 54. The *Motorola* court noted that in *Gutfreund v. Weiner* (In re Salomon Inc. Shareholders Derivative Litig.), 68 F.3d 554 (2d Cir. 1989), they had "... contemplated that a district court has jurisdiction to proceed with a case despite the pendency of an appeal from an order denying a motion to compel arbitration." *Motorola*, 388 F.3d at 54.

<sup>84</sup> *Motorola*, 388 F.3d at 54.

<sup>85</sup> 661 F.3d 904 (5th Cir. 2011).

<sup>86</sup> *Id.* at 907.

<sup>87</sup> *Id.*

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

an extension of the maturity date.<sup>92</sup> Eventually, however, Miller Sheriden defaulted on the loan and WEI brought suit against Miller seeking to enforce the guarantee.<sup>93</sup>

Miller filed a motion to compel arbitration, which was denied by the United States District Court for the Southern District of Texas.<sup>94</sup> Miller then appealed that decision and asked the district court to stay the trial on the merits of the underlying case pending the appeal of the motion to compel arbitration.<sup>95</sup> The district court refused to stay the trial on the merits.<sup>96</sup>

The Fifth Circuit adopted the Ninth Circuit's narrow reading of *Griggs*.<sup>97</sup> The Fifth Circuit noted that other courts had recognized a need for a broad reading of *Griggs* for some legal issues.<sup>98</sup> However, it was able to distinguish arbitration from the Constitutional protections of double jeopardy and sovereign immunity and the similar protection of qualified immunity.<sup>99</sup> The Fifth Circuit went on to state that a district court has the discretion to grant a stay.<sup>100</sup>

#### ANALYSIS OF THE ADVANTAGES OF STAYS

The majority of circuits who have decided this issue prefer an automatic stay of proceedings pending appeal of arbitrability.<sup>101</sup> However, some commentators have suggested that the automatic stay is inappropriate, and, instead, district courts should weigh the possible injury from granting the stay against the possible injury from denying the stay to make a determination about the stay.<sup>102</sup> However, such a district court decision against granting a stay is subject to appeal. Therefore, if a district court decision using such a weighing approach is

<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

<sup>94</sup> *Id.*

<sup>95</sup> *Id.*

<sup>96</sup> *Id.*

<sup>97</sup> *Id.* at 908-909.

<sup>98</sup> *Id.*

<sup>99</sup> *Id.* at 909. The Fifth Circuit cited *Digital Equip. Corp. v. Desktop Direct, Inc.*, 511 U.S. 863 (1994) in support of its contention that contractual arbitration provisions differ from provisions providing immunity from lawsuit. The *Digital Equip.* case showed how important immunity provisions were to the Supreme Court. Contractual provisions, on the other hand, do not provide immunity. They are an agreement between the parties that they will resolve disputes outside the courtroom. *Id.* at 910.

<sup>100</sup> *Id.* The Fifth Circuit refers to the four factor test in *Hilton v. Braunskill*, 481 U.S. 770 (1986) to determine if a stay is appropriate.

<sup>101</sup> See *Levin*, 634 F.3d 260; *Ehleiter*, 482 F.3d 207; *McCauley*, 413 F.3d 1158; *Blinco*, 366 F.3d 1249; *Bradford-Scott*, 128 F.3d 504.

<sup>102</sup> See Roger J. Perlstadt, *Interlocutory Review of Litigation-Avoidance Claims: Insights from Appeals Under the Federal Arbitration Act*, 44 Akron L. Rev. 375 (2011).

reversed upon appeal and arbitration is ultimately compelled, then many of the benefits of arbitration may be irrevocably lost to the party who desires to compel arbitration. Loss of these benefits of arbitration may undermine the intent of the Federal Arbitration Act.<sup>103</sup>

The advantages of the stay pending appeal of denial of the motion to compel arbitration as adopted by the majority of the circuits are numerous.

First, such an approach may save the parties the expense and time of having their case heard in two tribunals. Presumably, if parties signed an agreement containing an arbitration clause, these parties hoped that arbitration would be less expensive than litigation.<sup>104</sup> Allowing the district court to hear the merits of a dispute while the court of appeals hears an appeal about whether the dispute must be arbitrated increases the risk that the hearing of the dispute will be much more expensive than either arbitration or litigation.<sup>105</sup> For example, if the following scenario occurs, the parties have incurred much more cost than anticipated for either arbitration or litigation: District court denies motion to compel arbitration; court of appeals hears appeal of that denial; at the same time, district court proceeds to hear the merits of the case; later, the court of appeals reverses the denial of the motion to compel arbitration.<sup>106</sup> Then arbitration will occur, but at that point, the parties have incurred duplicative expense of trying the merits of the case twice, once before the district court and once before the arbitrator.<sup>107</sup>

Second, not only may the stay reduce the time and financial cost to the parties, it also upholds the goal of judicial efficiency.<sup>108</sup> Judicial resources are wasted if the parties are allowed to continue proceedings on the merits in district court while simultaneously awaiting the results of an appeal that may deny the district court's jurisdiction.<sup>109</sup>

Third, a stay pending appeal of arbitrability avoids the "risk of inconsistent handling of the case by two tribunals."<sup>110</sup> An inconsistency between a court and the arbitrator could affect the arbitrator's judgment or undermine the arbitrator's authority.

Fourth, the majority approach upholds the Federal Arbitration Act's goals and process.<sup>111</sup> As a general rule under the Federal Arbitration

<sup>103</sup> 9 U.S.C. §§ 1-16.

<sup>104</sup> See, e.g., *Bradford-Scott*, 128 F.3d 504.

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> *Id.*

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Id.* at 505.

<sup>111</sup> *Id.*



Act, parties may immediately appeal an order denying arbitration. The availability of the interlocutory appeal evidences Congress' intent that a stay would preserve the benefits of arbitration.<sup>112</sup> However, orders that enforce arbitration clauses may not be appealed until the end of the case.<sup>113</sup>

Fifth, the stay pending appeal of arbitrability may protect the privacy of the parties.<sup>114</sup> Some parties prefer arbitration because, unlike litigation, arbitration may help the parties avoid the negative publicity and divulgence of trade secrets and other confidential information in a public forum. Although some of this privacy has already been lost by virtue of the filing of the lawsuit, many of the details of the case may remain private if a stay occurs and then the court of appeals requires arbitration.<sup>115</sup> However, if the district court proceeds on the merits of the case before the court of appeals has the opportunity to decide whether arbitration is compelled, this privacy benefit may be lost forever to the parties, even if the court of appeals ultimately decides that the case is arbitrable.<sup>116</sup>

A sixth aspect of the majority approach is a respect for the differences in discovery available in arbitration as opposed to litigation.<sup>117</sup> If the parties did indeed enter a binding arbitration agreement, the stay would stop or prevent the pre-trial discovery that could occur pending the appeal of arbitrability in the event there is no stay of district court proceedings.<sup>118</sup> Limited discovery may be the bargained-for result and a cost savings that the parties intended in an arbitration agreement.<sup>119</sup> However, this could also be considered a disadvantage. The arbitration process may limit the access of the parties to all pertinent facts by eliminating many of the discovery tools available in litigation. This limit on discovery tools may impede the parties' search for truth in a case. Nevertheless, if the parties signed a binding arbitration agreement, this freedom from typical litigation discovery is a legal right of the party seeking arbitration.

A major disadvantage of the stay is a delay in the proceedings. Parties who sign an agreement containing an arbitration clause may have included the clause to achieve a resolution to any disputes more quickly than litigation.<sup>120</sup> The majority approach granting the stay will

<sup>112</sup> *Blinco*, 366 F.3d at 1251-2.

<sup>113</sup> *Bradford-Scott*, 128 F.3d at 506.

<sup>114</sup> *Levin*, 634 F.3d 260; *Bradford-Scott*, 128 F.3d 504.

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> *Id.*

<sup>119</sup> *Id.*

<sup>120</sup> *Bradford-Scott*, 128 F.3d 504.



allow a delay in resolution of the dispute.<sup>121</sup> If there is an unsuccessful appeal of a denial of a motion to compel arbitration, and the district court has already proceeded with hearing the dispute before the appeal about arbitrability is decided in the court of appeals, the parties may obtain a more timely decision from the district court on the merits of the case.<sup>122</sup> If there is a stay in the district court's hearing of the case on the merits until the court of appeals decides whether the case must be arbitrated, "an obstinate or crafty litigant [may have] too much ability to disrupt the district judge's schedule by filing frivolous appeals."<sup>123</sup> This is a rationale for the Ninth Circuit's position that an automatic stay should not occur when such an appeal of arbitrability occurs.<sup>124</sup> However, the majority circuits counter this position by stating that frivolous appeals may be quickly dismissed.<sup>125</sup> In addition, the appellant may ask that its appeal of arbitrability be expedited by the court of appeals.<sup>126</sup> The minority view allows the district courts to issue stays in their discretion, but the stays are not automatic.<sup>127</sup>

### PRACTICAL LESSONS

The cases described in this paper are good examples for businesses and attorneys who desire to preserve the benefits of arbitration. Unclear or conflicting arbitration provisions lead to costly litigation that the parties presumably desire to avoid through use of the arbitration clauses. In fact, the cost and delays may be even greater with inconsistent clauses or poorly written clauses than if there were no arbitration clauses, if the court of appeals ultimately chooses that litigation rather than arbitration shall determine the merits of a case. Cases that include inconsistent or poorly written arbitration clauses may not only include litigation of the merits, but also the additional steps of the district court determining arbitrability and the court of appeals hearing an appeal of arbitrability.

Clarity and consistency will help avoid disputes about whether a case should go to arbitration or litigation. For example, the language of the arbitration agreement in *Levin*<sup>128</sup> led to a dispute about whether an arbitration agreement should be applied retroactively.<sup>129</sup> The district

<sup>121</sup> *Id.*

<sup>122</sup> *Id.*

<sup>123</sup> *Id.*

<sup>124</sup> *Id.* (citing *Britton*, 916 F.2d 1405, 1412).

<sup>125</sup> See, e.g., *Bradford-Scott*, 128 F.3d at 506.

<sup>126</sup> *Id.* at 507.

<sup>127</sup> *Weingarten*, 661 F.3d 904; *Motorola*, 388 F.3d 39; *Britton*, 916 F.2d 1405.

<sup>128</sup> 634 F.3d 260 (4th Cir. 2011).

<sup>129</sup> *Id.* In *Levin*, the plaintiff was an investor, and the defendants, financial advisors, claimed that the dispute was subject to arbitration pursuant to a 2007 agreement between

court held that claims arising in 2007 and later would be subject to arbitration, but the district court refused to apply the 2007 agreement retroactively to require arbitration of pre-2007 claims.<sup>130</sup> Ideally, the arbitration agreement addresses the issue of retroactive application. In addition, one agreement involved in the *Bradford-Scott*<sup>131</sup> transaction contained a clause that stated that arbitration must occur for "any dispute or controversy between the parties ... relating to this Agreement" but the other agreement's arbitration clause was much narrower, applying to "payment disputes concerning license or support fees."<sup>132</sup> This inconsistent language in related agreements fueled a dispute about whether the dispute should be arbitrated or litigated.

In addition, the arbitrability of even broadly drafted arbitration clauses may be litigated if there is an argument that the claims arise from statutes that are severable from the contract or that the arbitration provisions are incomplete.<sup>133</sup> For example, a very broadly drafted arbitration provision in a promissory note led to litigation in *Blinco*<sup>134</sup> about whether Real Estate Settlement Procedures Act (RESPA) claims by a customer were arbitrable because the plaintiff argued that the note was severable from RESPA claims.<sup>135</sup> In addition, the plaintiff

the plaintiff and defendants. The defendants appealed and requested a stay of proceedings in district court pending the appeal. In *Levin*, the Fourth Circuit ultimately read the broad language of the arbitration agreement to hold that a 2007 agreement to arbitrate applied retroactively to disputes that arose from occurrences prior to 2007. *Id.*

<sup>130</sup> *Id.*

<sup>131</sup> *Bradford-Scott*, 128 F.3d 504.

<sup>132</sup> *Id.* at 505.

<sup>133</sup> See, e.g., *Blinco*, 366 F.3d 1249.

<sup>134</sup> *Id.* The arbitration provisions in *Blinco* stated:

All disputes, claims or controversies arising from or relating to this contract or the relationships which result from this contract, or the validity of this arbitration clause or the entire contract, shall be resolved by binding arbitration by one arbitrator . . . . This arbitration contract is made pursuant to a transaction in interstate commerce and shall be governed by the Federal Arbitration Act at 9 U.S.C. Section 1. Judgment upon the award rendered may be entered in any court having jurisdiction. The Parties agree and understand that they choose arbitration instead of litigation to resolve all disputes. The parties understand that they have a right or opportunity to litigate disputes in court, but that they prefer to resolve their disputes through arbitration, except as provided herein . . . . The parties agree and understand that all disputes arising under case law, statutory law, and all other laws including, but not limited to, all contract, tort, and property disputes, will be subject to binding arbitration in accord with this contract.

*Blinco*, 366 F.3d at 1250.

<sup>135</sup> *Blinco*, 366 F.3d 1249. The *Blinco*s alleged that Green Tree, a loan servicer, had failed to notify them that servicing of their loan had been transferred, and that this was a violation of the Real Estate Settlement Procedures Act (RESPA). "The *Blinco*s counter that it is Green Tree's independent statutory status as loan servicer that gives rise to their

attempted to invalidate the arbitration **provisions** in the note because they did not specify the name of the **arbitrator**, the place or arbitration, or who will bear the costs of the arbitration.<sup>136</sup>

The *Motorola* and *Weingarten* cases indicated the difficulties when documents containing arbitrations clauses were not signed by parties in a case.<sup>137</sup> For example, if a lender desires that guarantors be bound by an arbitration agreement, the arbitration agreement should be included **in the guaranty and not simply included in loan documents not signed by the guarantor.**<sup>138</sup> Guarantors and others who did not sign documents containing the arbitration clauses may attempt to invoke their right to a trial with its attendant rights to appeal. In addition, *Motorola* is a good reminder that a choice of law clause may determine whether a court will **compel arbitration.**<sup>139</sup>

**Employment claims** may fall within an arbitration clause in an **employment agreement.** However, if a person such as the plaintiff in *McCauley* works both as an employee and as an independent contractor, claims based upon work done as an independent contractor or claims based upon activities that occur outside of the scope of normal employee working hours may arguably fall outside of the arbitration agreement contained in the employment contract.<sup>140</sup> In *McCauley*, the plaintiff and defendant had agreed to arbitrate certain claims under the defendant employer's Dispute Resolution Program.<sup>141</sup> The plaintiff was injured while working for the defendant, and the defendant terminated the plaintiff as an employee.<sup>142</sup> The plaintiff sued the defendant for various claims, and the court granted the defendant's motion to arbitrate all of these claims except the negligence claims and the loss of consortium claims by the plaintiff's family.<sup>143</sup> One reason for the district court's denial of the motion in connection with negligence and loss of consortium was that these claims allegedly arose out of work by the plaintiff as an independent contractor instead of as an employee.<sup>144</sup>

claims, not the Note or the Mortgage. The Blincos argue that servicing is severable from the Note and Mortgage and accordingly do not rely upon the Note and/or Mortgage in making their RESPA claims." *Blinco*, 400 F.3d at 1311.

<sup>136</sup> *Id.* at 1312.

<sup>137</sup> *Weingarten*, 661 F.3d 904; *Motorola*, 388 F.3d 39.

<sup>138</sup> *Weingarten*, 661 F.3d 904.

<sup>139</sup> *Motorola*, 388 F.3d 39.

<sup>140</sup> See e.g., *McCauley*, 413 F.3d 1158.

<sup>141</sup> *Id.* at 1159.

<sup>142</sup> *Id.*

<sup>143</sup> *Id.*

<sup>144</sup> *Id.*



*Ehleiter v. Grapetree Shores, Inc.*<sup>145</sup> provides another good example of a party's error in an appeal to arbitrate. In *Ehleiter*, a party waited until after four years of pre-trial activity, including nineteen depositions, before requesting that an arbitration clause be enforced.<sup>146</sup> The *Ehleiter* court held that a party who engaged in such litigation waived its right to demand arbitration.<sup>147</sup> Parties who desire that a dispute be settled by arbitration need to review all agreements for arbitration and, if appropriate, promptly move that the dispute be arbitrated.

In summary, parties who desire the benefits of arbitration should, therefore, learn the following lessons about arbitration agreements from these cases: (a) draft arbitration clauses in contracts that are clear and consistent; (b) ensure that the arbitration provisions include a complete and satisfactory agreement about choice of arbitrator, choice of law, location, and costs; (c) be mindful that an arbitration agreement about employment may not cover services outside the scope or hours of employment; and (d) include arbitration clauses in guarantees and collateral agreements and make sure to obtain signatures of all parties that should be subject to arbitration on agreements containing the arbitration language. In addition, parties who desire the benefits of arbitration should promptly move to compel arbitration if the other party attempts to litigate rather than arbitrate. Failure to follow this advice may lead to expensive litigation that undermines many of the parties' goals underlying the original arbitration agreement, even if the motion to compel arbitration is ultimately successful.

## CONCLUSION

The U.S. Supreme Court has not considered the circuit split described in this paper. Only the *Motorola Credit Corp.* decision was appealed to the Supreme Court, and certiorari was denied in that case.<sup>148</sup> Although the majority of U.S. Circuit Courts of Appeals who have decided this issue have allowed an automatic stay, in 2011 the circuit split continued to grow.<sup>149</sup> Clearly, the issue is not settled. In addition to the issues discussed above, a disadvantage of the circuit split is that there is some uncertainty in those circuits that have not ruled on the issue.<sup>150</sup>

<sup>145</sup> 482 F.3d 207 (3<sup>rd</sup> Cir. 2007).

<sup>146</sup> *Id.* at 209-210.

<sup>147</sup> *Id.* at 225.

<sup>148</sup> 388 F.3d 39, *cert. denied*, 544 U.S. 1044 (2005).

<sup>149</sup> *Levin*, 634 F.3d 260; *Weingarten*, 661 F.3d 904.

<sup>150</sup> *See, e.g., A.O.A. v. Doe Run Resources Corporation*, 2012 U.S. Dist. Lexis 34275 (E. Dist. Mo. 2012). The district court noted the split in the circuits, noted that the Eighth Circuit had not ruled, and granted a stay.

The Supreme Court should carefully examine and resolve this circuit split the next time this issue is appealed to that level. The authors of this paper prefer the "bright-line" rule of granting an automatic stay of proceedings on the merits pending non-frivolous appeals of arbitrability. Such a bright-line rule should increase efficiency and simplicity, and it preserves the advantages of stays outlined in this article.