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VICTORIA'S SECRET'S SECRET REDUX: POST DECISION EFFECTS OF THE TRADEMARK DILUTION PROOF REQUIREMENT AND THE TRADEMARK DILUTION REVISION ACT OF 2006

by MALCOLM ABEL*

I. INTRODUCTION

The law of the dilution of trademark has been litigated continuously over the last 12 years since the passage of the Federal Trademark Dilution Act of 1995 (FTDA).[1] What is or is not dilution requires discussion of what is seen as a trademark as well as how a trademark is seen. Seeing what is not seen is sometimes a secret, but whose secret is it, and how long should it be a secret?

Victoria's Secret v. Victor's Little Secret began as a suit, in the Western District of Kentucky, Louisville Division, under the Lanham Act,[2] the FTDA,[3] and Kentucky common law, [4] alleging that the defendants, the Moseley's, were "committing trademark infringement and unfair competition."[5] Both the plaintiffs and the defendants moved

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[1] This act amended 15 U.S.C. §§ 1125 and 1127 (2003).

[2] 15 U.S.C. § 1051 et seq (2003).

[3] 15 U.S.C. § 1125(c) (2003).

[4] V Secret Catalogue, Inc. v. Moseley, No. 3:98CV-395-S, 2000 U.S. Dist. LEXIS 5215, at *2 (W.D. Ky., Feb. 9, 2000).

[5] *Id.*

for summary judgment[6] and the plaintiffs were granted their motion as to trademark dilution, but not as to trademark infringement.[7]

The Sixth Circuit Court of Appeals upheld the judgment of the District Court because Victoria's Secret's mark bore little relation to the good used in the market by Victoria's Secret, thus requiring a high degree of trademark protection.[8] On appeal to the U.S. Supreme Court, the issue was whether Victoria's Secret's trademark was diluted by the mere likelihood of harm or whether Victoria Secret had to prove the existence of actual harm. The judgment was reversed and remanded, finding that it was necessary to prove actual harm.[9] There are those who believed at the time that the court did not answer a central question in this case: How is a plaintiff supposed to show the dilution required as proof of injury?

Subsequent cases involved marks that sounded alike, involved negative associations, attempted piggy-backing, and tarnished the mark by portrayal in a negative light. Most of the cases, however, were found in the favor of the junior mark, with the senior mark lacking proof of 'actual dilution.' Congress began to consider changing of the FTDA to resolve what they saw as a proof problem and to clarify Congress' intention as to dilution, and, consequently, passed the Trademark Dilution Revision Act of 2006.

II. VICTORIA'S SECRET'S SECRET

A. District Court

There was no question that Victoria's Secret had an interest in protecting its mark, its name. When a small adult video and sex novelty shop in Kentucky wanted to call itself Victor's Secret, it would seem reasonable that Victoria's Secret would be concerned.[10] When it was brought to Victoria's Secret's attention by a well-meaning, and likewise concerned army officer stationed at nearby Fort Knox, Victoria's Secret

[6] "Defendants . . . also filed Motions to Strike Plaintiff's Response to the . . . [defendant's] Motion for Summary Judgment and [p]laintiff's Motion for Summary Judgment on the basis that [p]laintiffs included in those pleadings affidavits from person not previously identified as witnesses." The motions to strike were denied in a separate order because the court did not rely on any of the affidavits in question in arriving at its ruling on the motions for summary judgment. *Id.*

[7] *Supra*, note 4, at *15-16.

[8] V Secret Catalogue, Inc. v. Moseley, 259 F.3d 464, 2001 U.S. App. LEXIS 16937 (6th Cir. 2001) at 476.

[9] Moseley v. V Secret Catalogue, Inc., 123 S.Ct. 1115, 2003 U.S. Lexis 1945 (2003).

[10] Victor's Secret sold "a wide variety of items, including men's and women's lingerie, adult videos, sex toys and "adult" novelties." *Supra*, note 4, at *3.

could not easily ignore the possibility of harm to its mark.[11] The little store in Elizabethtown, Kentucky, though, could hardly be seen as a major threat to Victoria's Secret's business, as it was located in an obscure 1960s vintage strip mall on a two lane street off of the nearest major highway. One would have to know exactly where one was going to find it.[12] And, the nearest Victoria's Secret store was in Louisville, [13] nearly an hour away.[14]

Victoria's Secret contacted the little family store and asked it to change its name. It did change, from "Victor's Secret" to "Victor's Little Secret," with the word 'Little' being in smaller letters than 'Victor's' or 'Secret.'[15] There was no doubt that there were some who would make the mental association between Victor's Little Secret and Victoria's Secret. But, once one located the store and perused the items of latex garments displayed in the windows, there could hardly be any confusion on the part of a potential customer of either store. Victoria's Secret sued.

The District Court concluded that there was not any evidence of actual confusion as to the marks to sustain Victoria's Secret's claim of infringement.[16] Even if the Moseleys selected the name Victor's Secret with the intent to cause confusion, a store location in an off street strip mall was not likely to be confused with a professionally dressed upscale mall storefront of Victoria's Secret.[17] Similarly, the District Court dismissed the federal unfair competition claim and the state law infringement claim because those claims required the same proof of confusion as the federal infringement claim.[18]

As to the dilution claim, however, the District Court found for Victoria's Secret.[19] It simplistically found that Victor's Little Secret tarnished Victoria's Secret.[20] Victor's Little Secret sold adult novelties,

[11] The defendants asserted "that they were not aware of Victoria's Secrets' catalog or stores until they received a cease and desist letter from counsel for Victoria's Secret on February 25, 1998." *Id.* at *3-4. However, 39,000 Victoria's Secret Catalogues are distributed in Elizabethtown each year. *Id.* at *3.

[12] When the author traveled to Elizabethtown to find the store, the author had difficulty doing so, even though the author was familiar with the area. The author had to ask a local person to actually locate the store. There was no sign on the major highway to indicate that Victor's Little Secret was located on the two lane side street.

[13] Elizabethtown is on I-65, and Louisville is north of Elizabethtown on the same highway.

[14] There are two Victoria's Secret Stores in Louisville. *Supra*, note 4.

[15] The defendants changed the name of their store from "Victor's Secret" to Victors Little Secret" after receiving a cease and desist order from Victoria's Secret's legal counsel. *Id.* at *4.

[16] *Id.* at *5-6.

[17] *Id.* at *8.

[18] *Id.* at *12-13.

[19] *Id.* at *15-16.

[20] *Id.* at *15.

in addition to lingerie, which associated Victoria's Secret's mark with inventory of risqué quality.[21] The Moseleys were enjoined from using "Victor's Secret" or "Victor's Little Secret" or any similar marks,[22] and they appealed.

B. Court of Appeals

While giving greater discussion to the analysis of the FTDA than the District Court, [23] the Court of Appeals upheld the District Court's decision.[24] The Court turned its decision on the near identical semantic sounding marks as evidence of tarnishing and blurring, and the interpretation that the senior mark, Victoria's Secret, did not have to show actual loss, as any such proof would be extraordinarily speculative.[25] In deciding the relevant factors in determining the dilution of a mark under the FTDA, the Court reached the conclusion that while the qualities of all the tests across the other circuits were basically the same, they differed on "whether a plaintiff must prove actual present injury to its mark to state a federal dilution claim."[26] The Court considered two tests: the actual harm requirement in *Ringling Brothers*[27] and the inference of likely harm in *Nabisco*.[28]

The actual harm requirement in *Ringling Brothers* arose not from the statutory language itself, but from the historical perspective of erosion of the identity of the mark in the mind of the public.[29] Given that the FTDA provided a remedy for "actual . . . dilution and not for the mere likelihood of dilution,"[30] the proof would be difficult. The Fourth Circuit Court of Appeals established three acceptable forms of proof: (a) "proof of an actual loss of revenues, and replicating use as cause;"[31] (b) "skillfully constructed consumer survey designed . . . to demonstrate . . . further consumer impressions from which actual harm and cause might

[21] *Id.* at *15-16.

[22] *Id.* at *17.

[23] The court noted that it reviewed "the district court's truncated dilution analysis." *Supra*, note 8, at 471.

[24] *Id.* at 466.

[25] *Id.* at 474 and 475.

[26] *Id.* at 471.

[27] Ringling Bros-Barnum & Bailey v. Utah Division of Travel Development, 170 F.3d 449, 1999 U.S. App. LEXIS 4179 (4th Cir. 1999).

[28] Nabisco, Inc. v. PF Brands, Inc., 191 F.3d 208, 1999 U.S. App. LEXIS 20786 (2nd Cir. 1999).

[29] *Supra*, note 8, at 472.

[30] *Id.* (citing Ringling Bros-Barnum & Bailey v. Utah Division of Travel Development, 170 F.3d 449, 1999 U.S. App. LEXIS 4179 (4th Cir. 1999) at 458).

[31] *Supra*, note 8, at 474 (citing Ringling Bros-Barnum & Bailey v. Utah Division of Travel Development, 170 F.3d 449, 1999 U.S. App. LEXIS 4179 (4th Cir. 1999) at 458).

rationally be inferred;"[32] and (c) "relevant contextual factors such as the extent of the junior mark's exposure, the similarity of the marks, the firmness of the senior mark's hold, are of obvious relevance as indirect evidence that might complement other proof."[33]

The inference of likely harm in *Nabisco* turned on the junior mark causing dilution and the limitations of the proof requirement in *Ringling Brothers*.[34] A successful senior mark might have great difficulty showing diminishment of revenues were the result of the dilution of the senior mark's distinctiveness by the junior mark.[35] Further, to allow the junior mark to proceed so far into the marketplace as to actually cause damage to the senior mark would be economically disastrous to the owner of the junior mark, since the junior mark would have spent resources to establish a mark in the marketplace before finding out the mark was not proper.[36] Whereas confusion of a mark caused an injury immediately, dilution of a mark slowly destroyed the potency of the mark, to cause the economic harm later.[37] A remedy for dilution had to be available before the economic harm occurred, and could not wait for proof of actual harm, thus, an inference of likely harm to the senior mark should be proof enough.[38]

C. U.S. Supreme Court

On appeal from the Sixth Circuit Court of Appeals, the U.S. Supreme Court reversed and remanded.[39] The Court ruled that while it may not be easy to prove dilution of trademark, any difficulties in proof were insufficient to dispense with an essential element required by law.[40] That essential element was the proof of harm, not the likelihood of harm, but actual harm.[41] In applying common law dilution, many state statutes referred to the likelihood of harm, not an actual completion of harm.[42] In contrast, the FTDA's language of causing dilution of the distinctive quality of the famous mark was interpreted as requiring the showing of actual dilution.[43]

[32] *Id.*
[33] *Id.*
[34] *Supra*, note 8, at 474 & 475.
[35] *Id.* at 475.
[36] *Id.*
[37] *Id.* (citing H.R. Rep. No. 104-374 (1995), reprinted in 1996 U.S.C.C.A.N. 1029, 1032).
[38] *Id.* at 476.
[39] *Supra*, note 9. Justice Stevens wrote the majority opinion in a unanimous decision in the case, in which Justice Scalia joined all but Part III of the opinion and Justice Kennedy wrote a concurring opinion.
[40] *Id.* at 1125.
[41] *Id.* at 1124.
[42] *Id.*
[43] *Id.*

The Court sought to resolve the conflict between the circuit courts of appeal as to whether the *Nabisco* holding of likely harm or the *Ringling Brothers* holding of actual harm should prevail as to the harm issue.[44] When Congress amended the Lanham Act previously, the Act's antidilution provisions were deleted over concerns about infringing upon First Amendment protected expression.[45] The enactment of the FTDA included two exceptions designed to address those concerns: 1) the fair use exception in advertising and 2) noncommercial use.[46] Remarks made in Congress during the passage of the FTDA suggested that its purpose was to protect trademarks from "subsequent uses that blur the distinctiveness of the mark or tarnish or disparage it."[47] In the *Victoria's Secret* case, the decisions of the lower courts rested on the conclusion that Victor's Little Secret either 'tarnished' or 'blurred' Victoria's Secret's mark.[48] Because the FTDA granted injunctive relief if the distinctive quality of the famous mark was diluted by another's use of a mark,[49] the Court held that the language of the statute clearly required "a showing of actual dilution, rather than a likelihood of dilution."[50]

The Court stated that when the junior mark and the senior mark were not identical, the mere association of the junior mark with the senior mark in the minds of the consumers was insufficient to support an action of dilution.[51] A mental association would "not necessarily reduce the capacity of the famous mark to identify the goods of its owner, the statutory requirement for dilution under the FTDA."[52] Victor's Little Secret may have reminded some of Victoria's Secret, but it did not necessarily follow that customers of Victor's Little Secret would associate Victoria's Secret with the sex toys and adult videos, or associate Victor's Little Secret less with Victoria's Secret's upscale merchandise.[53]

Any claims regarding the expense of surveys and other instruments needed to show actual harm held no sway upon the U.S. Supreme Court.[54] In fact, the Court noted that circumstantial evidence would be sufficient if reliably proven, such as in the case where the junior mark

[44] *Id.* at 1122.
[45] *Id.*
[46] *Id.* at 1123. These exceptions were "'fair use' of a registered mark in comparative advertising or promotion, and the provision that noncommercial use of a mark shall not constitute dilution." *Id.*. *See* also 15 U.S.C. § 1125(c)(4).
[47] *Supra*, note 9 (citing 141 Cong. Rec. 38559-38561 (1995)).
[48] *Id.* at 1124.
[49] *Id.* (citing 15 U.S.C. § 1125(c)(1)).
[50] *Id.*
[51] *Id.*
[52] *Id.*
[53] Paraphrasing the court, *Id.* at 1124 and 1125.
[54] *Supra*, note 9, at 1125.

was identical to the senior mark.[55] Regardless of the difficulties in the requirements of proof, the Court could not justify eliminating the essential element of proof in the violation of a statute.[56] Justice Kennedy, in a concurring opinion, stated, "diminishment of the famous mark's capacity can be shown by the probable consequences flowing from use or adoption of the competing mark."[57] The unanimous decision of the U.S. Supreme Court was that summary judgment cannot be had on the mere allegation of harm from dilution, but that actual harm must be shown.[58]

III. VICTORIA'S SECRET, THE AFTERGLOW: POST DECISION APPLICATIONS

Savin Corporation (Savin) had used the trade name "Savin" in various forms since 1959 in connection with its office products, including photocopying, printing, and facsimile machines.[59] Its founder, Max Lowe, named Savin after his brother-in-law, Robert Savin.[60] The Savin Group had used the name "Savin" continuously since 1987 in connection with its business in engineering services.[61] Its founder, Dr. Rengachari Srinivasaragahaven, chose the name "Savin" by spelling "Nivas" backwards.[62] Savin Group did not investigate the use of the name prior to adopting it and using it to launch their websites.[63] The court ruled that the Savin Corporation failed to show actual dilution and awarded summary judgment to the Savin Group.[64]

In the most widely known case of dilution, in recent years, Ralph Nader was sued by MasterCard.[65] MasterCard had a series of advertisements known as "Priceless" in which a series of goods or services are listed with a price ending with an intangible which cannot be purchased "followed by the word or voice over: 'Priceless. There are some things money can't buy, for everything else there's MasterCard.'"[66] Ralph Nader's advertisements in his run for the Presidency in 2000 were

[55] *Id.*

[56] *Id.*

[57] *Id.* at 1126. Justice Kennedy also concluded that an injunction could still be had on remand if sufficient evidence of blurring or tarnishment were shown. *Id.*

[58] *Id.* at 1125.

[59] Savin Corporation v. Savin Group, No. 02-9377 (SAS), 2003 U.S. Dist. LEXIS 19220, at *3-5 (S.D.N.Y. Oct. 28, 2003).

[60] *Id.* at *4.

[61] *Id.* at *7-8.

[62] *Id.* at *7. Nivas was Dr. Srinivasaragahaven's nickname since college. *Id.*

[63] *Id.* at *8.

[64] *Id.* at *42-45.

[65] Mastercard Int'l Inc., v. Nader 2000, No. 00 Civ. 6068 (GBD), 2004 U.S. Dist. LEXIS 3644 (S.D.N.Y. Mar. 8, 2004).

[66] *Id.* at *2.

similar: "'[G]rilled tenderloin for fund-raiser; $1,000 a plate;' 'campaign ads filled with half-truths[;] $10 million;' 'promises to special interest groups[;] over $100 billion' . . . 'finding out the truth[;] priceless. There are some things that money can't buy.'"[67] The court found that there was no evidence that MasterCard's marks would suffer from negative associations by the use of those marks by Nader.[68] But, more importantly in this case, it also found that Nader's use of the marks was political, not commercial, and, therefore, exempt from the FTDA.[69]

Kellogg, a breakfast cereal producer, had, since 1963, use Toucan Sam, an anthropomorphic cartoon version of a toucan bird, on boxes of "Froot Loops."[70] Toucan Golf, Inc. (TGI), a manufacturer of golf equipment, applied to the United States Patent and Trademark Office (USPTO) to use the mark "Toucan Gold" on golf clubs and putters.[71] Kellogg opposed the application asserting the likelihood of confusion under the Lanham Act and the Trademark and Trial Appeal Board (TTAB) dismissed Kellogg without testimony.[72] Kellogg appealed the TTAB decision *de novo* to the district court[73] and added the claim of dilution under the FTDA.[74] The district court found for TGI because it was highly unlikely that consumers would be confused by similar marks of a business selling cereal and a business of selling golf clubs.[75] The court of appeals found that Kellogg did not show actual dilution, particularly that the consumer's recognition of its senior mark, as it related to Froot Loops, diminished in number after TGI's use of toucan marks for its golf clubs.[76]

Samantha Buck Lundberg owned a coffee house in Astoria, Oregon.[77] In 2002, she changed the name from "Astoria Coffeehouse" to "Sambuck's Coffeehouse."[78] The court found that mere association of "Sambuck's" with "Starbucks" was insufficient for a finding of dilution where Starbucks offered no evidence that the use of the junior mark lessened the capacity of the senior mark in its identification of its goods

[67] *Id.* at *2-3.
[68] *Id.* at *31.
[69] *Id.* at 27-29.
[70] Kellogg Co. v. Toucan Golf, Inc., 337 F.3d 616, 2003 U.S. App. LEXIS 14660 (6th Cir. 2003) at 620.
[71] *Id.* at 621 and 622.
[72] *Id.* at 622.
[73] *See* Kellogg Co. v. Toucan Golf, Inc., No. 4:99-CV-91, 2001 U.S. Dist. LEXIS 14451 (W.D. Mich. Sep. 6, 2001).
[74] *Supra*, note 70, at 622.
[75] *Id.*
[76] *Id.* at 628.
[77] Starbucks Corp. v. Lundberg, No. Civ. 02-948-HA, 2004 U.S. Dist. LEXIS 16141, at *1 (D. Or. Aug. 10, 2004).
[78] *Id.* at *1-2.

and services and distinguishing of those goods and services from other purveyors of the same.[79] In New York, Black Bear Micro Roastery sold special blends of coffee under the names "Charbucks Blend" and "Mister Charbucks"[80] and had annual revenues of less than $200,000 per year[81] versus Starbucks' $2.5 billion.[82] The court found that there was no direct evidence of actual confusion, but, given the proffered evidence by Starbucks, in the form of survey results which indicated a significant association of the junior mark with the senior mark and a significant negative association with coffee associated with the junior mark, concluded that a finder of fact should determine whether the evidence supported the dilution claim, and denied the summary judgment motion of Starbucks on that claim.[83]

The "Windshield Doctor" (junior mark) was sued by the "Glass Doctor" (senior mark) for infringement of a service mark.[84] The similarity of the marks was critical to the likelihood of confusion,[85] but evidence of actual confusion was not readily available because the suit began before the opening of the senior mark store in Los Angeles where the junior mark store was located.[86] The junior mark argued that the senior mark could not get a preliminary injunction because it did not show actual dilution.[87] The court ruled that actual dilution was not required, since "a cause of action for service mark infringement differs significantly both in substance and application to a cause of action for federal trademark dilution."[88]

Caterpillar manufactures and sells heavy equipment used in the construction industry under "Caterpillar" and several other variations of the name which it owns.[89] Disney made "George of the Jungle 2" a sequel to "'George of the Jungle,' a [cartoon] comedy that earned . . . [Disney] . . . $100 million . . . "[90] The movie portrayed George, a thick skulled noble of the jungle, contending with the "evil" machinations of his protagonists, who were trying to destroy Ape Mountain using

[79] *Id.* at *10-11.
[80] Starbucks Corp. v. Wolfe's Borough Coffee, Inc., No. 01 Civ. 5981 (LTS)(THK), 2004 U.S. Dist. LEXIS 19239, at *8-9 (S.D.N.Y. Sep. 28, 2004).
[81] *Id.* at *6.
[82] *Id.* at *4.
[83] *Id.* at *26-27.
[84] Synergistic Int'l, Inc. v. Windshield Doctor, Inc., No. CV 03-579 FMC (CWx), 2003 U.S. Dist. LEXIS 12660 (C.D. Cal. Apr. 28, 2003).
[85] *Id.* at *15-16.
[86] *Id.* at *17-18.
[87] *Id.* at *18.
[88] *Id.* at 18-19.
[89] Caterpillar, Inc. v. Walt Disney Co., 287 F. Supp. 2d 913, 2003 U.S. Dist. LEXIS 18618 (C.D. Ill. 2003) at 915.
[90] *Id.*

Caterpillar bulldozers with genuine trademarks which are unaltered by computer animation.[91] The court held that Victoria's Secret concerned blurring, and the question of tarnishment was left open.[92] But, if the court were to apply the actual dilution requirement to tarnishment, Caterpillar would not likely be able to prove it.[93] Even the argument that the movie portrayed Caterpillar in an insalubrious manner, it was not likely that a viewer of Disney's movie would confuse the fantastic nature of the movie and the movie's use of Caterpillar's bulldozers.[94]

IV. TRADEMARK DILUTION REVISION ACT OF 2006

Most of the cases after *Victoria's Secret* found for the junior mark, and that the senior mark failed to show "actual dilution." Following the mandate of the *Victoria's Secret* Court that actual dilution needed to be proven for the senior mark to benefit from the protection of the FTDA, Congress began to hold hearings to amend the FTDA. The purpose of legal protection of trademark is based on statutory law and does not arise from the Constitution.[95] While trademark law primarily protects the citizen from fraud and mistake, legislation to prevent dilution, in protecting famous marks from blurring and tarnishment, creates a property right in the actual trademark.[96] This protection of economic interest only, then, is a right in perpetuity, potentially, as opposed to copyright or patent which is for a limited period of time.[97] Thus, any whittling away of an economic interest, regardless of how small, would, in its cumulative effect, diminish the public's perception of the strength of the famous mark before it could be shown that there was actual dilution.[98] Once actual harm has occurred, that is, so that it can be shown, the mark would be, most likely, irreversible, and that was not the intent of Congress in passing the FTDA.[99]

The passage of the Trademark Dilution Revision Act (TDRA) changed Section 43 of the Lanham Act as to dilution.[100] Injunctive relief was now

[91] *Id.* at 916 and 917.
[92] *Id.* at 922.
[93] *Id.*
[94] *Id.*
[95] *Trademark Dilution Revision Act of 2005: Hearing Before the Subcomm. On the Courts, the Internet, and Intellectual Property of the H. Comm. on the Judiciary*, 109th Cong. Serial 109-2 (2005) (opening statement of Rep. Berman, Member, House Comm. on the Judiciary).
[96] *Id.*
[97] *Id.*
[98] *Id.*
[99] Patrick Leahy, *Statement Of Senator Patrick Leahy On The Trademark Dilution Revision Act of 2005 (H.R. 683)*, Mar. 08 2006, http://leahy.senate.gov/press/200603/030806e.html.
[100] Trademark Dilution Revision Act of 2006, Pub. L. No. 109-312, 120 Sta. 1730 (2006).

to be had by a famous mark when another used a mark which was "likely to cause dilution." [101] The TDRA clarified questions about dilution by establishing actions for both "dilution by blurring or dilution by tarnishment of the famous mark . . . "[102] and separate sections further defining blurring and tarnishment.[103] The TDRA defined a famous mark as one that "is widely recognized by the general consuming public of the United States as a designation of source of the goods or services of the mark's owner"[104] and delineated four factors to be included in the relevant factors by a court.[105] Previous concerns of lawmakers about the FTDA affecting First Amendment rights were addressed by providing exclusions from the TDRA for comparative advertising, parodying, criticism, or comment;[106] news reporting and commentary;[107] and noncommercial use.[108]

V. CONCLUSION

The required proof of dilution in *Victoria's Secret* was not a secret. It was clear: actual dilution needed to be evidenced. The prior decisions were split on the proof requirement. Victoria's Secret was an attempt to solve the differences in those decisions by requiring that evidence had to be shown which supported the essential element of the violation: harm to the senior mark. "[T]he mere fact that consumers mentally associate the junior user's mark with a famous mark is not sufficient to establish actionable dilution."[109] The FTDA was construed to require that the mental association of the junior mark must necessarily reduce the capacity of the senior mark to identify the goods of the user of the senior mark in the mind of the consumer. The U.S. Supreme Court was unanimous in its decision as to the proof requirement for blurring, but it did leave open that proof which would be required for tarnishment.

The actual consequences of dilution, however, "such as an actual loss of sales or profits,"[110] does not have to be proven. Circumstantial

[101] *Id.* § 2(1)(c)(1).
[102] *Id.*
[103] *Id.* § 2(1)(c)(2)(B) and (C).
[104] *Id.* § 2(1)(c)(2)(A).
[105] *Id.* § 2(1)(c)(2)(A)(i), (ii), (iii), and (iv) (2006). These four factors are: "(i) The duration, extent, and geographic reach of advertising and publicity of the mark, whether advertised or publicized by the owner or third parties; (ii) The amount, volume, and geographic extent of sales of goods or services offered under the mark; (iii) The extent of actual recognition of the mark; (iv) Whether the mark was registered under the Act of March 3, 1881, or the Act of February 20, 1905, or on the principal register." *Id.*
[106] *Supra*, note 100, § 2(1)(c)(3)(A)(i) and (ii).
[107] *Id.* § 2(1)(c)(3)(B).
[108] *Id.* § 2(1)(c)(3)(C).
[109] *Supra*, note 4, at *15.
[110] *Id.* at *14.

evidence would be sufficient where the proof of actual dilution may be inferred. The form that the inferential evidence might take could be survey research, such as that which is used in other cases or the testimony of experts qualified in the field of trademark law, infringement, and dilution. The proof might not be cheap, but it is the purpose of trademark law which is to be served. Although an action for dilution requiring proof of actual harm does not provide an easier remedy than trademark infringement, both dilution and infringement protection can and should exist together to provide the protection necessary for both consumers and competitors in the marketplace. The U.S. Supreme Court not only properly interpreted the intent of the law, but construed the FTDA narrowly enough to indicate the required proof necessary to show dilution of a trademark.

The TDRA, however, overturns *Victoria's Secret*, the showing of actual harm, and returns the federal law on dilution to the original intent of Congress, the showing of likelihood of harm. It does not, however, return it to the split decisions that existed prior to *Victoria's Secret*, a mixture of both actual harm and the inference of harm. The actual harm requirement had its roots in *Ringling Brothers*[111] and blossomed in the U.S. Supreme Court's decision in *Victoria's Secret.*[112] The alternative requirement was the inference of likely harm in *Nabisco*,[113] allowing a remedy before the actual harm occurred and before there was actual proof of harm.[114] It is this inference of likely harm, the likelihood of dilution, which is now the standard of proof under the TDRA.

The TDRA also overturns the decision in *Savin* as to actual harm, which defined a famous mark more broadly as only a mark which is arbitrary and fanciful.[115] Establishing separate actions for blurring and tarnishment clarifies questions previously before the courts prior to *Victoria's Secret*, and removes the differences between the two.[116] The TDRA will shift the direction of dilution questions before the courts to favor the senior marks, in a way that had not existed before. Now, junior marks are on notice: senior mark holders now have a no trespassing sign on and around their mark.

[111] *See* notes 29 and 30, *supra*.
[112] *See* note 49, *supra*.
[113] *See* note 34, *supra*.
[114] *See* note 38, *supra*.
[115] *Supra*, note 59, at *14 and *see* note 100, *supra*.
[116] *See* notes 98 and 99, *supra*.

CONTRACTUAL INDEMNITY CLAUSES: WHO PAYS THE ATTORNEY?

by ANTHONY EONAS* AND JASON PETERSON**

The prototypical contractual indemnity clause might look something like this: *Party A will indemnify and hold harmless Party B from and against all claims, damages, losses and expenses including attorney's fees arising out of or resulting from the performance of the contract, provided that any such claims, damage, loss or expense is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property including the loss of use resulting therefrom; and is caused in whole or in part by any negligent or willful act or omission of Party A.* Nearly every written contract includes a similar clause. However, do we really understand the ramifications of such a provision? For example under what circumstances is Party A responsible for the attorneys' fees incurred by Party B? In this article, we will analyze the relevant case law to guide Massachusetts practitioners around the pitfalls that abound from poorly drafted instruments.

INTRODUCTION

An indemnification clause is "[a] contractual provision in which one party agrees to answer for any specified or unspecified liability or harm that the other party might incur."[1] Indemnity agreements often provide

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[1] BLACK'S LAW DICTIONARY 342 (2d pocket ed. 1996).

contractual protection to the indemnitee to recover "reasonable" attorney fees from the indemnitor.[2] Those drafting such agreements, however, should consider the limited force of indemnity clauses in suits arising between indemnitors and indemnitees.[3] The majority rule seems to hold that indemnity agreements do not provide attorney fees to the indemnitee unless that contractual provision clearly indicates that the provision extends beyond the fees incurred by the indemnitee defending against third-party suits.[4] While no Massachusetts appellate court has ruled on the issue, recent trial court decisions and one First Circuit decision have reached inconsistent conclusions.[5] Thus, those drafting indemnity agreements that will be interpreted under Massachusetts law should take special care to delineate the extent of reimbursement of attorney fees by the indemnitor to the indemnitee.

The first section of this article will briefly explain the relative merits of fee shifting and the general exceptions to the American rule.[6] Next, this article will describe indemnity agreements and the myriad of considerations of attorney fees in indemnification provisions.[7] The next section will explain the case law surrounding indemnitor—indemnitee lawsuits.[8] Finally, the article will suggest that the proper course of action in Massachusetts is for the courts to fall in line with the majority rule that indemnity agreements should contain an indicia of reliability to apply to inter se lawsuits.[9]

[2] *See* Ryan D. Showalter, *Recent Developments: Nassif v. Sunrise Homes, Inc.—Settling the Foundation for Recovery of Attorney's Fees in Implied Indemnity Suits*, 74 TUL. L. REV. 1591, 1594 (2000) ("Generally, attorneys' fees may be recovered in an indemnity action . . . .").

[3] *See infra* notes 48-61 and accompanying text (discussing jurisdictions requiring indicia of reliability for inter se lawsuits).

[4] *See* Hooper Assoc. v. AGS Computers, Inc., 548 N.E.2d 903, 906 (N.Y. 1989) (holding attorney fee clause in indemnity agreement between parties not extended to same parties in litigation). In *Hooper*, the defendant agreed to indemnify the plaintiff for "reasonable counsel fees. *See id.* at 904. Nonetheless, the court held that "attorney fees incurred in litigation between them is contrary to the [American Rule, and] the court should not infer a party's intention to waive the benefit of the rule unless the intention to do so is unmistakably clear." *Id.* at 905.

[5] *See infra* notes 78-120 and accompanying text (discussing opposing Massachusetts case regarding interpretation of indemnity clauses in inter se lawsuits).

[6] *See infra* Section II.

[7] *See infra* Section III.

[8] *See infra* Section IV.

[9] *See infra* Section V.

II. SHIFTING OF ATTORNEY FEES

Traditionally, under the so-called English Rule, the loser within a lawsuit pays the winner's attorney's fees.[10] The loser-pays system takes two forms: in one, the loser pays regardless of whether he is the plaintiff or defendant; in the other, only the prevailing plaintiff may recover attorney fees.[11] By contrast, in the United States, under the American Rule, the litigant is responsible for his expenses regardless of the lawsuit's outcome.[12] "In the United States, the prevailing litigant is ordinarily not entitled to collect reasonable attorneys' fees from the loser."[13] Like most states, Massachusetts has broadly adopted the American Rule.[14]

American courts have developed various exceptions, however, to the prohibition on shifting fees.[15] One exception, and the focus of this article, is fee-shifting based on prior agreement.[16] In most cases, a contractual clause allows the prevailing party in litigation concerning

[10] *See* David A. Root, Note: *Attorney Fee Shifting in America: Comparing, Contrasting, and Combining the "American Rule" and "English Rule,"* 15 IND. INT'L & COMP. L. REV. 583, 590 (2005) (outlining history of loser pay rules in England beginning in 1275). The loser pays rule is justified by the principle that losing provides a fair basis to assess fees and that the winner deserves full compensation. *See id.* at 589. *But see* Thomas D. Rowe, Jr., *The Legal Theory of Attorney Fee Shifting: A Critical Overview*, 1982 DUKE L.J. 651, 651 (1982) (suggesting justification of English rule rests upon providing indemnity to winner rather than punishing loser).

[11] *See* Rowe, *supra* note 10, at 653 n.9.

[12] *See* Alyeska Pipeline Service Co. v. Wilderness Society, 421 U.S. 240 (1975).

[13] *Id.* at 247.

[14] *See* Waldman v. American Honda Motor Co., Inc., 597 N.E.2d 404, 406 (Mass. 1992) (describing usual rule in Massachusetts).

[15] *See* Root, *supra* note 10, at 585. Perhaps the broadest exception occurs when legislators carve out fee-shifting statutes. *See id.* at 588. "[T]here are more than 200 federal and close to 2,000 state statutes allowing the shifting of fees." *Id.* Examples under Massachusetts law include violating an individuals federal and state constitutional rights, retaliating against those residing in long-term facilities that file complaints, and business violating unfair trade practices. *See* MASS. GEN. LAWS ch. 12, § 11I (2000); MASS. GEN. LAWS ch. 19A, § 33A (2000); MASS. GEN. LAWS ch. 93A, § 9 (2000). Additionally, under the bad faith exception, courts may award attorney fees resulting from either opposing counsel or the parties themselves acting in bad faith. *See* Root, *supra* note 10, at 586. Bad faith awards may arise beyond the filing of an unwarranted lawsuit and include misconduct during the lawsuit because the obvious policy consideration is deterring poor behavior in and outside the courtroom. *See id.* Both the common fund and substantial benefit doctrines allow nonparty beneficiaries to share in the litigation costs. *See id.* at 586-87. Under the common fund, often arising in class actions, beneficiaries that are not involved in the litigation absorb the litigation fees. *See id.* The substantial benefit is similar but does not include an actual fund but substantial benefit applies to both non-pecuniary and pecuniary benefits. *See id.* Finally, a lesser-known exception allows a party to collect attorney's fees in enforcing a contempt order. *See id.*

[16] *See* Root, *supra* note 10, at 585.

the contract to recover attorney's fees from the losing party.[17] Based squarely on the principles of freedom of contract, the Massachusetts Supreme Judicial Court has stated: "[U]nder freedom of contract principles, generally, parties are held to the express terms of their contract, and the burden of proof is on the party seeking to invalidate an express term."[18] Courts, however, may choose not to enforce the clause in situations in which the public interest in freedom of contract is outweighed by public policy considerations.[19]

III. INDEMNITY AGREEMENTS

Indemnity may arise under three circumstances under Massachusetts law.[20] Common law indemnity, based on tort principles, arises when a person has committed no wrong, but has nevertheless paid the liability on behalf of a tortfeasor.[21] Massachusetts has long followed common law indemnity principles when a principal or master is compelled to pay for the wrongful acts of his agent or servant even though the principal or master has done no wrong.[22] Common law indemnity does not arise, however, when the indemnitee is partially negligent.[23] Indemnity may also arise under an implied contract basis if such a right may reasonably be inferred from a valid contract.[24] Generally, such implied indemnity arises when there are special factors between the two contracting

[17] *See* Kevin P. Allen, *Contractual Fee-Shifting Clauses—How to Determine "Prevailing Party" Status*, 74 PENN. B. ASS'N Q. 178, 178 (2003). Courts have chosen different criteria for determining the prevailing party. *See id.* at 180. Some have applied the more plaintiff friendly interpretation under statutes interpreting the same issue while others have developed their own criteria. *See id.*

[18] TAL Fin. Corp. v. CSC Consulting, Inc., 446 Mass. 422, 430 (2006).

[19] Beacon Hill Civic Ass'n v. Ristorante Toscano, Inc., 422 Mass 318, 321 (1996) ("[I]t is a principle universally accepted that the public interest in freedom of contract is sometimes outweighed by policy . . . .").

[20] *See infra* notes 21-30 and accompanying text.

[21] *See* Elias v. Unisys Corp., 410 Mass. 479, 482 (1991).

[22] *See* Kabatchnick v. Hanover-Elm Building Corp., 331 Mass. 366, 369 (1954). Massachusetts has limited the application of common law indemnity to personal injury actions. *See* Nicolaci v. Anapol, 387 F.d 21, 27 (1st Cir. 2004) (noting Massachusetts courts not extended common law indemnity to fraudulent transfer).

[23] *See* Rathbun v. Western Massachusetts Elec. Co., 395 Mass. 361, 364 (1985).

[24] *See* Great Atlantic & Pacific Tea Co. v. Yanofsky, 380 Mass. 326, 331-32 (1980) (holding lessor expressly agreeing to repair apartment must indemnify lessee against loss stemming from failure to make repairs); Kelly v. Dimeo, Inc., 31 Mass. App. Ct. 626, 628 (1991) ("[A] contract-based right to indemnification exists only if there is a binding contract between indemnitor and indemnitee in which such right is express *or from which it can be fairly implied*").

parties suggesting an intention of one party to indemnify the other party.[25]

The final circumstance under which indemnity may arise is under an express agreement.[26] An indemnity contract creates a primary contractual relationship whereby the promisor (indemnitor) creates a primary liability to be responsible for the performance of another without ever having direct control of the principal obligations.[27] Some commentators maintain that an indemnity agreement only arises when an indemnitor promises to reimburse the indemnitee after the indemnitee pays a third party.[28] Alternatively, the indemnitor may promise to assume the liability of the indemnitee.[29] In either situation, particularly the former, liability does not extend to the indemnitor until there is a judgment against the indemnitee on behalf of the third party.[30]

Massachusetts courts have held that indemnity agreements are contractual in nature and that courts should construe them with their ordinary and plain meaning.[31] Further, there should no bias towards the indemnitee or towards the indemnitor regardless of the identity of the party that drafted the agreement.[32] Once a right to indemnification has been established, courts should liberally enforce the contractual provisions and should only consider what is included in the provision and not any missing contractual terms.[33] However, "[a] contract should be construed to give it effect as a rational business instrument . . . ."[34] Further, the purpose of the agreement must be ascertained based on the intent of the parties and the sophistication of the contracting parties

[25] *See* Deck v. Black & Decker Mfg. Co., 389 Mass. 35, 38 (1983) (holding sales agreement alone insufficient to infer indemnification of seller buy buyer for injured buyer's employee).

[26] *See* Post v. Belmont Country Club, Inc., 60 Mass. App. Ct. 645, 652 (2004) (holding plain language of indemnity clause indemnified golf club from losses stemming from operation of golf carts).

[27] *See* Kimberly B. Castelez & Eric C. Surette, *Guaranry Contract Distinguished from Other Relationships*, AMERICAN JURISPRUDENCE, SECOND EDITION, May, 2006 at § 14 (contrasting guaranty agreements and indemnity agreements).

[28] *See* JOHN D. CALAMARI & JOSEPH M. PERILLO, THE LAW OF CONTRACTS 656 (4th Ed. 1998). *But see* Eric C. Surette, 41 AM JUR. 2D Indemnity § 1 (2006) ("It should be noted that the term "indemnity" encompasses any duty to pay for another's loss or damage and is not limited to reimbursement of a third-party claim.")

[29] *See* CALAMARI & PERILLO, *supra* note 28, at 656.

[30] *See id.*

[31] *See* Herson v. New Boston Garden Corp., 40 Mass App. Ct. 779, 782-83 (1996) (holding plain language of indemnification clause defeats indemnitee's subsequent negligence and separate contractual insurance provisions).

[32] *See* Agulnick v. American Hosp. Supply Corp., 507 F. Supp. 135, 137 (D. Mass. 1981).

[33] *See id.*

[34] Lewis v. Chase, 23 Mass. App. Ct. 673, 677 (1987).

should be considered in its enforcement of knowingly and voluntarily bargained provisions.[35]

An example of courts not construing indemnity agreements liberally arises when an indemnitee incurs attorneys' fees in defending its own negligence. The U.S. Supreme Court has held that, in order to shift responsibility stemming from the United States' own negligence to one of its contractors, "the mutual intention of the parties to this effect should appear with clarity from the face of the contract."[36] The majority of states seem to indicate that attorney fees are only recoverable if the indemnity agreement expressly addresses situations in which the indemnitor will be liable for the indemnitee's own negligence.[37] While Massachusetts courts have declined to consider the type of allegations against the indemnitee when determining the extent of the indemnitor's coverage, the Massachusetts SJC has noted that "[t]he general rule is that there must be express language creating an obligation to indemnify one against his own negligence."[38]

Another situation in which Massachusetts courts have wrestled over attorneys' fees arises under the *Gamache* exception.[39] Here, courts have allowed an insured to recovery its attorneys' fees when the insured attempts to establish an insurer's duty to defend.[40] Recently, however, the SJC has declined to extend the *Gamache* exception beyond an insurer's duty to defend to its obligation to indemnify the insured.[41] The court reasoned that there are not the same time constraints imposed on indemnity claims compared to the duty to defend.[42] An insured has more to lose through the time delay associated with establishing a duty to defend compared to an obligation to indemnify.[43]

[35] *See* Whittle v. Pagani Bros. Constr. Co., Inc., 383 Mass. 796, 798 (1981); *see also* Dev. Co. v. Turner Constr. Co., 35 Mass. App. Ct. 100, 107-08 (1993).

[36] *See* United States v. Seckinger, 397 U.S. 203, 212 (1970) (upholding indemnity agreement for damages paid to third party according to plain language of contract).

[37] *See* Eric C. Surette, 41 AM JUR. 2D Indemnity § 16 (2006) ("Clauses indemnifying the indemnitee for the indemnitee's own negligence are strictly construed and will not be construed to permit an indemnitee to recover for its own negligence unless the intention of the parties is clearly and unambiguously expressed.").

[38] *See* Rathbun v. Western Massachusetts Elec. Co., 395 Mass. 361, 364 (1985).

[39] *See infra* notes 40-42 and accompanying text.

[40] *See* Preferred Mut. Insur. Co. v. Gamache, 426 Mass. 93, 98 (1997) (holding owner of home owner policy entitled to reasonable attorneys' fee if duty to defend established under policy). The court declined to require a showing of bad faith or vexatious litigation by the insurer. *Id.* at 96.

[41] *See* Wilkinson v. Citation Insur. Co., 447 Mass. 663, 669 (2006) ("While the language used in some of our decisions regarding this exception suggested its broader application . . . we now expressly limit [it] to duty to defend.").

[42] *See id.* at 671. Unlike the duty to defend, indemnification only arises after the insured's liability was established. *See id.*

[43] *See id.*

IV. CASE LAW

The Massachusetts courts provide limited guidance to interpreting the scope of indemnification and ensuing attorneys' fees arising under inter se lawsuits.[44] The few cases addressing the issue are trial court decisions, and the one First Circuit case merely predicts the outcome reached by the Massachusetts SJC.[45] Jurisdictions outside of Massachusetts, however, have addressed the issue more extensively.[46]

A. Jurisdictions Not Supporting Recovery

New York has clearly come down on the side of opposing the recovery of attorneys' fees and may have the most well developed case law in this area.[47] Perhaps the most oft-cited case, both in and outside of New York, is *Hooper Associates v. AGS Computers*.[48] In *Hooper*, the indemnitor contracted to supply computer hardware to the indemnitee.[49] The contract included an indemnity provision providing that the indemnitor would indemnify and hold harmless the indemnitee for "any and all claims, damages, liabilities, costs and expenses, including reasonable counsel fees arising out of . . . [a number of service provisions by the indemnitor]."[50] The indemnitee unsuccessfully sued the indemnitor for breach of contract and sought to recover reasonable attorney fees per the indemnity provision.[51] The court scrutinized the contract in its entirety and determined that other contract provisions were consistent with only protecting claims from third parties.[52] "Construing the indemnification clause as pertaining only to third-party suits affords a fair meaning to

[44] *See infra* Sections IV.c-IV.d.
[45] *See id.*
[46] *See infra* Sections IV.a-IV.b.
[47] *See infra* note 49 and accompanying text.
[48] 548 N.E.2d 903, 903 (N.Y 1989).
[49] *See* Hooper Assoc., Ltd., 548 N.E.2d at 903.
[50] *Id.* at 904.
[51] *See id.*
[52] *See id.* at 905. The indemnity provision specifically provided protection arising out of breach of warranty, performance of any service, and the installation and maintenance of the system. *See id.* The court reasoned that each of the provisions was only susceptible to third party claims and none was within the domain of claims between the parties. *See id.*; *see also* Oscar Gruss & Son, Inc. v. Hollander, 337 F.3d 186, 200 (2d Cir. 2003)("Examining the parenthetical language in light of the surrounding provision, it can apply only to a situation where [the indemnitor] refuses to indemnify [the indemnitee] from a third party action and not to an action commenced by [the indemnitee] against [the indemnitor]). Other clauses consistent with the court's interpretation included a provision requiring notification by the plaintiff to the defendant. *See Hooper Associates*, 548 N.E.2d at 905.

all of the language employed by the parties in the contract and leaves no provision without force and effect."[53]

Even if there is language referring only to claims between the parties, New York courts are reluctant to infer that the parties contemplated reimbursement of attorney fees between the contracting parties.[54] In *Bourne Company v. MPL Communications*, the contractual agreement referenced the breach of covenants, warranties or representations, yet the court nonetheless held that providing indemnification for claims between the parties was not unmistakably clear.[55] The *Hooper* court, however, has seemingly left open the possibility that courts may consider the intent of the parties outside of the indemnity agreement in determining the scope of coverage.[56]

New Jersey courts have interpreted similar indemnity provisions even more narrowly.[57] In *Longport Ocean Plaza v. Cato & Associates*, the indemnitor appealed the lower court's award of attorneys' fees to the indemnitee.[58] The clause at issue broadly indemnified the plaintiff "to the fullest extent of the law."[59] The court, nevertheless, reversed the lower court reasoning that "indemnity" presumes an obligation to a third party typically embodied by a "tripartie relationship."[60] Further, because the contract included a "hold-harmless" provision, the court noted the inconsistency of including that clause in suits arising between two contracting parties, thus further demonstrating an intent to only extend indemnification to liability to third parties.[61]

B. *Jurisdictions Supporting Recovery*

Other jurisdictions infer that an indemnity agreement applies equally to inter se litigation.[62] The Eighth Circuit, interpreting Minnesota law,

53 *See* Hooper Associates, 548 N.E.2d at 905.

54 *See* Bourne Co. v. MPL Communications, Inc., 751 F.Supp. 55, 57 (S.D.N.Y. 1990) (noting *Hooper* court did not consider breach of warranty and representation language).

55 *See id.* at 57-58.

56 *See* Promuto v. Waste Mgmt., Inc., 44 F. Supp. 2d 628, 650 (S.D.N.Y. 1999) (finding summary judgment in favor of plaintiff on attorney fees pursuant to indemnity agreement). "[The] defendants' obligation to indemnify plaintiffs for . . . attorney's fees, associated with an action between the parties 'can be clearly implied from the language and purpose of the entire agreement and the surrounding facts and circumstances.'" *Id.* at 652. *But see* Foster Poultry Farms, Inc. v. Suntrust Bank, 355 F. Supp. 2d 1145, 1154 (rejecting interpretation of *Hooper* in *Promuto v. Waste Management*). "The cases following *Hooper* do not examine 'intent' from the parties 'conduct,' but rather find it, if at all, in the language of the contract." *Id.*

57 *See infra* notes 58-61 and accompanying text.

58 *See* 137 Fed. Appx. 464, 465 (3rd Cir. 2005).

59 *Id.* at 466.

60 *See id.* at 467.

61 *See id.*

62 *See infra* notes 63-77 and accompanying text.

noted that the plain meaning of "indemnity" makes no reference to a limitation of third-party protection.[63] In *Litton Microwave Cooking Products v. Leviton Manufacturing*, the indemnitor manufacturer indemnified a retail seller as part of a purchase order for electrical components prepared by the seller.[64] The circuit court affirmed the lower court's finding that the indemnity agreement was not limited to the recovery of those attorneys' fees incurred in suits against third parties.[65] The court noted that it was construing the contract terms in accordance with their plain and ordinary meaning and that interpreting the provision as the indemnitor argued would "produce the odd result of paying [the indemnitee's] attorney's fees, if, but only if [the indemnitee] waited to be sued by consumers for the damage resulting from the breach of warranty."[66]

The Iowa Supreme Court reached a similar conclusion in *Payne Plumbing & Heating v. McKiness Excavating & Heating*.[67] In *Payne*, both the indemnitee general contractor and the indemnitor subcontractor damaged a pipe during the renovation of a college campus.[68] The lower court found against the application of the indemnification provision because the damages were sought directly by the indemnitee.[69] In reversing, the supreme court dismissed the lower court's reasoning that such an interpretation would effectively make the indemnitor an insurer.[70] Instead, the court broadly interpreted the portion of the indemnity agreement extending coverage to "any and all damage."[71] Further, the court noted the public policy consideration of an interpretation that would illogically encourage the indemnitee to contract to have a third party repair the pipe prior to suing the indemnitor under the agreement.[72]

[63] *See* Litton Microwave Cooking Prod. v. Leviton Mfg. Co., 15 F.3d 790, 796 (8th Cir. 1994) (extracting meaning of "indemnity" from Webster's Dictionary). Indemnity is defined as: "1. a: to secure or protect against hurt or loss or damage; b: to exempt from incurred penalties or liabilities. 2. to make compensation to for incurred hurt loss or damage." MERRIAM-WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY, 1147 (3d ed. 1986).

[64] *See* Litton Microwave Cooking Products, 15 F.3d at 792.

[65] *See id.* at 798. The indemnitee sued the manufacturer for breach of warranty. *See id.* The switches for microwave ovens manufactured by the indemnitor started several fires in the ovens. *See id.* at 792.

[66] *Id.*

[67] 382 N.W.2d 156, 158 (Iowa 1986).

[68] *See id.* at 158.

[69] *See id.* at 160.

[70] *See id.*

[71] *Id.*

[72] *See id.*

In Ohio, a Federal District Court extended the definition of "indemnity" to suits between the contracting parties as well as to those stemming from third party injuries.[73] In *Battelle Memorial Institute v. Nowsco Pipeline Services*, the indemnitor contracted to test its prototype at the indemnitee's facility.[74] An explosion damaged the facility and the indemnitor's tools, and both parties sought recovery from one another.[75] In denying several summary judgment and declatory judgment motions, the court emphasized the similarity of "indemnification" and "reimbursement" and noted that that "reimburse" does not specifically require reimbursement for losses resulting from third parties.[76] "Ohio and Sixth Circuit definitions of indemnification that a party wishing to narrow an indemnification clause to third-party damages is obligated to limit the scope of the clause expressly; and absent such express limitation, indemnification clauses may apply to damage suffered by the contracting parties themselves."[77]

V. MASSACHUSETTS CASE LAW

A. *Massachusetts Case Law Not Supporting Recovery*

Several Massachusetts trial court decisions support the proposition that inter se indemnity provisions are invalid without an express statement extending coverage beyond third parties.[78] In *Petit v. BASF Corporation*, the indemnitee and cross claim plaintiff sued the indemnitor general contractor for attorneys' fees incurred in its defense of a negligence action brought by the general contractor.[79] The broadly drafted agreement between the parties indemnified and held the indemnitee harmless.[80] The court reasoned that in cases in which the parties are in litigation against one another, there is an "obligation upon one to indemnify the other for fees and costs should result only where the indemnity provision *specifically* expresses the intent of the parties

[73] *See* Battelle Memorial Inst. v. Nowsco Pipeline Serv., Inc., 56 F. Supp. 2d 944, 950 (S.D. Ohio).

[74] *See id.* at 946. The indemnitee operated a scientific research testing facility that included an below the surface pipeline used for testing magnetic flux leakage tools used in the gas industry. *See id.* at 945.

[75] *See id.* at 947. One of the indemnitor's flux leakage tools became lodged in the pipe and a fire ignited when the indemnitor introduced a second tool to dislodge the first one. *See id.*

[76] *See id.* at 950.

[77] *Id.* at 951.

[78] *See infra* notes 79-86 and accompanying text.

[79] 2001 Mass. Super LEXIS 124, at *1 (Mass. Super. 2001).

[80] *See* Petit v. BASF Corp., 2001 Mass. Super LEXIS 124, at *1 (Mass. Super. 2001). "[A]ny and all liability, damage, loss, cost, expense (including attorney fees), claim demand suit, action, judgment or recovery . . . ." *Id.* at *3.

to provide for costs thus incurred."[81] Thus, the indemnitee was only entitled to those attorney fees that it incurred in defending against the third party and not those incurred in the cross claim action between the indemnitee and the general contractor.[82]

Further, in *Astrolabe, Inc. v. Esoteric Technology*, the indemnitee plaintiff had contracted for the indemnitor defendant to market and distribute the plaintiff's software.[83] After the indemnitor threatened to terminate the contract, the indemnitee sought a declaratory judgment and the reimbursement of attorneys' fees stemming from that action.[84] In denying the recovery of attorneys' fees, the court pointed to the absence of an express indication that the parties intended the indemnity agreement to cover inter se attorneys' fees.[85] "The parties intended any indemnification rights to arise out of suits from third parties against [the indemnitee] regarding these issues. Paragraph 7 [of the agreement] references only breaches of the Agreement's 'covenants, warranties, and representations' and not each party's obligations under the contract."[86]

In *Great Northern Insurance Company v. Paino Associates*, the Massachusetts Turnpike Authority (MTA), as defendant and indemnitee, sought judgment for the recovery of attorneys' fees in its third party complaint against its independent contractor and indemnitor.[87] The court noted that the agreement was a device to protect the indemnitee from undue liability resulting from the commercial relationship with the indemnitor. Therefore, "analysis of an indemnification agreement ought take into account the presumption against fee shifting, thus requiring an express provision . . . ."[88] "The agreement in question does not overcome a presumption against fee-shifting nor does it convert [the indemnitor] from a commercial indemnitor to a liability insurer."[89]

Additionally, "[u]nless the language of a contract clearly expresses the intent of the parties to provide indemnification for attorneys fees and costs in litigation with one another, there is presumption against

[81] *Id.* at 10 (emphasis added).
[82] *See id.* at 11.
[83] See 2002 U.S. Dist. LEXIS 5764, at *2 (D. Mass. 2002).
[84] *See id.* at *3.
[85] *See id.* at *15.
[86] *Id.* at *16.
[87] See 2006 U.S. Dist. LEXIS 76626, at *2-*3. The MTA also sought recovery against Caliber One. *See id.* at 2. The lawsuit arose after arson destroyed one of the MTA's buildings. *See id.* at *2. The court dismissed the applicability of the *Gamache* exception discussed *supra* after determining that the defend-and-indemnify clause did not render the indemnitor an insurer such that the MTA could recover attorneys' fees for enforcing a duty to defend. *See id.* at *6-*7.
[88] *Id.*
[89] *Id.* at 12.

allowing such a recovery."[90] In *Grant v. Hexalon Real Estate*, a third party defendant indemnitee sued a separate third party defendant indemnitor to recover its settlement costs and attorneys' fees incurred in its defense against the defendant as well as its attorneys' fees incurred in prosecuting the claim against the indemnitor.[91] The court allowed the summary judgment motion permitting recovery for its settlement and defense costs, but denied the attorneys' fees incurred in the claim against the indemnitor.[92] Once again, the court noted the absence of a specific statement requiring the indemnitor to pay the indemnitee's attorneys' in an action brought by the indemnitee against the indemnitor.[93]

Other jurisdictions interpreting Massachusetts law have ruled similarly. For example, the Federal District Court of New Jersey noted that "Massachusetts courts . . . subscribe to the presumption that an indemnification agreement providing for attorneys' fees will not be interpreted to require the reimbursement of attorneys' fees incurred by the indemnitee in an action against the indemnitor to enforce the indemnity agreement unless the language . . . is explicitly clear."[94] In *Shan Industries v. Tyco International*, the two parties had agreed upon indemnification rights within an Asset Purchase Agreement and the indemnitee plaintiff claimed that it was entitled to reimbursement for reasonable attorney fees in enforcing the provision.[95] In granting the indemnitor defendant's motion for summary judgment denying attorneys' fees, the court relied upon two trial court cases in concluding that Massachusetts law was in line with the reasoning in *Hooper*.[96] "[T]his court will not interpret [the agreement] expansively to permit recovery of [the indemnitee's] attorneys' fees incurred in prosecuting the instant action."[97]

[90] *Grant v. Hexalon Real Estate, Inc.*, 1997 Mass. Super. LEXIS 366, at *7 (Mass. Super. 1997).

[91] *See id.* at *2. The plaintiff had been employed by the third party indemnitor when he slipped and fell and suffered a serious head injury. *See id.* The plaintiff sued a number of parties including the building's real estate provider and the service provider in charge of snow and ice removal. *See id.*

[92] *See id.* at *6.

[93] *See id.* at *7.

[94] Shan Industries v. Tyco Int'l 2005 U.S. Dist. 30170, at *24 (D.N.J. 2005).

[95] *See id.* at *5.

[96] *See id.* at *17 (citing Petit v. BASF and FDIC v. Fedders Air Conditioning.; *see also supra* notes 79-82 and accompanying text (discussing *Petit*). *FDIC v. Fedders Air Conditioning* was a Massachusetts case interpreting Illinois law so its relevance is limited. *See Shan Industries*, 2005 U.S. Dist. LEXIS, at *25 (noting district court applied Illinois law).

[97] *See Shan Industries*, 2005 U.S. Dist. LEXIS, at *25.

B. Massachusetts Case Law Supporting Recovery

Alternatively, in *Hill v. Cabot, Inc.*, a Massachusetts Superior Court allowed the indemnitee seller's summary judgment motion ordering the indemnitor buyer to pay the indemnitee's reasonable attorneys' fees and costs.[98] The indemnitor had purchased property from the indemnitee and the indemnitor sued the indemnitee for concealing the presence of hazardous waste.[99] The purchase agreement included an indemnity clause indicating that the "indemnitor is responsible for attorneys fees 'incurred in . . . defending against any litigation . . . arising from . . . the failure of the Premises to conform . . . with standards of environmental quality'".[100] The court noted that the contractual language applied beyond suits brought by a third party.[101] The court's reasoning, however, was merely conclusory and does not cite any supporting case law or precedent.[102]

In *Agulnick v. American Hospital Supply Corp.*, the indemnitee purchased the assets of the indemnitor.[103] Eventually, a party sued both the indemnitor and the indemnitee for patent infringement.[104] The indemnitee cross-claimed for its fees and expenses incurred in its: (1) counter claim against the plaintiff; (2) defense of the counterclaim brought on behalf of the indemnitors; and (3) the cross claim to recover the fees.[105] Relying upon the broad proposition that courts reasonably construe indemnity provisions considering the parties' intentions and circumstances, the court upheld the attorneys' fees.[106]

Perhaps the most comprehensive case is a recent First Circuit decision in *Caldwell Tanks v. Haley & Ward*.[107] In *Caldwell*, the indemnitor manufactured a tank designed by the indemnitee

[98] *See* No. 1994 WL 878954, at *11 (Mass. Super. 1994).

[99] *See id.* at *1. The purchase and sale agreement acknowledged the presence of hazardous material. *See id.* Further, contemporaneously with the closing, the indemnitor acknowledged receiving a number of reports regarding the potential of environmental contamination. *See id.* at *2. While the parties entered a settlement agreement, the indemnitor sued for additional expenses incurred after discovering more hazardous material underneath a tank. *See id.* Ultimately, the court found allowed the indemnitee's summary judgment motion dismissing the indemnitor's claims. *See id.* at *11.

[100] *Id.* at *8.

[101] *See id.*

[102] *See id.* at *8 f.n. 14 (drawing conclusion without supporting case law).

[103] *See* 507 F. Supp. 135, 136 (D. Mass. 1981).

[104] *See id.*

[105] *See id.* at 137.

[106] *See id.*

[107] *See* No. 06-1697 2006 U.S. App. LEXIS 30118 (1st Cir. 2006).

engineering firm.[108] After the manufacturer repaired damages to the tank, it sued a number of parties including the indemnitee for negligent misrepresentation of the design.[109] The indemnitee counterclaimed for protection from all claims pursuant to the indemnity clause.[110] The jury sided with all of the defendants including the indemnitee.[111] The indemnitor filed a motion for judgment notwithstanding the verdict and the indemnitee sought recovery of its attorney fees for its defense of that action.[112]

The trial court judge court found in favor of the indemnitor on the motion for judgment notwithstanding verdict and disallowed the indemnitee's claim for attorneys' fees.[113] The lower court cited two Massachusetts cases and several out-of-state decisions in drawing its conclusion that "there is no right to indemnification of claims between an indemnitor and indemnitee unless the contract expressly contemplates such entitlement."[114] While the court conceded that Massachusetts interprets indemnification agreements broadly, it nonetheless found a narrower standard in the context of indemnitor-indemnitor litigation.[115]

The First Circuit, however, upheld the jury's initial finding and reversed the district court's decision that had eliminated the indemnitee's recovery of attorneys' fees.[116] The court posited the issue as "whether Massachusetts courts have adopted a rule that an indemnity agreement must contain an express statement—that the contract governs costs and attorney's fees incurred by an indemnitee in defense of unsuccessful claims brought by its indemnitor in order to depart form the American rule."[117] In its reversal, the court cited *Cabot v. Hill* in support of its conclusion that there are no special rules requiring an indemnity contract to apply only to third parties in the absence of specific language.[118] Further, the court took the familiar

[108] *See* Caldwell Tanks, Inc. v. Tnemec Co., Inc., 417 F. Supp. 2d 179, 180 (D. Mass. 2006), *rev'd by* No. 06-1697 2006 U.S. App. LEXIS 30118 (1st Cir. 2006).

[109] *See id.*

[110] *See id.*

[111] *See id.*

[112] *See id.*

[113] *See id.* at 183.

[114] *See id.* at 182.

[115] *See id.*

[116] *See* Caldwell Tanks, Inc. v. Haley & Ward, Inc., No. 06-1697 2006 U.S. App. LEXIS 30118, at *26 (1st Cir. 2006). The court noted, however, that it was merely interpreting Massachusetts law and not creating new law. *See id.* at *20. "We lack the authority to establish for Massachusetts new special rules for shifting defense costs under inter se indemnity contracts." *Id.* at *21.

[117] *See id.* at *2-*3.

[118] *See id.* at *14. *See also supra* notes 98-102 and accompanying text.

tactic of referring to the black letter definition of indemnity and noted that it does not refer to a third party.[119] Finally, the court relied on the extensive Massachusetts law establishing that indemnity agreements do not require an "indicia of reliability."[120]

VI. ANALYSIS

Should the Massachusetts SJC have an occasion to establish the necessity of a clear indicia for an indemnitee to recover attorneys' fees in an inter se lawsuit, the court should disregard the First Circuit's decision in *Caldwell*. Instead, the SJC should fall in line with the reasoning of the New York courts in *Hooper* and its progeny. The *Hooper* court decision is more consistent with the general rule against shifting attorneys' fees given Massachusetts case law the court's approach in other areas of indemnification.

Massachusetts courts, like most courts, interpret contracts according to their plain meaning.[121] Because of the ambiguity surrounding whether the plain meaning of "indemnity" encompasses third parties, courts should err on the side of not strictly enforcing the clause because of the general public policy opposing the shifting of attorneys' fees.[122] Perhaps the best example of a Massachusetts court requiring express language in another context is in the context of an indemnitor indemnifying against its own negligence.[123] Further, the SJC has refused to extend the recovery of attorneys' fees incurred in establishing an insurer's obligation to indemnify.[124] This shows the courts deference to the American rule in the context of indemnification.

The reasoning in *Caldwell Tanks* is tenuous at best. The only case on point cited by the First Circuit contained almost no support or reasoning in reaching its decision.[125] Additionally, the court dismisses relevant case law out of hand. Several Massachusetts trial court decisions clearly require an indicia of reliability for the cost of claims brought the indemnitee against the indemnitor.[126] The general proposition and reasoning should be identical to cases in which the indemnitor brings a claim against the indemnitee and the court fails to explain any distinction.

[119] *See id.* at *15. *See also supra* note 63.
[120] *See id.*
[121] *See supra* note 18 and accompanying text.
[122] *See supra* note 19 and accompanying text.
[123] *See supra* note 38 and accompanying text.
[124] *See supra* note 41 and accompanying text.
[125] *See supra* notes 98-102 and accompanying text.
[126] *See* Caldwell Tanks, Inc. v. Haley & Ward, Inc., No. 06-1697 2006 U.S. App. LEXIS 30118, at *18 n.6 (1st Cir. 2006).

VII. CONCLUSION

Overall, while the First Circuit has addressed the issue, its decisions should not deter the SJC from reaching an entirely different outcome. The public policy against shifting attorney fees along with Massachusetts case law suggests that inter se lawsuits should not include attorney fees without a clear indicia of reliability in the indemnification agreement. Instead, the SJC should fall in line with the majority rule as so many states already have.

SECONDARY COPYRIGHT INFRINGEMENT: WHO IS LIABLE?

by WILLIAM E. GREENSPAN*

INTRODUCTION

Consider a hypothetical situation whereby Professor Smith rents out the second floor of his duplex to Jones. Smith lives on the first floor. There is a steady stream of traffic whereby Jones has visitors who come and go, leaving with CDs and DVDs. Apparently Jones is selling counterfeit copyrighted CDs and DVDs, but Smith does nothing because Jones is a quiet tenant who always pays his rent on time.

While teaching his Business Law class, Smith tells his students it is acceptable if they do not purchase the copyrighted textbook for the course because Smith has placed a copy of the textbook on reserve at the library. Smith suggests the students may make copies of the pages assigned for homework in lieu of purchasing the text.

Clearly, Jones and the students who make copies of the text are liable for copyright infringement. They are direct infringers. However, when the copyright owners of the CDs, DVDs, and textbooks discover the facts stated above, they sue Smith for copyright infringement, claiming he is secondarily liable as a vicarious or contributory infringer.

To what extent will Smith be liable for copyright infringement? The answer to this question is of concern to authors, publishers, and the public including internet service providers, software engineers, computer manufacturing companies that provide CD and DVD burners on their

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computers, distributors of unauthorized intellectual property, business entities, and real property owners. Authors seek a fair return for their creative labor. Publishers desire to maximize profits. The public wants easy access to information.

This paper will (1) review relevant statutory law and legislative history relating to direct and secondary liability for copyright infringement, (2) discuss case applications of secondary liability for copyright infringement, (3) recommend tactics on how to avoid secondary liability for copyright infringement, and (4) raise issues for further resolution.

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,"[1] Congress enacted the first copyright law of the United States in 1790. Comprehensive revisions were then made in 1831, 1870, and 1976.[2] "The immediate effect of our copyright law is to secure a air return for the author's creative labor. But the ultimate aim is, by this incentive, to simulate artistic creativity for the general public good."[3] One purpose of copyright law is to create a balance between "the interest of authors ... in the control and exploitation of their writings ... on the one hand, and society's competing interests in the free flow of ideas [and] information on the other hand."[4]

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

Consistent with the ultimate aim and purpose, copyright law has given a person who creates an original[5] work of authorship in a fixed

[1] U.S. Const. Art. I, § 8, cl. 8.

[2] 17 U.S.C. §§ 101 *et. seq.* (2006).

[3] Twentieth Century Music Corporation v. Aiken, 422 U.S. 151, 156 (1975).

[4] Sony Corp. v. Universal City Studios, 464 U.S. 417, 429-30 (1984).

[5] "Original" or "originality" as the term is used in copyright law "means only that the work was independently created by the author (as opposed to copied from other works), and that it possesses at lease some minimal degree of creativity." Feist Publications, Inc. v. Rural Tel. Serv. Co., 499 U.S. 340, 345 (1991). *See* Kay Berry, Inc. v. Taylor Gifts and Bandwagon, Inc., 421 F.3d 199 (3rd Cir. 2005) (holding decorative rocks original sculptural works qualified for copyright protection); Silverstein v. Penguin Putnam, Inc., 368 F.3d. 77 (2nd Cir. 2004) (holding that a publisher's compilation of previously uncollected Dorothy Parker poems was not sufficiently original for copyright protection); Therapeutic Research Faculty v. NBTY, Inc. et. al., No. 2:05-cv-2322-GEB-DAD, 2007 U.S. Dist. LEXIS 8147 (E.D. Cal. Jan. 25, 2007) (holding a publication that includes over 1,100 pharmacist-prepared monographs containing detailed evidence-based information was sufficiently original to be entitled to copyright protection); C.B.C. Distribution & Marketing, Inc. v. Major League Baseball, 443 F.Supp.2d 1077 (E.D. Mo. 2006) (holding baseball player's names and playing records are factual information in the public domain, lacking originality for copyright protection); Le Book Publishing, Inc. v. Black Book Photography, 418 F.Supp.2d 305 (S.D.N.Y. 2005) (holding directories targeted to the "creative

form[6] six exclusive rights, three of which are to do and to **authorize** reproduction of the work in copies,[7] distribution of copies of the copyrighted work to the public by sale or other transfer of ownership,[8] and in the case of audiovisual works, performance of the copyrighted work publicly.[9]

The subject matter of a copyright includes (1) literary works, (2) musical works, (3) dramatic works, (4) pantomimes and choreographic works, (5) pictorial, graphic, and sculptural works, (6) motion pictures and other audiovisual works, (7) sound recordings, and (8) architectural works.[10] Any person who violates any of the exclusive rights of a copyright owner is liable for copyright infringement.[11] The Copyright Act provides various remedies for copyright infringement including injunctive relief,[12] impoundment or destruction of infringing goods or the means to reproduce them,[13] actual damages and any additional profits of the infringer or statutory damages (currently ranging from $200 to $150,000 per violation),[14] and costs and a reasonable attorney's fee to the prevailing party.[15]

B. Secondary Liability for Copyright Infringement

Originally the Copyright Act did not provide for secondary liability. The courts relied on common law tort doctrines. The common law theory for secondary copyright liability was articulated by the U.S. Court of Appeals for the Second Circuit in 1971 in *Gershwin Publishing Corp. v. Columbia Artists Management, Inc.*[16] The court held Columbia Artists secondarily liable for copyright infringement when concert artists performed copyrighted musical compositions at concerts sponsored by

industries," such as those in the business of fashion, advertising, media, and visual production were original compilations entitled to copyright protection); R&B, Inc. v. Needa Parts Manufacturing, Inc., 418 F.Supp.2d 684 (E.D. Pa. 2005) (holding short sequences of five-digit numbers used to identify automotive parts were not copyrightable when dictated by the logic of a numbering system because they lacked the minimal degree of creativity to meet the originality requirement for copyright protection).

[6] 17 U.S.C. § 102(a) (2006).

[7] 17 U.S.C. § 106(1) (2006).

[8] 17 U.S.C. § 106(3) (2006).

[9] 17 U.S.C. § 106(4) (2006).

[10] 17 U.S.C. § 102(a) (2006). "Literary works" are works, other than audiovisual works, expressed in numbers, or other verbal or numerical symbols or indicia, regardless of the nature of the material objects, such as books, periodicals, manuscripts, phonorecords, films, tapes, disks, or cards, in which they are embodied. 17 U.S.C. § 101 (2006).

[11] 17 U.S.C. § 501 (2006).

[12] 17 U.S.C. § 502 (2006).

[13] 17 U.S.C. § 503 (2006).

[14] 17 U.S.C. § 504 (2006).

[15] 17 U.S.C. § 505 (2006).

[16] 443 F.2d 1159 (2nd Cir. 1971).

local community concert associations that Columbia Artists promoted. Columbia Artists was secondarily liable even though it did not itself perform the protected musical compositions.

The court noted two distinct theories of recovery for secondary copyright liability. First, "vicarious" liability: "One may be vicariously liable if he has the right and ability to supervise the infringing activity and also has a direct financial interest in such activities." One may be liable as a vicarious infringer "even though he has no actual knowledge that copyright monopoly is being impaired."[17] Second, "contributory" infringement: "Similarly, one who, with knowledge of the infringing activity, induces, causes or materially contributes to the infringing conduct of another, may be held liable as a contributory infringer."[18]

An example of vicarious liability occurred when a department store was liable for the direct infringing sale of pirated records manufactured and sold by its retailing concessionaire. Even though the department store was not aware of the illegal activity, it retained the ultimate right of supervision over the conduct of the concessionaire and received a percentage of the concessionaire's sales.[19] An example of contributory infringement happened when a court held that "an advertising agency which placed non-infringing advertisements for the sale of infringing records, a radio station which broadcasted such advertisements and a packaging agent which shipped the infringing records could each be held liable as a 'contributory' infringer if it were shown to have knowledge, or reason to know, of the infringing nature of the records."[20]

Currently, when plaintiffs sue defendants for secondary copyright infringement, the plaintiff virtually always alleges both vicarious and contributory infringement. Courts sometimes use the theories interchangeably when determining secondary copyright infringement. Secondary copyright liability encompasses either theory of recovery.

Returning to the exclusive rights of the copyright owner, section 106 of the 1976 Copyright Act states "the owner of copyright under this title has the exclusive right to do AND TO AUTHORIZE any of the following...." The "authorize" reference was added to the 1976 Copyright Act. When this new statutory phrase was added, the House report explained that use of the phrase "to authorize" was intended to avoid any questions as to the liability of contributory infringers:

[17] *Id.* at 1162.

[18] *Id.*

[19] 443 F.2d 1159 at 1162, citing Shapiro, Bernstein & Co., Inc. v. H.L. Green Co., 316 F.2d 304 (2nd Cir. 1963).

[20] 443 F.2d 1159 at 1162, citing Screen Gems-Columbia Music, Inc. v. Mark-Fi Records, Inc., 256 F. Supp. 399 (S.D.N.Y. 1966).

> The exclusive rights accorded to a copyright owner under section 106 are "to do and to authorize" any of the activities specified in the [six] numbered clauses. Use of the phrase "to authorize" is intended to avoid any questions as to the liability of contributory infringers. For example, a person who lawfully acquires an authorized copy of a motion picture would be an infringer if he or she engages in the business of renting it to others for purposes of unauthorized public performance.[21]

The purpose of this amendment was to codify the existing common law theories for secondary copyright infringement. Thus plaintiffs have continued to sue alleged secondary copyright infringers, including cases involving the subject matter of technology that did not exist in 1976.

III. CASE APPLICATIONS ON SECONDARY LIABILITY FOR COPYRIGHT INFRINGEMENT

In *Sony Corp. of America v. Universal City Studios,*[22] the United States Supreme Court laid the groundwork for determining secondary copyright liability. *Sony* was also used as a springboard for a string of cases involving peer-to-peer file sharing of musical compositions on the Internet, leading up to *Metro-Goldwyn-Myer Studios, Inc. v. Grokster, Ltd.*[23]

A. VTRs

Sony is probably on of the most well known decisions in copyright law. In 1984 consumers of the Sony Video Tape Recorder (VTR), as well as Sony, were anxiously waiting for the Supreme Court's decision on whether the sale of Sony's VTR made Sony secondarily liable under the Copyright Act. Since technological change had rendered the Copyright Act ambiguous, the Court considered the purpose and aim of the copyright law: to motivate the creativity of authors, but, more importantly, to allow the public access to these creative efforts. The court ruled the sale of the VTRs to the general public did not constitute contributory copyright infringement. Common sense would dictate that the court had to find for Sony. Otherwise one could argue that the manufactures of printing presses and copying machines would also be secondarily liable for copyright infringement.[24]

The court gave several reasons why Sony should prevail: (1) no employee of Sony "had either direct involvement with the allegedly infringing activity or direct contact with purchasers of Betamax who

[21] H.R.Rep. No. 94-1476, at 61 (1976), reprinted in 1976 U.S.C.C.A.N. 5659, 5674.

[22] 464 U.S. 417 (1984).

[23] 545 U.S. 913 (2005).

[24] 464 U.S. at 430.

recorded copyrighted works off-the-air,"[25] (2) the Betamax was "capable of commercially significant noninfringing uses,"[26] (3) viewers' time-shifting to allow watching a program at a later time "may enlarge the total viewing audience and that many producers are willing to allow private time-shifting to continue, at least for an experimental time period,"[27] and (4) "Betamax could still legally be used to record noncopyrighted material or material whose owners consented to the copying,"[28] Thus the general understanding of *Sony* was that the sale of copying equipment, like the sale of other articles of commerce, does not constitute copyright infringement if the product may be widely used for legitimate, noninfringing purposes.

B. *Peer-to-Peer Music File-Sharing*

Sony set the stage for a series of peer-to-peer, music file-sharing cases on the Internet. Most notably, federal courts of appeals decided *Napster*[29] in 2001, *Aimster*[30] in 2003, and *Grokster*[31] in 2004. All three cases had similar factual situations. The defendants in each case distributed free software that allowed computer users to share electronic music files. Napster facilitated the sharing of music files through a central server, while Aimster and Grokster facilitated this through peer-to-peer networks (directly with each other, rather than through central servers).

In *Napster* and *Grokster* the Ninth Circuit interpreted *Sony* as immunizing from all secondary liability any technology capable of substantial or commercially viable noninfringing use, unless the distributor of that technology had actual knowledge of specific instances of copyright infringement and failed to act upon that knowledge. The Ninth Circuit held *Napster* secondarily liable for copyright infringement because it knowingly encouraged and assisted users to infringe plaintiffs' copyrighted musical compositions. Partial evidence of this was that Napster "promoted the site with screen shots listing infringing files."[32]

[25] *Id.* at 438.

[26] *Id.* at 442.

[27] *Id.* at 443.

[28] *Id.*

[29] A&M Records, Inc. v. Napster, Inc., 239 F.3d 1004 (9th Cir. 2001).

[30] In re: Aimster Copyright Litigation, 334 F.3d 643 (7th Cir. 2003).

[31] MGM Studios, Inc. v. Grokster Ltd., 380 F.3d 1154 (9th Cir. 2004).

[32] 239 F.3d at 1020. Napster is a good example of the power of injunctive relief as a remedy for copyright infringement. Napster was forced into bankruptcy. As a result, the copyright owners sued Bertelsmann and Hummer Windblad to recoup damages on the theory of vicarious and contributory infringement, claiming the defendants supplied Napster with the necessary funding and held significant power and control over Napster's operations. UMG Recordings, Inc. et al. v. Bertelsmann AG, et al., 222 F.R.D. 408 (N.D. Cal. 2004).

On the other hand, the Ninth Circuit held in favor of Grokster because, according to *Sony*, Grokster's product was capable of substantial noninfringing uses and the distributor had no actual knowledge of infringement by users "owing to the decentralized architecture" of the software.[33] Meanwhile in *Aimster* the Seventh Circuit found *Aimster* liable for secondary copyright infringement because it "failed to show its service is ever used for any purpose other than to infringe the plaintiffs' copyrights."[34]

The United States Supreme Court granted certiorari in *Grokster*[35] probably because there was a split between the Seventh and Ninth Circuits. The question before the Court was "under what circumstances the distributor of a product capable of both lawful and unlawful use is liable for acts of copyright infringement by third parties using the product."[36] Answering that question, the Court did not rely on *Sony*. Instead it used an "inducement to infringe" theory: "We hold 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."[37] The Court vacated the judgment of the Court of Appeals and remanded for further proceedings, finding substantial evidence that Grokster committed secondary copyright infringement. Partial evidence of infringement was that Grokster (1) "sent users a newsletter promoting it's ability to provide particular copyrighted materials," (2) confirmed that the "principal object" was use of its software to download copyrighted works, and (3) provided no evidence that it "made an effort to filter copyrighted material from users downloads or otherwise impede the sharing of copyrighted files."[38]

Several commentators have made exhaustive studies on secondary copyrighted infringement, peer-to-peer cases leading up to *Grokster*.[39]

[33] MGM Studios, Inc. v. Grokster, Ltd., 545 U.S. 913, 927 (2005).

[34] 334 F.3d at 653.

[35] MGM Studios, Inc. v. Grokster, Ltd., 543 U.S. 1032 (2004).

[36] 545 U.S. at 918.

[37] *Id.* at 919.

[38] *Id.* at 926. An internet service provider often claims immunity from copyright infringement under the 1998 Digital Millennium Copyright Act (DMCA), 17 U.S.C. § 512, which provides greater certainty to service providers concerning their legal exposure for infringement, giving the service providers "safe harbors" in certain limited circumstances sparing them from penalties for carrying copyright content on the grounds they were innocent conduits. For a summary of the application of the DMCA, *see* Ellison v. Robertson, 357 F.3d 1072, 1076-77 (9th Cir. 2004).

[39] See J. Heath Loftin, *Comment: Secondary Liability for Copyright Infringement: Why the Courts May be Nearing the End of the Line for Imposing Further Liability on Peer-to-Peer Software Distributors*, 37 CUMB. L. REV 111 (2006/2007) (concluding that "between instituting the *Sony* doctrine, with its focus on elements of intent or purpose, the Supreme

When one thinks of secondary copyright liability, one of the first issues that comes to mind is what are the rules when one manufactures or distributes a product capable of lawful and unlawful use? The Supreme Court has somewhat clarified that issue in *Grokster*. However, there are other secondary copyright liability questions not directly related to this issue. The Supreme Court did not overrule *Columbia Artists*. Thus the theories of vicarious and contributory liability enunciated in *Columbia Artists* are still alive and well as evidenced by the following secondary copyright infringement cases discussed below. The bulk of the most recent cases alleging secondary copyright liability roughly fall into four categories: (1) music clubs, retail music stores, and radio stations, (2) instructional teaching materials and photographs, (3) sculptural and architectural works, and (4) computer software and source code.

C. Music Clubs, Retail Music Stores, and Radio Stations

In *EMI April Music v. Know Group*,[40] Taylor and Bryant were the managing members of The Know Group, which owned and operated an entertainment establishment called the Tephejez in Dallas, Texas. Despite repeated warnings from the American Society of Composers, Authors and Publishers (ASCAP) that Tephejez needed to obtain a license from ASCAP to perform copyrighted music, neither Taylor nor Bryant accepted ASCAP's offer. The district court found Taylor and Bryant, as well as The Know Group, vicariously liable for copyright infringement because "Taylor and Bryant had the authority to control Know Group's business and affairs, including managing the infringing activities at Tephejez." Since Taylor and Bryant were also "entitled to participate in the profits of the business" they had a direct financial interest in the infringing activity.[41] In a similar case, *Realsongs v. Gulf*

Court provided a system for imposing liability upon manufacturers responsible for facilitating copyright infringement that takes into goals and purposes of the Copyright Act"); Mark Bartholomew and John Tehrenian, *Article: The Secret Life of Legal Doctrine: The Divergent Evolution of Secondary Liability in Trademark and Copyright Law*, 21 BERKELEY TECH. L.J. 1363 (2006) (laying the groundwork for further study on the imbalance between the trademark and copyright secondary liability); *Matthew Helton, Article: Secondary Liability for Copyright Infringement: BitTorrent as a Vehicle for Establishing a New Copyright Definition for Staple Articles of Commerce*, 40 COLUM. J.L. & Soc. Probs. 1 (2006) (proposing a rule that where a staple of commerce is capable of commercially significant noninfringing uses, an individual or company can avoid secondary liability by showing that the defendant employed "reasonable methods" to prevent copyright infringement).

[40] No. 3:05-CV-1870-M, 2006 U.S. Dist. LEXIS 80967 (N.D. Texas Nov. 6, 2006).

[41] *Id.* at *11. *See also* Van Halen Music v. Edwin T. Palmer, 626 F.Supp. 1163 (W.D. Ark. 1986) (deciding a club owner was vicariously liable for the copyrighted music the club disc jockey played without permission from the copyright owner); KECA Music, Inc. v. Dingus McGee's Co., 432 F.Supp. 72 (W.D. Mo. 1977) (holding Dingus McGee's cocktail

Broadcasting Corp.,[42] a radio station manager was vicariously liable for playing unauthorized music even though he instructed all disc jockeys and station employees not to play ASCAP music.

In another music-related case, two retail music stores purchased and sold approximately 75 copies of improperly labeled CDs containing unauthorized copyrighted music in *Harris v. Thomas*.[43] The retailers claimed they were not involved with any aspect of the manufacturing process of any of the CDs. Nevertheless, the court held the retailers could be held liable for contributory infringement. "Generally an intent to aid or participate is necessary," stated the court. However, a plaintiff "does not have to show the defendant has actual knowledge of the infringing activity; it is sufficient that the defendant have the reason to know that infringement is taking place. In other words, it is sufficient that defendant have constructive knowledge of the infringing activity."[44] These music-related cases demonstrate how secondary copyright liability can arise on either a vicarious (*EMI* and *Realsongs*) or contributory (*Harris*) copyright liability theory.

D. Instructional Teaching Materials and Photographs

In *Pavlica v. Behr*,[45] Robert Pavlica, Ph.D., alleged contributory infringement, contending "defendants (Behr, Wulff, New York Academy of Sciences, and the Researchers Foundations of State University of New York) have each induced infringement of [Pavlica's] copyrights by advising numerous teachers and administrators in various school districts that they were and are permitted to reproduce [Pavlica] copyrighted works, ... and in reliance upon each Defendant's representations, teachers, administrators and personnel in various school districts reproduced [Pavlica's] Copyrighted Works in violation of [Pavlica's] exclusive rights in his Copyright Registrations."[46] The district court ducked the issue by finding there was no proof that any teacher actually copied the materials. Just "because the teachers were told they could copy the material does not mean they did. To be found liable for

lounge and restaurant vicariously liable for copyright infringement even though the musical groups hired by it performed copyrighted musical compositions in direct contravention of specific directions from defendant to perform only original musical compositions).

[42] 824 F.Supp. 89 (M.D. La. 1993).

[43] No. CA 02-0518, 2004 U.S. Dist. LEXIS 23103 (E.D. La. Nov. 15,2004).

[44] *Id.* at *7. *See also* Screen Gems-Columbia Music, Inc. v. Mark-Fi Records, Inc., 256 F.Supp. 399 (S.D.N.Y. 1996) (finding the sale of albums for a price suspiciously below market value was sufficient to allow a reasonable trier of fact to conclude the defendant had constructive knowledge of the alleged infringers activities).

[45] No. 03 Civ. 9628 (DC), 04 Civ. 8152 (DC), 2005 U.S. Dist. LEXIS 29877 (S.D.N.Y. Nov. 29, 2005).

[46] *Id.* at *1.

contributory infringement, there must be proof of actual copying."[47] In other words, for a defendant to be held liable for contributory or vicarious copyright infringement, a direct infringement must have occurred.

In a similar case, freelance photographers claimed defendant, for a profit, facilitated and encouraged copyright infringement by allowing third parties to copy articles that contained plaintiff's photographic images. Since the plaintiff could not identify any third party who copied the photographs, the defendant was not liable for contributory or vicarious copyright infringement. In *Resnick v. Copyright Clearance Center, Inc.*[48] the court held a "defendant is not liable under a contributory or vicarious theory of liability unless plaintiffs show direct infringement by a third party."[49] The outcome may very well have been different in *Pavlica* and *Resnick* if the plaintiffs were able to identify direct, infringing third parties.[50]

E. Sculptural and Architectural Works

In *Societe Civile Succession Richard Guino v. International Foundation for Anticancer Drug Discovery,*[51] Societe owned the copyrights in a set of bronze sculptures. International Foundation permitted Beseder, Inc., a local art gallery, to display and sell several replicas of the sculptures at the "Jewels of the Sea" ball held by International Foundation to raise money for its anti-cancer programs. Since Beseder displayed and sold these replicas without permission from the copyright owner, Beseder was a direct infringer. Nevertheless, Societe sued, among others, International Foundation and its President and Chief Executive Officer, Horn, for contributory and vicarious infringement. Societe claimed Horn had the right and ability to supervise International Foundation's sale of the sculptures, and received direct financial benefit from that transaction.

The court reviewed the requirements for contributory copyright infringement: One who, with knowledge of an infringing activity, induces, causes or materially contributes to the infringing conduct of another, is a contributory infringer. In this case, the court found International Foundation had neither "actual knowledge" nor "reason to know" of Beseder's direct infringement. International Foundation was

47 *Id.* at *4.

48 422 F.Supp.2d 252 (D.C. Mass. 2006).

49 *Id.* at 258.

50 *See, e.g.*, Hotaling v. Church of Jesus Christ of Latter-Day Saints, 118 F.3d 199 (4th Cir. 1997) (noting there was no dispute the defendant had made unauthorized copies and had made the copies available to the public at its library branches).

51 No. CV 06-01540-PHX-NVW, 2006 U.S. Dist. LEXIS 80768 (D. Ariz. Nov. 3, 2006).

an organization focused on advancing anti-cancer programs and had little reason to know Beseder was committing copyright infringement.[52]

The court then reviewed the requirements for vicarious copyright infringement: A defendant is vicariously liable for copyright infringement if he (1) enjoys a direct financial benefit from another's infringing activity and (2) has the right and ability to supervise the infringing activity. In this case the court concluded there was no evidence to prove the International Foundation nor Horn received any direct financial benefit from Beseder's sale of the sculptures. In addition, even though Horn had the right and ability to supervise International Foundation's activities, there was insufficient evidence to show Horn had the ability to supervise Beseder's activities. To sustain a claim of vicarious infringement, the right of supervision must exist between the alleged vicariously infringing defendant (Horn) and the direct infringer (Beseder). Thus the International Foundation and Horn could not be liable for contributory or vicarious copyright infringement.[53]

The opposite result occurred in the case of a copyrighted architectural work, the plans for a house, a Cedar Cove home, created by Beckwith. Depietri expressed an interest in such a home. Depietri visited the model home, and measured the room sizes and layout of the house. Subsequently Depietri asked Beckwith to build a house similar to the Cedar Cove home on Depietri's lot. Although they reached an agreement, Depietri call Beseder a short time later and said he (Depietri) was going in a different direction and was no longer going forward with the agreement. Depietri then hired two other designer/builders—Battle Associates and Wood & Clay - to build the house. In *Beckwith Builders v. Depietri*,[54] Beckwith sued, among others, Battle Associates and Wood & Clay as direct copyright infringers, and Depietri as a contributory infringer. The court found Depietri liable for contributory copyright infringement, mainly because Depietri knew the Cedar Cove home was a copyrighted architectural work, hired Battle Associates and Wood & Clay, and induced their allegedly infringing conduct.[55] The obvious difference between *Societe* and *Beckwith* was "knowledge" or the lack thereof.

F. Computer Software and Source Code

In *QSRSoft, Inc. v. Restaurant Technology, Inc.*,[56] QSRSoft explains that every McDonald's Restaurant has a computer system, an in store

[52] *Id.* at *13-16.
[53] *Id.* at *16-20.
[54] No. 04-cv-282-SM, 2006 U.S. Dist. LEXIS 67060 (D. N.H. Sept. 15, 2006).
[55] *Id.* at *38.
[56] No. 06 C 2734, 2006 U.S. Dist. LEXIS 80729 (N.D. I11. Nov. 2, 2006).

processor (ISP), that stores data about the restaurant's sales performance and status. McDonald's Corporation has approved QSRSoft and Restaurant Technology (RTI) as back-office vendors, meaning that each has access to the data in the ISP. Both QSRSoft and RTI provide software tools to McDonald's Restaurant owners and operators to help each of the franchisees process information more efficiently. Apparently Clutter, President of RTI, as well as Starkey, a shareholder, officer, and director of RTI, convinced a McDonald's franchisee, FAF, to reveal its confidential access code and password to QSRSoft's DotComm copyrighted software. RTI then used the FAF password to access the QSRSoft system and extract information to develop a similar product for McDonald's franchisees. QSRSoft sued Clutter, Starkey, and RTI for direct, vicarious and contributory copyright infringement.[57]

The court denied the defendants' motion to dismiss, explaining there were sufficient facts to find the defendants liable for direct, vicarious and contributory infringement. RTI directly infringed QSRSoft's copyrighted materials in violation of QSRSoft's exclusive right as the copyright owner to reproduce the work in copies. Clutter and Starkey possessed the right and ability to supervise the infringing activities of RTI. Clutter and Starkey had a direct financial interest in RTI's infringing activities. Clutter and Starkey had knowledge of RTI's infringing conduct and actively induced, caused, and materially contributed to the infringing conduct of RTI.[58] *QSRSoft* illustrates a situation where a corporation can be liable as a direct copyright infringer, while it officers and principal shareholders can be secondarily liable as vicarious and contributory infringers.[59]

IV. RECOMMENDED TACTICS ON HOW TO AVOID SECONDARY LIABILITY FOR COPYRIGHT INFRINGEMENT

Having reviewed several cases on secondary copyright liability, it is evident there are three ways a defendant may be liable for copyright infringement: as a direct infringer, as a vicarious infringer, and/or as a

[57] *Id.* at *2 - 6.

[58] *Id.* at *14-16.

[59] *See also*, Airframe Systems, Inc. v. L-3 Communications, No. 05CV 7638 (GBD), 2006 U.S. Dist. LEXIS 64362 (S.D.N.Y. Sept. 6, 2006) (holding defendant not liable for contributory or vicarious infringement for copying software program source code relating to aircraft maintenance and engineering services); NCR Corporation v. The ATM Exchange, Inc., No. 1:05cv383, 2006 U.S. Dist. LEXIS 30296 (S.D. Ohio May 17, 2006) (deciding ATM Exchange could be liable for contributory infringement concerning software and source code for maintaining and servicing Automatic Teller Machine equipment); Monotype Imaging, Inc. v. Bitstream, Inc., 376 F.Supp.2d 877 (N.D. I11. 2005) (finding no contributory copyright infringement in font technology software).

contributory infringer. What steps can one take to avoid being held secondarily liable as a vicarious or contributory infringer?

First, be honest. Get permission from copyright owners before engaging in any activity that would constitute direct, vicarious, or contributory infringement. For example, if a business owner allows a public performance of a copyrighted musical composition at one's establishment, it would cost much less to get a licenses from ASCAP, BMI, and SESAC (music licensing agencies acting on behalf of composers) than to pay damages of up to $150,000 per violation.

Second, if copyright infringement has occurred, be aware that copyright owners will likely target the secondary infringer, rather than the direct infringer. Typically the secondary infringer is the party who has the financial ability to satisfy a judgment against it, whereas direct infringers can be numerous, lacking in financial resources, and sometime anonymous. It is more efficient to pursue the secondary infringer and obtain injunctive relief. The secondary infringer is usually in a position to be able to obtain liability insurance to cover any adverse judgment for damages against it.

Third, if one manufactures or distributes a product that is capable of both infringing and noninfringing uses, the manufacturer or distributor should be sure to only advertise the noninfringing uses of the product. If a party receives an e-mail, letter, phone call or other means of communication that it is facilitating copyright infringement, do not ignore that communication. Investigate. If infringing activity is taking place, make every reasonable effort within one's control to stop the infringing activity. If the activity occurs on a website, develop filtering tools or other mechanisms to diminish infringing activity. In other words, do not be passive; take affirmative steps to prevent copyright infringement.

Finally, do not knowingly induce, cause, or materially contribute to the infringing conduct of another. It is easy to say "I did not know." However knowledge has been defined as actual knowledge or constructive knowledge. If one had reason to know or should have known about the infringing activity, that meets the knowledge requirement.

Going back to Professor Smith in the introduction to this paper, can he honestly convince a court he did not know about the infringing activities of his tenant and his students? Professor Smith could be liable as a vicarious infringer for the illegal activities of his tenant, Jones. Smith had the right and ability to supervise the tenant's activities by terminating the lease. In addition, Smith had a direct, financial interest in the tenant's activities as evidence by the rent collected each month.

Professor Smith could also be liable as a contributory infringer if he knew or should have known students were or would be making copies of the text. Smith induced and materially contributed to the students' direct copyright infringement by placing a copy of the textbook on reserve at the library, and suggesting the students may make copies of the pages assigned for homework in lieu of purchasing the text.

V. ISSUES FOR FURTHER RESOLUTION

One continuing issue, concerning pursuing contributory copyright infringers, is jurisdictional. What if an infringer is operating outside of the United States? United States copyright law does not extend beyond its borders. For example, if a college student is downloading infringing copyrighted music from a website in Madagascar, does a United States court have extraterritorial jurisdiction to hear the case?[60] As a practical matter, a plaintiff may have no other alternative but to sue the direct infringing college student in the United States.

Since the Supreme Court in *Grokster* did not clarify *Sony*, another issue to be resolved is to what extent a product needs to be capable of noninfringing uses to be immune from secondary copyright infringement liability. Likewise, as a result of the inducement rule in *Grokster*, how will courts apply the rule to secondary liability cases that will find defendants liable in appropriate situations without discouraging others from engaging in technological innovations? What standard of "intent" will courts adopt when one is accused of intentionally inducing copyright infringement? It is probably best to let the courts wrestle with these issues for a while before Congress steps in again to amend the Copyright Act.

VI. CONCLUSION

Congress and the courts will continually deal with the challenge of applying existing copyright law to new technological advances, maintaining a balance of interests among the competing interests of copyright owners, publishers, and the public. As one commentator perceptively noted:

> No black flags with skull and crossbones, no cutlasses, cannons, or daggers identify today's pirates. You can't see them coming; there's no warning shot across your bow. Yet rest assured the pirates are out there because today there is plenty of gold (and platinum and diamonds) to be had. Today's pirates operate not on the high seas but on the Internet, in illegal CD factories, distribution centers, and on the

[60] *See*, Zippo Manufacturing Company v. Zippo Dot Com, Inc., 952 F.Supp. 1119 (W.D. Pa. 1997) (establishing personal jurisdiction standards based on defendant's operation of a website).

street. The pirate's credo is still the same—why pay for it when it's so easy to steal?[61]

[61] Bradley D. Spitz, *Note: Cyber-Swashbuckling? The U.S. Copyright Holder's Battle Against Extraterritorial Peer-to-Peer Network Infringement in U.S. Courts will not end with Grokster*, 16 IND. INT'L & COMP. L. REV. 423 (2006) (*citing* Recording Industry Association of America, Anti-Piracy, at http://www.riaa.com/issues/piracy/default.asp (2003)).

EUROPEAN PRIVACY LAW AND THE CONTROVERSY OVER U.S. ACCESS TO EUROPEAN MONEY TRANSFER DATA HELD BY SWIFT

by CARTER MANNY*

INTRODUCTION

On June 23, 2006, the New York Times[1] and the Los Angeles Times[2] ran articles revealing the existence of a secret counterterrorism program, initiated by the United States Treasury shortly after the attacks of September 11, to gain access to financial records in a huge commercial database of international payment transactions. The data came from a European-based business known by the acronym SWIFT (the Society for Worldwide Interbank Financial Telecommunication) which operates the world's largest telecommunications service used by banks and other financial institutions to transmit messages relating to international electronic transfers of money. The newspaper accounts were particularly upsetting to officials in Europe who were concerned that financial transactions of huge numbers of innocent European citizens, including transfers entirely within Europe, were being

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1 Eric Lichtblau and James Risen, *Bank Data Sifted in Secret by U.S. to Block Terror*, N.Y. TIMES, June 23, 2006, at A1.

2 Josh Meyer & Greg Miller, *U.S. Secretly Tracks Global Bank Data*, LOS ANGELES TIMES, June 23, 2006, at A1.

scrutinized by a foreign government contrary to European data protection law which protects privacy as a fundamental human right.[3]

SWIFT's actions, and the actions of the National Bank of Belgium and the European Central Bank, both of which act as overseers of SWIFT, have been reviewed by Belgian and European authorities. The reviews resulted in an opinion issued by the Belgian Privacy Commission in September 2006,[4] an opinion issued by the group of European data protection commissioners known as the Working Party in November 2006,[5] and an opinion by the European Data Protection Supervisor issued in February 2007.[6] This article will consider all three opinions and the status of the controversy surrounding SWIFT as of March 2007.

I. FACTS

SWIFT, based in Belgium, is a cooperative which operates a financial messaging service known as SWIFTNet FIN Service, used by over 7,000 banks, brokerages, stock exchanges and other financial institutions when transferring funds internationally.[7] SWIFT's system transmits payment instructions and does not handle customer funds. The transfer of funds goes through a separate system operated by the Federal Reserve in the U.S. and its counterparts in other countries.[8] Messages sent over SWIFT's system include the names of the parties, account numbers and other information.[9]

[3] *See* Council Directive 95/46, 1995 O.J. (L281) 31 [hereinafter *Data Protection Directive*]. The Data Protection Directive is the primary source of European data protection law and provides a framework for data protection legislation in each of the Member States of the European Union.

[4] Avis Relatif a la Transmission de Données a Caractère Personnel par la SCRL SWIFT Suite aux Sommations de l'UST (OPAC), *available at* http://www.privacycommission.be/communiqué%E9s/ AV37-2006.pdf (last visited Mar. 23, 2007) [hereinafter *Belgian Privacy Commission Opinion.*] An English translation titled *Opinion On the Transfer of Personal Data by the CLSR SWIFT by Virtue of UST (OFAC) Subpoenas* is available through the search engine at the Belgian Privacy Commission's website using the following URL: http://193. 191.208.6/juris/jurfv.htm.

[5] Opinion 10/2006 On the Processing of Personal Data by the Society for Worldwide Interbank Financial Telecommunication (SWIFT), *available at* http://ec.europa.eu/ justice_home/ fsj/ privacy/docs/ wpdocs/ 2006/ wp128_en.pdf (last visited Feb. 19, 2007) [hereinafter *Working Party Opinion WP128.*]

[6] EDPS Opinion on the Role of the European Central Bank in the SWIFT Case, *available at* http://www. edps.europa.eu/ EDPSWEB/webdav/ site/ mySite/ shared/ Documents/ Supervision/ Inquiries/ 07-02-01_ Opinion_ECB_ role_ SWIFT_ EN.pdf (last visited Feb. 19, 2007) [hereinafter *EDPS Opinion*].

[7] Meyer & Miller, *supra* note 2. The New York Times has reported that SWIFT is led by Brooklyn, NY, native, Leonard Schrank. *See* Lichtblau & Risen, *supra* note 1.

[8] Meyer & Miller, *supra* note 2.

[9] Lichtblau & Risen, *supra* note 1.

Founded by a group of European banks in 1973 as the operator of a secure encrypted system to replace the use of telex to send payment instructions, SWIFT currently handles over 11 million messages a day.[10] Although SWIFT is used worldwide, its operations are especially significant in Europe. Over three fifths of its messages are for Europe, while approximately one fifth are for the Americas and the remaining fifth are for locations in the rest of the world.[11] SWIFT has an operations center in Europe and another in Manassas, Virginia, which "mirrors" all data held at the center in Europe.[12] Both centers store messages for 124 days.[13]

Following the terrorist attacks of September 11, 2001, which some leaders of U.S. financial services firms saw as an attack on their industry as well as their country, a Wall Street executive told a Bush administration official about SWIFT's database.[14] That comment is credited with prompting the Bush administration to consider using SWIFT data for counterterrorist purposes, an activity the CIA had proposed in the late 1990s when trying to trace Osama bin Laden's funds. The CIA had planned to use a clandestine operation to gain access to SWIFT's network, but the U.S. Treasury blocked the effort out of concern that it might anger the banking industry.[15]

After September 11, intelligence officials reconsidered a clandestine CIA operation but the proposal was again opposed by the U.S. Treasury, which decided to approach SWIFT directly instead.[16] Another factor in the U.S. Treasury's decision may have been longstanding frustration with delays of several months in obtaining financial records requested from foreign governments through conventional international channels.[17] In issuing subpoenas to obtain data from SWIFT's U.S. operations center, the U.S. Treasury relied upon authority under the International Emergency Economic Powers Act of 1977, an executive order signed by President George W. Bush on September 23, 2001, and U.S. Treasury regulations sanctioning global terrorism.[18]

[10] *Working Party Opinion WP128, supra* note 5, at 10; Meyer & Miller, *supra* note 2.

[11] *Working Party Opinion WP128, supra* note 5, at 7.

[12] Meyer & Miller, *supra* note 2.

[13] *Working Party Opinion WP128, supra* note 5, at 8.

[14] Lichtblau & Risen, *supra* note 1.

[15] Meyer & Miller, *supra* note 2.

[16] Lichtblau & Risen, *supra* note 1.

[17] Meyer & Miller, *supra* note 2.

[18] *See* Legal Authorities Underlying the Terrorist Finance Tracking Program, *available at* http://www.ustreas.gov/press/releases/reports/legalauthoritiesoftftp.pdf (last visited Mar. 18, 2007) (citing the International Emergency Economic Powers Act of 1977, 50 U.S.C. § 1702; Executive Order 13224, 66 Fed. Reg. 49079 (2001); 31 C.F.R. § 594.101, et seq. and 31 C.F.R. § 501.602. An analysis of the legal authority for the subpoenas is beyond the scope of this article.

Although the New York Times article reported that "American officials saw SWIFT as a willing partner,"[19] SWIFT contends that it decided to negotiate with the U.S. Treasury in an attempt to obtain some safeguards for the data rather than challenge the subpoenas in a U.S. court where a decision in the government's favor could mean no safeguards for the data at all.[20] However, it appears that transfers were made for a number of months before the U.S. Treasury implemented safeguards requested by SWIFT. For example, it was not until August 2002 that the U.S. Treasury agreed to provide audits by an independent consulting firm, Booz Allen and Hamilton, to verify that searches were based on intelligence leads about suspected terrorists.[21] In September 2003, the U.S. Treasury provided SWIFT with a letter promising support if governments of other countries and other third parties questioned SWIFT's compliance with the subpoenas.[22] It is not clear when other safeguards were put in place. The additional safeguards include limits on search criteria[23] and review by the U.S. Treasury's assistant secretary for intelligence of requests for access to data.[24] SWIFT was also able to negotiate an arrangement which prevents direct access to its database. When SWIFT receives a subpoena, the data covered by the subpoena are transferred from SWIFT's U.S. operations center to a "black box" owned by the U.S. Treasury, but controlled by two SWIFT officials known as "scrutinizers."[25] The U.S. Treasury then performs focused searches on the data in the "black box."[26] SWIFT's "scrutinizers," are allowed to be present when the data are searched and have the ability to raise objections.[27]

Between September 2001 and June 2006, SWIFT received a total of 64 subpoenas[28] and transferred huge amounts of messaging data to the U.S. Treasury on which tens of thousands of searches were performed.[29] The scope of the subpoenas has been described in one European study as "materially, territorially and in time very wide" in that they demanded data for any transactions which relate or may relate to terrorism, involving specified countries over a specified time period of up

[19] Lichtblau & Risen, *supra* note 1.
[20] *Belgian Privacy Commission Opinion, supra* note 4.
[21] Lichtblau & Risen, *supra* note 1.
[22] *Belgian Privacy Commission Opinion, supra* note 4.
[23] *Belgian Privacy Commission Opinion, supra* note 4.
[24] Meyer & Miller, *supra* note 2.
[25] *Belgian Privacy Commission Opinion, supra* note 4.
[26] *Working Party Opinion WP128, supra* note 5, at 9.
[27] Meyer & Miller, *supra* note 2.
[28] *Working Party Opinion WP128, supra* note 5, at 8.
[29] Meyer & Miller, *supra* note 2 (quoting U.S. Undersecretary of the Treasury Stuart Levey.)

to several weeks.[30] Another study characterized the subpoenas as "non individualized mass requests."[31] The data could involve messages wholly within the EU, as well as ones going to or from the U.S.[32] SWIFT data can be used in "link analysis" to identify people with whom a known terrorist has had financial dealings. However, privacy advocates question the effectiveness of "link analysis" because it can identify innocent people who have had routine financial dealings with terrorist suspects.[33]

Because the existence of the U.S. Treasury's use of the data was secret prior to mid 2006, it is difficult to know how effective the program has been in dealing with terrorist threats. The program has received mixed reviews from government officials interviewed anonymously by the New York Times and the Los Angeles Times for the articles published in June, 2006. Some officials credited analysis of SWIFT data with providing a link that led to the capture in Thailand in 2003 of an al Qaeda operative, Riduan Isamuddin, also known as Hambali, who was believed to have planned the 2002 Bali bombing.[34] They also believe SWIFT data helped identify Usair Paracha, a man living in Brooklyn, New York, who was convicted in 2005 of aiding an al Qaeda operative by agreeing to launder $200,000 through a bank in Pakistan.[35] A supporter of the U.S. Treasury's activities has called SWIFT "the mother lode, the Rosetta stone" for financial data.[36] However, other U.S. officials interviewed felt that the SWIFT program has been only marginally successful against al Qaeda, which long ago switched to informal ways of transferring money, but much more useful in tracking low and mid level operatives in other militant groups including Hezbollah, Hamas and Palestinian Islamic Jihad.[37] Former U.S. Congressman and 9/11 Commission Co-chair Lee Hamilton, who has been briefed on the use of SWIFT data, has stated that he could not point to specific successes of efforts on terrorist financing, although he acknowledged that U.S. intelligence agencies have made significant progress in recent years.[38]

II. SCRUTINY OF SWIFT'S ACTIONS BY EUROPEAN OFFICIALS

Shortly after the publication of newspaper articles, the European Parliament adopted a resolution requesting reports from the EU

[30] *Working Party Opinion WP128, supra* note 5, at 8.
[31] *Belgian Privacy Commission Opinion, supra* note 4.
[32] *Working Party Opinion WP128, supra* note 5, at 8.
[33] Meyer & Miller, *supra* note 2.
[34] Lichtblau & Risen, *supra* note 1.
[35] *Id.*
[36] *Id.*
[37] Meyer & Miller, *supra* note 2.
[38] *Id.*

Member States and EU institutions on the legality of the transfers.[39] The privacy advocacy organization, Privacy International, and others filed complaints with some of the data protection authorities in the Member States.[40] The Belgian Privacy Commission conducted an investigation which resulted in publication of an opinion in September 2006. The group of European data protection commissioners known as the Working Party issued an opinion in November. Because the reasoning in the two opinions is similar, they will be considered together.

A. Controller or Processor?

One significant issue is whether SWIFT is acting as a "controller" or a "processor" under data protection law. The distinction is important because the obligations of controllers are more extensive than those of processors. SWIFT contended that it operates like a telecommunications service provider because it transmits messages between businesses, and therefore should be held only to the low data protection standards of a "processor" under Belgian law and the Data Protection Directive. Both the Belgian Privacy Commission and the Working Party rejected this assertion and concluded that SWIFT has authority to determine the "purpose and means" of processing, which makes it a "controller" under data protection law. Both institutions reasoned that SWIFT determines the "purpose and means" of processing by determining the method of encryption used to transmit the messages securely, by determining the location of SWIFT's data centers and by determining the data protection policy which SWIFT imposes on its users. The data protection officials rejected SWIFT's argument that an organization which transmits messages between businesses can only be a "processor." The officials compared SWIFT's system to networks operated by VISA and Mastercard and to networks used for airline reservations, all of which have been determined to be "controllers" in prior opinions adopted by the Working Party. The Belgian Privacy Commission and the Working Party concluded that the financial institutions who use SWIFT to transmit messages, and SWIFT itself, are co-controllers of the data, because each exercises some authority to determine the "purpose and means" of processing.[41]

An analysis of SWIFT's behavior after receiving the subpoenas from the U.S. Treasury provides even stronger indication that SWIFT was acting as a controller. SWIFT clearly was determining the "purpose and

[39] *EDPS Opinion, supra* note 6, at 1.

[40] *Belgian Privacy Commission Opinion, supra* note 4, at 2.

[41] *See Belgian Privacy Commission Opinion, supra* note 4, at 9; *Working Party Opinion WP128, supra* note 5, at 10.

means" of processing the message data when it secretly negotiated with the U.S. Treasury to establish terms of transfer, the audit process, the use of the "black box" system and the participation of SWIFT "scrutinizers." Moreover, SWIFT was also exercising a type of control when it made the decision not inform the financial institutions that use SWIFT that their customers' data was being transferred to the U.S. Treasury.[42]

B. Violations of Data Protection Law

As a controller, SWIFT has a duty to provide notice of how the data will be used. This duty extends not only to the financial institutions that use SWIFT to send messages, but to the customers of those institutions whose data are being sent. If a bank customer is requesting an electronic transfer of funds, for example, notice of what SWIFT will be doing with the data should be provided to the bank customer at the time he or she orders the transfer.[43] SWIFT failed to provide the notice required by data protection law.

The Belgian Privacy Commission found that the normal functioning of SWIFTNet Fin resulted in a violation of Belgian data protection law with respect to the transfer of messages to be "mirrored" at the operations center in the U.S.[44] In general, transfers of personal data from the EU to countries which lack adequate privacy protection under European standards are prohibited unless one of several exceptions set forth in the Data Protection Directive and in national data protection law permits the transfer. It is well established that U.S. law does not meet the standard of adequacy set forth in the Data Protection Directive.[45]

The Belgian Privacy Commission rejected SWIFT's arguments that the transfers for the purpose of "mirroring" the messages were within exceptions. The transfers to the U.S. were not within the exception for transfers necessary for performance of a contract between the data subject and data controller, because payment instructions could be transmitted through rival payment services available in the

[42] *See Id.*

[43] *See Belgian Privacy Commission Opinion, supra* note 4, at 17; *Working Party Opinion WP128, supra* note 5, at 20.

[44] The Working Party's Opinion WP 128 did not consider the transfer of data to the U.S. except in the context of SWIFT's onward transfer to the U.S. Treasury.

[45] *See Data Protection Directive, supra* note 3, Art. 25. *See also* Issuance of Safe Harbor Principles and Transmission to European Commission, 65 Fed. Reg. 45,666 (2000) (Safe Harbor allow U.S. organizations to qualify for receipt of personal data from Europe by agreeing to provide protection for personal data. Safe Harbor would not be needed if privacy protection in the U.S. met European standards under the Data Protection Directive).

international payment market. In addition, placing an operations center in the U.S. for the purpose of mirroring messages does not satisfy the "important public interest" exception, because the operations center could be located elsewhere, and should be in a country, unlike the U.S., which provides an adequate level of privacy protection.[46] The Working Party considered the same exceptions in the context of the transfers to the U.S. Treasury and came to the same conclusions after performing a very thorough analysis.[47]

Both the Belgian Privacy Commission and the Working Party found numerous problems with SWIFT's transfer of message data to the U.S. Treasury. By "mirroring" all data processing activities in an operations center in the U.S., SWIFT put itself in a situation where it was foreseeable that the data would be subject to U.S. subpoenas.[48] Under Article 6 of the Data Protection Directive, data may not be processed for purposes incompatible with the purpose for which they were collected. Because the message data were collected for commercial purposes, their use for antiterrorism purposes is contrary to Article 6.[49] The Working Party also found that even for the purpose of investigating alleged terrorism, only specific and individualized data should be transferred by SWIFT, and that the transfers should be on a case by case basis in order to comply with the principle of proportionality in the Directive.[50] That was not the situation here where massive amounts of data were transferred.

Both the Belgian Privacy Commission and the Working Party noted the existing legal measures between governments to combat money laundering and terrorist financing. These include measures pursued through the Financial Action Task Force (FATF),[51] the Egmont Group,[52] and processes set forth in a mutual legal assistance agreement signed

[46] *Belgian Privacy Commission Opinion, supra* note 4, at 13.

[47] *Working Party Opinion WP128, supra* note 5, at 23-25.

[48] *Working Party Opinion WP128, supra* note 5, at 15.

[49] *Id.*

[50] *See Working Party Opinion WP128, supra* note 5, at 16. *See also Data Protection Directive, supra* note 3, Art. 6 (providing that processed data must be adequate, relevant and not excessive in relation to the purposes for which they were collected.)

[51] The Financial Action Task force (FATF) is an inter-governmental body, founded in 1989, whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing. *See, e.g.*, http://www.fatf-gafi.org (last visited Mar. 28, 2007).

[52] The Egmont Group is a network of financial intelligence units in 100 countries. In the U.S., the financial intelligence agency which works with the Egmont Group is the Financial Crimes Enforcement Network (FinCEN). *See, e.g.* http://egmontgroup.org/about_egmont.pdf (last visited Mar. 28, 2007). *See also* http://www.fincen.gov (last visited Mar. 28, 2007).

by the EU and U.S. in 2003.[53] Although the Belgian Privacy Commission acknowledged that SWIFT was caught between conflicting requirements of U.S.[54] and European law, it felt that SWIFT should have been more active in pursuing alternative courses of action, considering that the massive amounts of data covered by the subpoenas and the unlimited storage time are contrary to the European data protection principle of proportionality. Instead of negotiating independently and in secret, SWIFT could have attempted to direct the dispute toward existing cooperative procedures to combat money laundering and terrorist financing through the Financial Action Task Force.[55] SWIFT also could have notified European authorities specializing in data protection to consider the effect of European law on mass transfers of personal data. The Belgian Privacy Commission concluded by recommending that the best resolution of conflict between the U.S. need for financial data to combat terrorism, and the requirements of European data protection law, would be to reach an agreement between the European Union and the United States on sharing of financial information similar to the one involving airline passenger data.[56]

III. SCRUTINY OF THE ACTIONS OF CENTRAL BANKS

A. The National Bank of Belgium

In a resolution passed on July 5, 2006, the European Parliament asked the Member States to consider the roles the central banks played in SWIFT's activities.[57] As a cooperative, SWIFT is subject to oversight by the central banks of the G-10 Group which includes the National Bank of Belgium.[58] The central banks in their capacities as overseers were informed in February 2002 of SWIFT's transfer of data pursuant to the subpoenas, and concluded that SWIFT's actions were outside the

[53] *See* Agreement on Mutual Legal Assistance Between the European Union and the United States of America, 2003 O.J. (L181) 34.

[54] The Belgian Data Protection Commission stated that it cannot question the enforceability of U.S. law or the subpoenas. *Belgian Privacy Commission Opinion, supra* note 4.

[55] The Financial Action Task Force is an inter-governmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing. Information about FATF is available at http://www.fatf-gafi.org (last visited Mar. 26, 2007).

[56] *See Belgian Privacy Commission Opinion, supra* note 4, at 26.

[57] *Id.* at 15.

[58] The G-10 Group is composed of the national banks of Belgium, Canada, Germany, France, Italy, Japan, the Netherlands, Sweden, Switzerland and England. The group also includes the European Central Bank and the Federal Reserve System in the U.S. *See EDPS Opinion, supra* note 6, at 5.

scope of their oversight responsibilities.[59] Based upon information supplied by the Belgian central bank, the Belgian Privacy Commission concluded that because oversight is performed from a system perspective to ensure that payments and settlements are functioning properly, the National Bank of Belgium was not determining the purpose or means of processing data, and therefore was not acting as a "controller" under data protection law in its oversight role.[60] Although the Belgian Privacy Commission concluded that the central bank could be a "controller" in its capacity as a user of SWIFT's messaging service, it did not consider whether the National Bank of Belgium might have violated Belgian data protection law as a user.[61]

B. The European Central Bank

In addition to the Data Protection Directive, there is an EU regulation, Regulation 45/2001, which imposes data protection standards for EU institutions.[62] Those standards are monitored by an EU official known as the European Data Protection Supervisor (EDPS).[63] In July 2006, Parliament asked the European Data Protection Supervisor to determine whether the European Central Bank (ECB) was obligated under Regulation 45/2001 to react to the possible violation of data protection law which had come to its attention.[64] In February 2007 the EDPS issued an opinion on the European Central Bank's responsibilities in connection with SWIFT's transfer of data to the U.S. Treasury.[65] Following an analysis consistent with the approaches taken earlier by the Belgian Privacy Commission and the Working Party, the European Data Protection Supervisor considered the European Central Bank's roles in its capacities as an overseer of SWIFT, as a user of SWIFT's messaging service, and as a maker of policy relating to payment systems. Although the EDPS concluded that the ECB was not a "controller" in its capacity as an overseer, the EDPS recommended that the ECB urgently explore and promote solutions to bring compliance with data protection rules within the scope of oversight. The

[59] *See Belgian Privacy Commission Opinion, supra* note 4., at 15. *See also* UK Treasury Knew of US Hunt Through British Bank Data, *available at* http://www.theregister.co.uk/2007/02/16/ swift_htm_ treasury_/ print.html (last visited Mar. 23, 2007).

[60] *See Belgian Privacy Commission Opinion, supra* note 4., at 15

[61] *Id.*

[62] *See generally,* Parliament and Council Regulation 45/2001, 2001 O.J. (L8) 1(on the protection of individuals with regard to the processing of personal data by the Community institutions and bodies and on the free movement of such data)[hereinafter *Regulation 45/2001*].

[63] *See, Id.* Art. 1 (2).

[64] *EDPS Opinion, supra* note 6, at 1.

[65] *See generally, EDPS Opinion, supra* note 6,.

European Data Protection Supervisor labeled the four years of secrecy surrounding SWIFT's actions "regrettable," and called for clarification of rules on oversight and confidentiality that led to the secrecy.[66] The EDPS found the European Central Bank to be a "controller" in its capacity as a SWIFT user, and called for the ECB to explore solutions to make its payment operations fully compliant with data protection requirements as soon as possible.[67] As a policymaker, the European Central Bank should work to ensure that all payment systems used by it and other financial institutions are compliant with data protection law.[68] In closing, the European Data Protection Supervisor recommended that the wide range of existing EU and international measures for fighting crime and terrorism which are already available should be fully exploited before proposing new international agreements.[69]

IV. POSSIBLE OUTCOMES OF THE SWIFT CONTROVERSY

Authority to enforce data protection laws rests with the data protection agencies and prosecutors in each EU Member State. Their enforcement powers include the ability to impose fines and the ability to block transfers of data outside the EU. In December 2006, the Belgian public prosecutor announced that he would not be taking legal action against SWIFT.[70] As of March 2007, there were no indications of enforcement actions in other member states. The lack of enforcement activities is undoubtedly a sign of concern that enforcement could trigger serious economic consequences if the system of international payments were disrupted in any way.

Collectively through the Working Party and individually, however, data protections agencies have urged SWIFT and the financial institutions that use its messaging service to take corrective action, including notice to individual customers that information about their international transfers of funds may be provided to the U.S. Treasury.[71] An official of the British Banking Association has reported that its member banks have written their customers warning them that U.S.

[66] *EDPS Opinion, supra* note 6, at 11.

[67] *Id.*

[68] *EDPS Opinion, supra* note 6, at 12.

[69] *Id.*

[70] *See* US Terrorist Financing Investigations and the Role of SWIFT, *available at* http://www.swift.com/ index.cfm?item_ id=61228 (last visited Feb. 20, 2007).

[71] *See, e.g.*, DPAs Probe Banks Breaches of European Data Laws, 85 PRIVACY LAWS & BUSINESS INTERNATIONAL NEWSLETTER 4 (2006)(reporting that the data protection authorities are in dialogue with the financial institutions in their countries and that the Spanish authority has instructed banks to inform their customers about U.S. Treasury scrutiny of SWIFT transactions).

investigators may be able to gain access to information regarding their international transactions.[72] While notice to data subjects is an important data protection principle, it is not sufficient to provide a basis under the Data Protection Directive for transfers of data to the U.S. Consent of the data subject, however, would provide such a basis.[73] In late January 2007, the European Central Bank announced that when using SWIFT's messaging service, it will seek the consent of data subjects involved in payment transactions by means of an explicit condition in the relevant documentation.[74] It is likely in the short term, at least, that commercial banks and other financial institutions will also attempt to obtain consent from individual customers before making electronic transfers of funds involving SWIFT messaging.[75]

There has been disagreement among European officials on a longer term solution to the SWIFT problem. Calls by some officials for an EU - U.S. agreement on use of financial data for counterterrorism purposes[76] led to the start of negotiations between representatives of the European Commission and the U.S. Treasury in late February 2007.[77] Some members of the European Parliament and people charged with enforcement of data protection principles, however, are concerned that a bilateral agreement may favor the U.S. position and erode European privacy rights.[78] They point to an agreement that allows the U.S. Department of Homeland Security to have access to airline passenger reservation information for flights from Europe to the U.S. as an example of how privacy rights are being diminished. The European Parliament, however, has proposed a transatlantic data sharing

[72] *See* Banks Unleash Paper Tigers Over Terror Data Probe, *available at* http://www.theregister.co.uk/ 2007/03/07bank_probe/print.html (last visited Mar. 23, 2007).

[73] *See Data Protection Directive, supra* note 3, Art. 26(1)(a).

[74] *See* letter dated Jan. 30, 2007, from Jean-Claude Trichet, President of the European Central Bank, to Pervenche Beres, Chairwoman of the European Parliament's Committee on Economic and Monetary Affairs, *available at* http://www.ecb.eu/ pub/pdf/other/ 070130beresswiften.pdf (last visited Feb. 19, 2007).

[75] SWIFT announced in February 2007 that it planned to join the U.S. Safe Harbor program. *See* EU Makes Little Progress in Talks With U.S. On Protections for Probes of Money Transfers, 6 PRIVACY AND SECURITY L. REP. (BNA) 374 (2007).

[76] *See* U.S. Terrorist Financing Investigations and the Role of SWIFT, *available at* http://www.swift.com/ index.cfm?item_id=61228 (last visited Feb. 20, 2007)(reporting that the Prime Minister of Belgium and the President of the European Central Bank had called for EU - U.S. negotiations).

[77] *See* EU Makes Little Progress in Talks With U.S. On Protections for Probes of Money Transfers, 6 PRIVACY AND SECURITY L. REP. (BNA) 374 (2007).

[78] *See, e.g.*, EU Privacy Official Warns About Exchanges By Law Enforcement of Data Across Borders, 5 PRIVACY & SECURITY L. REP. (BNA) 1658 (2006) (reporting warnings by European Data Protection Supervisor Peter Hustinx).

agreement with stronger protections to prevent governments prying unnecessarily into the private lives of ordinary people.[79]

Parliament has gone further and called for SWIFT to end its practice of mirroring message data at its operations center in the U.S.[80] Parliament also noted that other European businesses with operations in the U.S., including banks, insurers and telecommunications companies, should consider ending the practice of sending personal data to the U.S. where it could be reached through U.S. subpoenas.

CONCLUSION

As a company based in Europe with over three fifths of its messaging business involving European transfers, SWIFT should have paid far greater attention to the requirements of European data protection law. There should have been better analysis of the question of whether SWIFT's activities made it a "controller" or "processor." Given the Data Protection Directive's limitations on international data transfers, there should have been better assessment of risks associated with "mirroring" data at an operations center in the U.S. From a data protection perspective, it would be better to do "mirroring" at a second operations center in the EU.

SWIFT management also should have been more cautious in their response to the U.S. Treasury's subpoenas. They should have more fully realized the implications under European data protection law and should have sought advice and assistance from data protection authorities and others in Europe promptly after receiving the subpoenas.

The SWIFT controversy presents broader data protection issues. As with the controversy involving U.S. access to airline passenger reservation data, it appears that U.S. measures for combating terrorism are having the effect of eroding privacy protection for Europeans. While Europeans are being notified of what is happening with their data, in practice they have little choice as to whether that data will be available to U.S. authorities, other than to forego the use of electronic systems for transferring money and to avoid airline travel to the U.S. As the European Parliament fears, other types of banking, insurance and telecommunications data of Europeans may also be vulnerable to U.S. government scrutiny.

Although from the European perspective these sorts of concerns could be addressed by a comprehensive data sharing agreement between the

[79] *See, e.g.,* Europe Demands Say on US Data Trawling, *available at* http://theregister.co.uk/ 2007/02/15/ eu_grabon_ us/print.html (last visited Feb. 23, 2007).

[80] *See* Pull European Data From the US, *available at* http://www.theregiser.co.uk/ 2007/02/15/ US_ retreat/ (last visited Feb. 17, 2007).

EU and the U.S. containing effective limits and protections, recent history shows that such agreements tend to favor the U.S. position and serve to weaken rather than preserve privacy protection for Europeans.

As with a regular LLC, a Series LLC enjoys special legal benefits—limited legal liability, continuity of life, centralized management and readily-transferable ownership interests—which historically were only accorded to corporations. Regular LLCs emerged and spread across the United States between 1977 and 1996. They provided an attractive alternative business organization form because these new hybrids combined the traditional benefits (including taxation advantages) of sole proprietorships and partnerships with the corporate advantage of limited liability.[2]

Another important corporation-like benefit is what might be called the ability-to-multiply. Based on twentieth-century legal developments,[3] corporations became the first business organizations to enjoy the powerful quartet of limited liability, continuity of life, centralized management and readily-transferable ownership interests *in combination with* the ability to charter a network of wholly-owned affiliated business entities (subsidiaries), each of which would ordinarily (if properly incorporated, capitalized and managed) enjoy a completely separate legal identity from the parent corporation (what can be thought of as a vertical affiliation) and also vis-à-vis its brother and sister subsidiaries (what can be thought of as a type of sideways affiliation).[4] Furthermore, each subsidiary corporation in such a corporate network was empowered to charter its own network of wholly-owned vertically- or sideways-affiliated subsidiaries, each of those also enjoying a separate legal identity.

The remarkable privilege of the ability-to-multiply has proven to be every bit as indispensable as the privileges of limited liability, continuity of life, centralized management and readily-transferable ownership interests to the success of modern corporations. For example, the ability-to-multiply privilege has allowed corporations to segregate risk-

[2] The court observed in *In re ICLNDS Notes Acquisition, L.L.C.*, 259 B.R. 289, 292 (Bankr. D. Ohio 2001) "[A]n LLC is neither a corporation or a partnership, as those terms are commonly understood. Instead, an LLC is a hybrid." For an "inside" story behind the emergence of LLCs in the United States as told by a legal scholar who acquired personal knowledge about this development through her work in the Pass-through and Special Industries Division of the Chief Counsel's Office of the Internal Revenue Service (1990-1994), *see* Susan Pace Hamill, *Story of LLCs: Combining the Best Features of a Flawed Business Tax Structure*, BUSINESS TAX STORIES 295, 295-303 (2005).

[3] *See infra* notes 29-34.

[4] "If the sole shareholder is itself a corporation, a parent-subsidiary relationship arises. Two or more subsidiaries of a common parent corporation—siblings—are sometimes called 'brother-sister corporations.'" Harry G. Henn, LAW OF CORPORATIONS §258, at 508 (2d ed. 1970).

taking among affiliated subsidiaries,[5] to limit the reach of state long-arm statutes with respect to assertions of personal jurisdiction,[6] and to redistribute system-wide profits among the subsidiaries both domestically and internationally to minimize federal[7] and state taxation.[8]

Similar to corporations, however, regular LLCs have only been able to enjoy the benefit of the ability-to-multiply by creating separate legal entities, with the attendant paperwork and state registration fees.[9]

[5] For a discussion of the principle of "piercing the corporate veil," including situations in which the fiction of separate legal identities of parent and subsidiary corporations traditionally could be set aside, *see id.* §146 at 250-55. For a critique of the practice of "piercing the corporate veil," *see* Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479 (2001).

[6] In general, the rules for "piercing the corporate veil" in a jurisdictional context appear to parallel the rules applied in a liability context. *See e.g.* Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89 (1985).

[7] 26 U.S.C. § 482 (2007) is designed to control so-called "transfer pricing" among the affiliated units of a multinational corporate network. 26 U.S.C. § 482 also mandates "arms-length" pricing of intra-firm transactions to restrict the transfer of profits out of units of the system located in "high" tax jurisdictions and into units established in "low" or no tax countries. The IRS has promulgated a complex and ever-changing set of "transfer pricing" regulations under § 482; *See e.g.* James R. Mogle, *Transfer Pricing and the Future of International Transfer Pricing: Practical and Policy Opportunities Unique to Intellectual Property, Economic Substance, and Entrepreneurial Risk in the Allocation of Intangible Income*, 10 GEO. MASON L. REV. 925 (2002). In a seemingly never-ending game of cat-and-mouse with multinational enterprises, which employ creative teams of accountants and tax attorneys to find ways to circumvent IRS transfer pricing rules. *See e.g.* Wagdy M. Abdallah & Athar Murtuza, *Transfer Pricing Strategies of Intangible Assets, E-Commerce and International Taxation of Multination*, INT'L TAX J. 5 (March, 22 2006).

[8] Similar tax issues also arise domestically as corporate networks try to shift profits from units in high-tax states to units in low- or no-tax states. *See e.g. Lanco, Inc. v. Director, Div. of Taxation*, 908 A.2d 176 (N.J. 2006) (holding that a corporation doing business in New Jersey cannot use an out-of-state subsidiary to hold patent and trademark rights and collect royalty payments on those rights from the New Jersey company, which then deducts such royalty payments to shield this portion of its profits from state corporate income tax). In an analogous situation, several states including Massachusetts have recently challenged the Wal-Mart practice of having operating store units paying property rents to out-of-state holding company units as a technique for shielding such rent payments from the relatively high corporate taxes in some of the states where stores operate. *See e.g. States Move to Close Tax Shelter That Benefits Wal-Mart, Others*, WALL ST. J., Mar. 7, 2007, at A2.

[9] Regular LLCs can enjoy a corporation-like ability-to-multiply through the use of subsidiary single-member LLCs; but, these lower-tier LLCs carry with them additional fees and state tax filing requirements, which impose expense and paperwork burdens for an LLC wishing to segregate a large number of individual assets, such as hundreds of rental properties. Alternatively, because regular LLCs (as well as limited partnerships, partnerships and trusts) generally have the power to own corporate stock and act as incorporators, it is possible to graft the corporate-subsidiary structure onto the LLC framework. This route, however, entails the costs, formalities, complexities and public disclosures of corporations generally, as well as the associated adverse tax consequences.

Now, a few pioneering states have given statutory authorization to new, modified forms of LLCs that provide for the establishment of designated "series" or "cells" applicable to specified business properties or business operations.[10] In at least certain respects, the series of a Series LLC, also sometimes called "cell LLCs" or "mini LLCs," may closely resemble a set of brother-sister sideways-affiliated corporate subsidiaries, but without the need to create new, separate legal entities.[11] Most of the state statutes authorizing Series LLCs explicitly provide that the debts, liabilities and obligations relating to one series are enforceable only against the assets of that series and not against the assets of the Series LLC generally or the assets of any other individual series,[12] generally similar to the limited liability of a corporate subsidiary.

What is unique about Series LLCs is that they purport to permit one entity to, essentially, infinitely subdivide itself (and the assets/property under its control) into separate entities which are insulated from each other's liabilities without having to jump through the legal hoops of creating new legal entities at the state level. The Series LLC structure

[10] Delaware was the first state to amend its Limited Liability Act in 1996 to permit an LLC agreement to explicitly provide for the establishment of one version of a *series LLC* according to the encompassing Bishop and Kleinberger definition at *supra*, note 10, "a single LLC with segregated assets and liability within a single LLC." *See* 6 DEL. CODE. ANN. § 18-215 (a)—(b) (2007). Several other states followed suit: Illinois in 2005, *see* 805 ILCS 180/37-40 (2005), Iowa in 2006, *see* IOWA CODE § 490A.305 (2006), Oklahoma in 2006, *see* 18 OKL. ST. § 2054.4, Nevada in 2006, *see* NEV. REV. STAT. § 86.291 (2006), Tennessee in 2006, *see* TENN. CODE ANN. § 48-249-30, Wisconsin in 2006, *see* WIS. STAT. § 183.0504 , and Utah in 2006, *see* UTAH CODE ANN. § 48-2c-606 . As discussed in part III, *infra*, however, to date the Illinois series LLC statute goes considerably further than any other toward establishing each series of a series LLC as a separate legal entity. *See e.g.* Colombik & Godfrey, *supra* note 1. Professors Bishop and Kleinberger observe that: "The *series LLC* is to be distinguished from an LLC with simply multiple classes of owners. By way of contrast, a *series LLC* is a single LLC with segregated assets and liability within a single LLC. Like an LLC with a series or multiple classes of owners, a series also has a similar ownership structure. The difference is that, in a *series LLC*, each class of owners separately owns the assets only in a specified series, but has no ownership interest in all of the LLC's assets as a whole". Bishop & Kleinberger, *supra* note 1, at §1.07[1].

[11] *See generally* Bishop & Kleinberger, *supra*, note 1 at §2.11. One California practitioner in this field has called a series LLC "essentially a master LLC that has separate divisions, similar to an S corporation with Q-subs," Debbie Newcomb, *Series LLCs and the FTB*, (2007), *available at* www.seriesllc.net/CalFTB_SeriesLLC_Apr06.pdf. A potentially important distinction can be drawn, however, between a series of a series LLC and brother-and-sister corporate subsidiaries. Whereas brother and sister subsidiaries are affiliated through a common parent company, the series of a series LLC are not necessarily commonly owned and controlled.

[12] *See* Charles T. Terry & Derek D. Samz, *An Initial Inquiry into the Federal Tax Classification of Series Limited Liability Companies*, 9 TAX NOTES 110 (Mar. 6, 2006). *See also* Harris & Despotes, *Limiting Liability Within the LLC: Another Reason to Choose Delaware?*, 5 J. LIABILITY COMPANIES 132 (Winter 1999).

may, therefore, facilitate the infinitely-small segregation of business risks without incurring the double taxation of corporations and while also minimizing paperwork (separate articles of incorporation for each subsidiary; separate annual filings) capitalization requirements, filing fees (original/annual), and public scrutiny. This type of business structure appears to be especially well suited to a modern economy, heavily based on financial and service industries and an ever-expanding electronic commerce component, as opposed to the corporate structure which emerged to serve a now increasingly obsolete bricks-and-mortar economy. For the reasons explained in part III(D) of this article, if the trend toward expanding state authorization and recognition of Series LLCs continues, especially in the advanced form adopted by Illinois in 2005,[13] Series LLCs may prove to be a particularly attractive business organization alternative for a large number of non-public businesses, especially for many start-up businesses[14] and perhaps as well for the recent explosion of private equity buy-outs of publicly-held corporations.[15]

A large number of questions remain open, however, about the legal treatment that will be accorded to a Series LLC in its home state, in other states, and by federal government agencies, particularly the IRS. Among the more intriguing questions are: whether and to what extent the Series LLC structure will be recognized in a state other than the home state; whether the legal standards that have developed with regard to "piercing the corporate/LLC veil" will correspondingly be applied to "piercing the Series LLC veil" for purposes of legal liability and personal jurisdiction; whether states will impose "unitary taxation" rules on a Series LLC; how will Series LLCs be taxed on the federal and state level; and whether a series of a Series LLC can file for bankruptcy on its own.

After background sections briefly summarizing the defining characteristics of corporations and the emergence of the regular LLC hybrid, this article will analyze the still sketchy emerging law regarding Series LLCs and offer some thoughts on how key legal issues might be

[13] *See* note 10 *supra*.

[14] In Stephen B. Presser, *Thwarting the Killing of the Corporation: Limited Liability, Democracy and Economics*, 87 NW. U.L. REV. 148, 155-56 (1992), the author argues that limited liability was originally rooted in a legislative desire to encourage small entrepreneurs with limited financial means to start and grow new businesses.

[15] "Series LLCs could be used to partition large corporate enterprises without triggering the consolidated return regulations, reduce state taxes, skirt the disguised sale rules, or even avoid recognizing gain on sales of assets or entire businesses." Craig A. Gerson, *Taxing Series LLCs*, 45.5 TAX MANAGEMENT MEMORANDUM 1 (Mar. 8, 2004); *see also* J. Cuff, *Series LLCs and the Abolition of the Tax System*, 2 BUSINESS ENTITIES 26 (Jan-Feb. 2000).

resolved. Based on this analysis, this article will also offer a few suggestions about what types of businesses may find the Series LLC structure, if available, preferable to either a corporation or a regular LLC.

II. COMPARING AND CONTRASTING ALTERNATIVE FORMS OF BUSINESS ORGANIZATION

A. *Traditional Forms of Business Organization*

Before the emergence of the LLC hybrid form of business organization, a business enterprise could choose from among seven principal organizational structures:[16] (a) individual (or sole) proprietorship; (b) general partnership; (c) limited partnership; (d) joint-stock association; (e) business trust; (f) corporation; and, (g) professional corporation or association. For federal tax purposes, however, these seven alternatives were subsumed within one of four tax categories:[17] (a) individual; (b) partnerships; (c) Subchapter C corporation; and, (d) Subchapter S corporation.

Of the seven organizational choices without regard to tax considerations, the first five (a)—(e) are unincorporated entities and traditionally were governed by aggregate theory, meaning that the entire enterprise, including its owners, is aggregated and treated as an aggregate for most if not all legal purposes.[18]

Entities governed by aggregate theory do not enjoy limited legal liability. If any part of the aggregate (such as a division or branch office) becomes vulnerable to a creditor attack, for example as the result of a lawsuit, the assets of the entire aggregate, including the personal assets of the owners (sole proprietor or general partners in a partnership), are treated as being available to pay creditor claims.

Furthermore, if there is any change in the ownership interests of an entity governed by aggregate theory, such as if the sole proprietor or a general partner dies or retires, or if a new partner joins the partnership, the original legal entity is terminated and a new legal entity must be created to carry on the business.[19] For a large partnership (and traditionally most law firms, accounting firms and investment banks were organized as partnerships), perhaps including branch offices in

[16] *See* Henn, *supra* note 4, §16, at 36-37.

[17] *Id.*

[18] *Id.*

[19] *See e.g.* Mass. Gen. Laws ch. 108A §31 (1999). Many states have mollified the application of the common law rule terminating partnerships upon the death, disability, bankruptcy or other change in the identity of any of the partners by legislation providing that if at least two of the remaining partners are willing to continue the business as a partnership, they can so elect. *See e.g.* Mass. Gen. Laws ch. 108A §31 (1999).

foreign countries, every change in partnership was an accounting nightmare requiring tallying up the value of the partnership interests of each partner in the old firm, translating the value of foreign assets back into U.S. dollars, drafting and executing a new partnership agreement with the new/continuing partners, and arranging new capital contributions to run the new partnership.

By contrast, corporations were governed by entity theory and thus were treated as legal entities separate and distinct from their owners.[20] Inherent in the corporate form of business organization were certain traditional legal attributes:[21] (a) the power to take, hold, and convey property in the corporate name; (b) the power to sue and be sued in the corporate name; (c) centralization of management; (d) transferability of ownership interests; (e) perpetual succession; and, (f) limited legal liability.

The corporate privilege of limited legal liability meant that creditors of a corporation, after exhausting all of the corporate assets to pay their claims, could not ordinarily go after the personal assets of the owners of the corporation, namely the stockholders.[22] In the case of a parent-subsidiary relationship, limited legal liability meant that creditors of a subsidiary corporation normally would be unable to reach the "deep pocket" of the parent corporation, which owned the stock of the subsidiary, or of the brother and sister subsidiaries.[23]

This corporate attribute thus permitted a corporation to segregate its risk-taking. Particularly risky business ventures, such as a pharmaceutical company marketing a new, potentially risky drug, might thereby be able to insulate the parent company's assets and capital by marketing the new drug through a properly organized and capitalized subsidiary corporation.[24]

[20] *See* Henn, *supra* note 4 §16, at 36-37.

[21] The specific set of legal powers granted to a corporation is a function of the state incorporation law in the state of incorporation. A comprehensive list of typical corporate powers appears in the Model Business Corporation Act. *See* 1969 Model Business Corporation Act § 4 (a)—(r) (3d. 1997 Supp.). *See also* William H. Blackwell, *General Provisions and Corporate Purposes and Powers*, 15 S.C.L. REV. 444 (1962-1963).

[22] *See e.g.* 1984 Model Business Corporation Act § 6.22 (1984).

[23] *See generally Notes: Liability of a Corporation for Acts of a Subsidiary or Affiliate*, 71 HARV. L. REV. 1100-51, 1122-5 (1958); *see also* Henry W. Ballantine, *Separate Entity of Parent and Subsidiary Corporations*, 14 CALIF. L. REV. 12 (1925).

[24] In the 1990s bankruptcy of the Dow Corning Corporation over silicone breast implant litigation, for example, the courts ultimately held that the assets of the two joint-venture corporate partners (Dow Chemical Company, Inc. and Corning Incorporated) could not be reached by plaintiff-litigants). *See e.g. In re Dow Corning Corp.*, 194 B.R. 121 (1996).

Because of the corporate privileges of continuity of life and readily-transferable ownership interests,[25] millions of ownership interests (i.e., shares of stock) in a corporation can change hands (e.g., by trading on a stock exchange) every day, but the corporation continues its legal existence. This is an enormous advantage relative to sole proprietorships and partnerships, and it makes possible the modern system of public equity financing of business enterprise.

While the advantages of limited liability, continuity of life, centralized management and ease of transfer of ownership interests were and remain attractive to businesses, federal tax law imposed a "toll" on these advantages. Since 1913, corporations have been separately taxable entities, subject to federal income tax.[26] No deduction is allowed to a corporation for the amounts paid as a dividend[27] except in limited circumstances.[28] The inability of corporations to claim a deduction for amounts distributed to shareholders as dividends, coupled with the inclusion of those same amounts in the taxable income of the recipient shareholders, is often referred to as "double taxation" of corporate dividends.

B. The Ability-to-Multiply Attribute of Corporations

The corporate privilege of the ability-to-multiply is a corollary of the traditional legal attribute of a corporation's power to take, hold, and convey property in its own name. Historically, a corporation's ability to establish an affiliated subsidiary, much less a network of such subsidiaries, was sharply limited by state law mandates that at least three adult natural persons act as incorporators[29] in creating a corporation.[30] Gradually, more jurisdictions began to permit a single natural person incorporator and, eventually, a corporate incorporator.[31]

[25] Although the corporate privileges of continuity of life and readily-transferable ownership interests are usually treated as independent corporate characteristics, *see e.g. supra* note 20, *infra* note 38, and accompanying text; in practice these characteristics go hand-in-hand and one is typically of relatively little value absent the other.

[26] *See* 26 U.S.C. §11 (1993).

[27] Under 26 U.S.C. §301(c)(1) (2003), shareholders are generally required to include dividends in their taxable income.

[28] For example, under 26 U.S.C. §247 (2005), public utilities may deduct dividends paid on certain preferred stock. Also, under 26 U.S.C. §162(a)(1) (2004), a corporation may deduct amounts paid as "reasonable" compensation to an employee who is also a shareholder.

[29] "Incorporators are the persons who formally incorporate the corporation," Henn, LAW OF CORPORATIONS (1970) §185, at 357.

[30] *Id.* at §131.

[31] *Id.* For example, by 1967, Delaware's corporation law provided that: "Any person, partnership, association or corporation, singly or jointly with others [may serve as an incorporator]," DEL. CODE ANN. §101(a) (1967).

Facilitating this legal evolution was the familiar practice of using "dummy" or "accommodation" incorporators who satisfied applicable qualification requirements where the real party in interest (e.g., an existing corporation) was ineligible to serve as the incorporator.[32]

Although in theory a parent-subsidiary corporate relationship could also be established when an existing corporation purchased all of the stock of another existing, previously unaffiliated corporation, this route was originally blocked by laws and court decisions that prevailed well into the early 1900s which prohibited a corporation from purchasing the shares of stock of another corporation.[33] By the mid-1900s, however, corporation statutes and court decisions began to recognize the power of a corporation to acquire and hold the shares of other corporations.[34] It is the corporate power to acquire and hold shares of stock in another corporation that makes possible the parent-subsidiary relationship. It was also the recognition of this corporate power that led to the emergence of the modern multinational enterprise during the latter half of the twentieth century, provoking a storm of criticism and prompting dire predictions about the future of the nation state which are still debated today.[35] Modern corporate and LLC networks may comprise multiple chains of vertically-affiliated entities in combination with multiple groups of sideways-affiliated entities.

C. The Emergence of Business LLCs

The first legislation authorizing formation of a business LLC in the United States was Wyoming's 1977 LLC statute.[36] Until this time, corporations were the only form of business organization that afforded a business enterprise direct statutory limited legal liability for all of its owners.[37]

Taking advantage of the corporate form of business organization, however, also entailed a number of drawbacks and disadvantages, most

[32] *See e.g.* Henn, *supra* note 29.

[33] *See e.g. Robotham v. Prudential Ins. Co.*, 53 A. 842 (N.J. Ch. 1903).

[34] *See e.g.* R. Stevens, HANDBOOK ON THE LAW OF PRIVATE CORPORATIONS, §17 (2d. ed. 1949). *See also Jamieson v. Chicago Title & Trust Co.*, 371 U.S. 232 (1963) (holding that a 1933 Illinois statute empowering Illinois corporations to deal in shares of other domestic and foreign corporations applied to Illinois corporations incorporated prior to 1933).

[35] For a seminal work on this issue, see generally Raymond Vernon, SOVEREIGNTY AT BAY: THE MULTINATIONAL SPREAD OF U.S. ENTERPRISES (Basic Books 1971). *See also* Richard Barnett & Ronald Mueller, GLOBAL REACH: THE POWER OF THE MULTINATIONAL CORPORATIONS (1974).

[36] *See* Wyoming Limited Liability Company Act, WYO. STAT. § 17-15-101 (1977).

[37] *See generally* Susan Pace Hamill, *The Limited Liability Company: A Possible Choice For Doing Business?*, 41 U. FLA. L. REV. 721, 722-23 (1989). Limited partnerships offer limited liability only to the limited partners; the general partner(s) of a limited partnership remain liable for the debts of the partnership.

notably double taxation of profits at the federal level. Double taxation of corporate profits could be avoided if the entity could qualify for the Subchapter S election in federal tax law, but such S Corporations were subject to cumbersome restrictions—such as a limitation on the number of shareholders;[38] a prohibition against S-Corporation stock being owned by most trusts, other corporations, business entities or even estates;[39] a prohibition against S-Corporation owners who are not U.S. citizens or resident aliens;[40] and a restriction against an S Corporation issuing more than one class of stock[41]—that do not apply to partnerships or other unincorporated business entities.[42]

Accordingly, there was a strong impetus from at least certain business interests to create a new form of business organization that would enjoy the "best of both worlds"[43]—the limited legal liability of a corporation melded with the favorable taxation, formation, and operation rules that applied to a partnership.

Between the passage of the Wyoming LLC statute in 1977 and the early 1990s, even while other states considered authorizing LLCs,[44] federal tax issues dogged LLCs and limited their utility as a business vehicle.[45] In 1960, the IRS issued what became known as the "Kintner regulations,"[46] named after a leading 1954 U.S. Court of Appeals case,[47] to provide guidance on whether a business would be classified as a sole proprietorship/partnership or a corporation for federal tax purposes. Under the Kintner regulations, a business entity that possessed at least three out of four of the characteristics of centralized management,

[38] *See* 26 U.S.C. §1361(b)(1)(A) (2005). S corporations were originally limited to 35 shareholders, which was expanded in 2001 to permit 75 shareholders, and again in 2006 to permit 100 shareholders.

[39] *See* 26 U.S.C. §1361(b)(1)(B) (2005).

[40] *See* 26 U.S.C. §1361(b)(1)(C) (2005).

[41] *See* 26 U.S.C. §1361(b)(1)(D) (2005).

[42] *See generally* James S. Eustice, *Subchapter S Corporations and Partnerships: A Search for the Pass Through Paradigm (Some Preliminary Proposals)*, 39 TAX L. REV. 345 (1983-1984).

[43] *See* Hamill, STORY OF LLCS, at 295 (2005).

[44] *Id.* at 296.

[45] *Id.* at 296-98.

[46] *See* 26 C.F.R. 301.7701-1 (2006), as in effect prior to amendment by 61 F.R. 66584 (1996), which was effective as of Jan. 1, 1997. For earlier U.S. Supreme Court cases articulating what eventually became the "Kintner regulations," *see Morrissey v. Commissioner*, 296 U.S. 344 (1935); *Swanson v. Commissioner*, 296 U.S. 362 (1935); *Helvering v. Combs*, 296 U.S. 365 (1935); and *Helvering v. Coleman-Gilbert Assoc.*, 296 U.S. 369 (1935).

[47] *United States v. Kintner*, 216 F. 2d 418 (9th Cir. 1954). Certiorari was not sought.

continuity of life, transferability of ownership interests, and limited liability would be classified and taxed as a corporation.[48]

It seemed clear under the authorizing statute that Wyoming LLCs did *not* enjoy the corporate benefits of continuity of life or free transferability of ownership interests and, therefore, avoided the corporate tax classification. Nevertheless, it took three years for the IRS to issue a private letter ruling conceding that a Wyoming LLC qualified for partnership taxation under its regulations.[49] At substantially the same time, the IRS threatened to reverse itself on this very point by floating regulations proposing to base corporate taxation exclusively and conclusively on whether an unincorporated entity enjoyed the single characteristic of limited liability under state law.[50]

After widespread criticism, however, the IRS withdrew the proposed rulemaking in 1983 and announced instead that it would study the question of what impact limited liability should have on taxation of a business entity.[51] Over the next ten years, LLC growth continued to be stymied by such tax uncertainty: fewer than 100 Wyoming LLCs were organized,[52] and only Florida, in 1982, joined Wyoming in enacting LLC legislation.[53] Not until 1988 did the IRS issue a revenue ruling finally conceding that a Wyoming-type of LLC would be taxed as a partnership even though this entity enjoyed limited liability.[54] This belated ruling also reaffirmed that, under the long-standing "four characteristics" test set out in the partnership classification regulations, each of the characteristics would be accorded equal weight.[55]

Once the IRS had confirmed partnership tax status for Wyoming-type LLCs, the movement to adopt similar legislation in other states began to pick up steam, at first haltingly, then in a rush. In 1990, Colorado and Kansas joined the club; in 1991, Virginia, Utah, Texas and Nevada came onboard; and, between 1992 and 1996, LLC legislation swept

[48] The IRS applied the Kintner regulations to early LLCs, eventually codifying these rules at 26 C.F.R. 301.7701-2 (2006). This led to some very creatively drafted LLC agreements as lawyers struggled to reconcile their clients' desires to enjoy as many corporation-like benefits as possible without incurring federal taxation as a corporation.

[49] *See* I.R.S. Priv. Ltr. Rul. 81-06-082 (Nov. 18, 1980).

[50] *See* 45 Fed. Reg. 75, 710 (1980) (codified at 36 C.F.R. pt. 301).

[51] *See* Hamill, STORY OF LLCS, at 295, note 7 (2005).

[52] *See* Susan Pace Hamill, *The Limited Liability Company: A Catalyst Exposing the Corporate Integration Question*, 95 MICH. L. REV. 393, 402, n. 46 (1996).

[53] *See* Florida Limited Liability Company Act, 1982 FLA. LAWS 82-177 (Apr. 21, 1982).

[54] Rev. Rul. 88-76, 1988-2 C.B. 360.

[55] *Id.* Because the Wyoming LLC statute did not accord the characteristics of continuity of life and free transferability of interests to LLCs, these entities strongly resembled the classic general partnership. *See e.g.* Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L. J. 1459, 1469-70 (1998).

the-Box" rules in 1997 afforded U.S. businesses a much welcomed flexibility in choosing a suitable organizational structure.[68] Still, the restrictive corporate model of the ability to multiply, requiring the creation of separate legal entities in order to effectively segregate risk-taking within an enterprise, remained a serious limitation for some types of businesses. If it were somehow possible to segregate risk-taking within a business with minimal additional costs and paperwork, more efficient and targeted capital allocations would be achievable. This capability could be especially useful for small, start-up businesses.

In 1996, Delaware took the lead in becoming the first state to enact Series LLC legislation.[69] A few other states soon followed.[70] The Series LLC statute passed by Illinois in 2005 is regarded by many in the field to represent the most advanced Series LLC legislation to date.[71]

The Illinois Series LLC statute is the first to specifically provide that each series of a Series LLC may independently contract, hold title to assets, grant security interests, sue and be sued, and otherwise conduct business and exercise the powers of a limited liability company.[72] By contrast, the Delaware Series LLC statute only states that assets and liabilities are segregated for each series of a Series LLC, but is silent on a series being a separate legal entity for ownership purposes or for purposes of suing or being sued.[73]

B. *Overview of Legal Principles Applicable to Series LLCs*

The several Series LLC statues contain a number of important requirements that must be kept in mind when considering this form of business organization.[74] In general, the state enabling statutes provide that the "...debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to a particular series shall be enforceable against the assets of such series only, and not against the assets of the limited liability company generally, or any other series thereof...."[75] In order to achieve this desirable goal, however, the statutes generally impose three requirements. First, the limited liability operating agreement must permit the establishment of separate series and must provide that the assets of each separate series

[68] *See generally* Hamill, STORY OF LLCS (2005).
[69] *See supra* note 13.
[70] *Id.*
[71] *See e.g.* Colombik & Godfrey, *supra* note 1.
[72] *Id.*
[73] *Id.*
[74] *Id.*
[75] Compare 6 DEL. CODE. ANN. § 18-215 (a)—(b) (2007) with 805 ILCS 180/37-40 (b) (2005).

shall not be subject to the debts or obligations of any other series.[76] This requirement can be met through proper drafting of the Series LLC Agreement. Second, notice of the separate liability of each series must be publicly available.[77] Generally, this requirement is met by including a statement that the LLC is authorized to establish separate series and that the individual series are not liable for the debts and obligations of the other series or of the LLC as a whole on the certificate forming the LLC that is filed with the applicable secretary of state's office.[78]

The third requirement concerns the operation of the LLC and its series, the statutes typically providing that "...separate and distinct records..." must be maintained for each series, and the assets associated with each such series must be reflected on those separate records and be accounted for separately.[79] This requirement has proven troublesome to administer since most Series LLC enabling statutes, other than Illinois', do not specify whether a separate series of an LLC is authorized to contract, sue or take title to property in its own name rather than in the name of the LLC as a whole.[80] Consequently, practitioners often resort to using nominees to take title to assets on behalf of a series of a Series LLC. Only Illinois' LLC statute specifically provides that "(e)ach series ... may, in its own name, contract, hold title to assets, grant security interests, sue and be sued and otherwise conduct business and exercise the powers of a limited liability company under the Act."[81] Practitioners are also concerned that clients will not keep separate books and records and that such failure will lead courts to breach the liability compartmentalization of a Series LLC.

Despite the seemingly broad cross-liability shield between series contemplated by statute, a number of common situations are likely to arise in which that shield will be breached. The use of guarantees, indemnification agreements, mortgages, pledges and similar contractual obligations have long been used to regulate the liability of multiple parties for a single debt or obligation. Nothing in any of the current Series LLC statutes would prohibit a lender from, for instance, requiring the separate series of an LLC, and/or the members of each such series, to guarantee the debt of a particular series, especially where all of the series were owned by the same group of members.

Although most LLCs can elect under the "Check-the-Box" regulations to be taxed either as a disregarded entity or partnership (depending on

[76] *Id.*
[77] *Id.*
[78] *Id.*
[79] *Id.*
[80] *Id.*
[81] *Id.*

the number of members) or as a corporation, it is less clear whether the separate series of a Series LLC will be treated as separate entities for tax purposes. Among knowledgeable commentators, there is general agreement as to the possible options: (i) taxing the various series of a Series LLC as a single entity; (ii) treating each series as a separate partnership or sole proprietorship, depending on the number of members of such series; and (iii) taxing the Series LLC as if it were a single entity with different types of interests, as one would treat a special allocation partnership (where the items of income and expense of the partnership are allocated among the members according to their interests in the specific series, rather than pro rata) or a corporation with multiple classes of stock.[82]

The current starting point for an analysis of the proper tax treatment of Series LLCs (having more than one member) is 26 CFR §301.7701-1, which provides that in order to be treated as a separate entity for tax purposes, an organization must: (i) be an "entity" that is "separate and distinct from its owners";[83] and (ii) be a "business entity."[84] These determinations are a "...matter of federal tax law [that] does not depend on whether the organization is recognized as an entity under local law."[85] The seeming clarity of these regulatory distinctions is muddied, however, by the example that co-owners who merely maintain and lease apartments in an apartment building, or who share expenses to dig a common drainage ditch on their properties, have not created a separate entity for tax purposes, while co-owners of an apartment building who provide services to the occupants in addition to leasing space have created a separate entity.[86] While intertwined, the legal concepts of "entities" and "business entities" are distinct, and both tests must be met. Generally, an entity exists where the economic relationship between the owners and their assets has been altered, either by law when the assets are assigned to the enterprise in exchange for stock or membership interests or by contract between the parties.[87] According to the regulations, business entities are distinguished from trusts, the purpose of which is to take title to property for the purpose of protecting or conserving it for beneficiaries.[88]

Thus, a Series LLC where each series merely leases commercial real estate under a triple-net lease and does not provide the tenant with any services in connection with the lease could well be properly treated as an

[82] *See e.g.* Stephens & Schultz, *supra* note 1 and Mooney, *supra* note 1.
[83] 26 C.F.R. 301.7701-1(a) (2006).
[84] 26 C.F.R. 301.7701-2(a) (2006).
[85] 26 C.F.R. 301.7701-1(a) (2006).
[86] 26 C.F.R. 301.7701-1(a)(2) (2006).
[87] *See generally* Mooney, *supra* note 1.
[88] 26 C.F.R. 301.7701-4(a) (2006).

aggregate of co-owners for federal tax purposes, while a different Series LLC where the separate series were all intertwined in a single activity or in several common activities could be treated as a single entity with multiple classes of members if each of the series have separate owners. But, what would be the tax result in the case of two co-owners each owning 50% of "Series A", which owns a building leased under a triple net lease and 50% of "Series B", which operates a fast food restaurant? Would "Series A" be treated as a non-entity for tax purposes and "Series B" treated as an entity, or would both series be amalgamated into a single entity? These and other questions remain unanswered under current law.

C. *Unsettled Legal Issues Relating to Series LLCs*

1. *Liability Shield Issues*

In general, LLCs in a vertically-affiliated chain of regular LLCs enjoy a liability shield comparable to or perhaps even better than that accorded to units of a vertically-affiliated chain of parent-subsidiary corporations.[89] In the case of a wholly-owned parent-subsidiary corporate relationship, there is only a one-way liability shield: a liability of one unit of a vertically-affiliated corporate system puts at risk the assets of all of the units in the chain below the liable unit.[90] "Piercing the veil" in such a vertically-affiliated chain has traditionally been narrowly limited to situations involving fraud, undercapitalization relative to business needs, co-mingling of assets and/or management, and the failure to maintain separate financial records.[91]

Whether courts will recognize a liability shield between the individual series of a Series LLC, however, remains an open question. The statutory language of both the Delaware[92] and the Illinois[93] Series LLC

[89] *See generally* James R. Cambridge, *Piercing the Veil of a Michigan Limited Liability Company* (unpublished working paper); John C. Murray, *'Piercing the Corporate Veil' of a Limited Liability Company*, *available at*, ABA RPPT Electronic Publication (2002), available at, www.abanet.org/rppt/publications/edirt/2002/2002-2/art-murray.pdf; Stanford A. Graham, *The Myth of Corporate Veil Protection: Are Your Assets at Risk?*, Bullet Proof Veil, Compliance Management and Insight, Inc. (2002), *available at*, http://www.bulletproofveil.com/pdf/whitepaper.pdf.

[90] Thus, one advantage that LLCs have over corporations is the protection of the entity's assets from lawsuits against the LLC members by means of the "charging order." By contrast, a corporation offers liability protection (for shareholders) only from a lawsuit directed against the entity. Ownership interest in a corporation is not protected in a lawsuit against a shareholder.

[91] *See e.g. Lumax Indus. v. Aultman*, 669 A. 2d 893 (Pa. 1995).

[92] 6 DEL. CODE. ANN. § 18-215 (b) (2007) provides that if certain formalities are satisfied, "then the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to a particular series shall be enforceable against the assets of such

statutes provide that brother-sister series are shielded from one another's liabilities, and the Series LLC is insulated from the liabilities of its series. But, there have been no court cases thus far to indicate whether even the home courts of the respective Series LLC states will fully honor that liability shield and, if so, under what conditions and with what limitations. It is still more problematic whether the courts of other states that do not themselves have Series LLC statutes will honor the liability shield between the series of another state's Series LLCs.[94]

Even assuming that courts recognize some type of liability shield between the series of a Series LLC, the strength of that shield is uncertain. The members of a Series LLC, if properly established and managed, should in theory be entitled to a liability shield comparable in strength to that of the units of a vertically-affiliated chain of regular LLCs, including the advantage over a corporate system of enjoying a *two-way* shield between brother-sister members.[95] But, organizationally, the series of a Series LLC may be seen as bearing a stronger resemblance to sideways-affiliated brother-sister corporate subsidiaries than to a vertically-affiliated chain. Based on this analogy, it could be argued based on so-called "enterprise liability" theories that the sideways liability shield of a Series LLC is more vulnerable than the shield for a vertically-affiliated chain.[96] It is too early to say whether the members of a Series LLC will be treated by the courts comparably to a vertically-affiliated chain or to a sideways-affiliated chain, assuming the liability shield between series is respected at all.

series only, and not against the assets of the limited liability company generally or any other series thereof...."

[93] 805 ILCS 180/37-40 (b) (2005) contains a recitation almost identical to that of Delaware's Series LLC statute; *see supra* note 92.

[94] . In *Series LLCs: A Great Idea ... But Not for You*, Business Advisor Report (March 2006), *available at*, www.reish.com/publications/article_detail.cfm?ARTICLEID=578, Stephen Halper comments on how a Delaware Series LLC will be treated in California observes: "There is no assurance that California courts will respect the liability shield purportedly afforded by series LLCs." This skepticism was expressed even taking account of California's (regular) LLC Act (CAL. CORPS. CODE §17450 1996), which provides that "the laws of the state ... under which a foreign limited liability company is organized shall govern...."

[95] *See* Geoffrey Christopher Rapp, *Preserving LLC Veil Piercing: A Response to Bainbridge*, 31 IOWA J. CORP. L. 1063, 1081, n. 121 (Summer 2006).

[96] In the often-cited case of *Walkovszky v. Carlton*, 223 N.E. 2d 6 (N.Y. 1966), the sole shareholder of 10 corporations, each owning and operating two taxicabs, was found not to be operating a single business despite the commingling of financing, supplies, taxi repairs, employees and garaging. *See generally* A.B. Atkins, *The Impact of the Growth of Enterprise Liability on the Theory of Damages in Accident Cases*, 20 LA. L. REV. 50 (1959-1960); and *Should Shareholders Be Personally Liable for the Torts of Their Corporations?*, 76 YALE L. J. 1190, Comment (1967).

A question related to, but not controlled by, the state liability shield issue is whether and to what extent the insolvency of one series of a Series LLC will impact other series and the Series LLC generally.[97] Because bankruptcy courts operate under the federal Bankruptcy Code, state legislation and court decisions recognizing a separate legal identity for each series of a Series LLC may carry some weight in a bankruptcy proceeding but may not be conclusive.[98] Based on the recent bankruptcy court treatment of regular LLCs,[99] however, a series of a Series LLC organized under a statute such as that of Illinois (that clearly defines each series as a separate legal entity) is more likely to be treated as a separate entity for bankruptcy purposes.[100]

2. Personal Jurisdiction Shield Issues

In the context of the familiar parent-subsidiary corporation relationship, the principles of "piercing the veil" today are reasonably well-settled.[101] For corporations, there is no material distinction between "piercing the veil" for liability and personal jurisdiction purposes. If the separate legal identities of parent and subsidiary can be disregarded for liability purposes, the "doing business" activities of one will also bring the other within reach of a state long-arm statute.[102] Similar rules would seem to apply to a vertically-affiliated chain of regular LLCs.[103] "Piercing the veil" in either case remains relatively uncommon.[104]

Because only a handful of states currently have Series LLC statutes, however, and because so many questions persist about the extent to which the supposed liability shield between brother-sister series will be recognized, certain unique problems relating to the interaction of a liability shield and a jurisdiction shield may arise.

For example, a Series LLC organized under Illinois law may comprise series A, B and C. Series A operates exclusively in Illinois and cannot

[97] *See e.g.* Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036 (1991).

[98] *Id.*

[99] *See e.g.* Robert B. Thompson, *The Limits of Liability in the New Limited Liability Entities*, 32 WAKE FOREST L. REV. 1 (1997). *See also* In re: KRSM Properties, LLC, 318 B.R. 712, 44 Bankr. Ct. Dec. (CRR) 17, Bankr. L. Rep. (CCH) P 80216, 94 A.F.T.R.2d 204-7281 (B.A.P. 9th Cir. 2004) (holding that a California limited liability company, whose only members were two people married to each other is nevertheless a separate legal entity eligible to be a debtor in bankruptcy, and relying on state law to assist in making that determination where federal bankruptcy law is silent).

[100] *Id.*; *supra* note 97.

[101] Jacob Stein, *Tax Tips: Advanced Asset Protection and Tax Planning with LLCs*, 29 LOS ANGELES LAWYER 17, 20, n. 26 (June 2006).

[102] *See supra* note 7.

[103] *See e.g.* Rapp, *supra* note 95, Thompson, *supra* note 97, and Thompson, *supra* note 99.

[104] *Id.*

fairly be said, based on its own activities, to have the minimum contacts with any other state needed to constitutionally support long-arm jurisdiction. On the other hand, series B and series C qualify to do business and, indeed, carry on business in California, which thus far does not have its own series LLC legislation.

Under these circumstances, if series C incurred an unsatisfied judgment in California, it would not be entirely surprising for the California courts to ignore the sideways liability shield between series B and series C and allow series C's judgment creditors to collect the unsatisfied portion of the judgment against the assets of series B. A more interesting question, however, is whether the California courts could constitutionally ignore the supposed jurisdictional shield between brother-sister series of this Series LLC in order to also reach the assets of series A.

If the judgment creditor tried to enforce its California judgment in Illinois against series A, the Illinois courts would presumably respect the liability shield between brother-sister members of an Illinois Series LLC and deny enforcement. But, if California can bring series A within the reach of its long-arm statute based on the in-state business activities of series B and series C, then the assets of series A might also be at risk. This uncertainty could force a Series LLC to limit the business activities of its several series to only those states that clearly recognize the liability shield between series.

At this point, there is no case law addressing these Series LLC jurisdictional issues. As in the previous discussion of liability shield issues, the jurisdictional shield issues may also be strongly influenced by whether the Series LLC structure is seen as more analogous to a vertically-affiliated chain or to a sideway-affiliated chain which could expose the Series LLC to an "enterprise liability" argument.

3. *Tax Shelter / Transfer Pricing Issues*

Another question troubling many practitioners is how the series of a Series LLC will be treated for federal and state tax purposes. Under the current check-the-box classification rules, a Series LLC is allowed to file a single unified federal tax return, but it is not yet clear whether each series can alternatively elect to be taxed as a separate entity.[105] The complex Sec. 482 transfer pricing issues that arise in connection with multinational corporate enterprises[106] would not be a problem here because each series of a state-chartered Series LLC would be a domestic taxable entity. But, the pooling of different series' profits and losses

[105] *See supra* notes 82-88 and accompanying text. *See also* Terry & Samz, *supra* note 12.

[106] *See supra* note 7.

could perhaps still be used to shelter profits from federal taxation. For example, if a Series LLC has two series, one of which always reports a profit and the other a loss, will the Series LLC be permitted to continue to file a single federal tax return such that the profits of one series are canceled out by the other's losses resulting in little or no tax liability?

In addition, intra-series financial transactions could also be used to try to shelter a portion of a Series LLC's overall profits from state taxation. A state could conceivably find itself in a financial Catch-22 in deciding whether to treat the individual series of a Series LLC as separate legal entities or as part of a single unitary enterprise.

For example, the California Franchise Tax Board (FTB) has been struggling to establish the appropriate approach to taxation and fee assessments for Series LLCs.[107] Initially, the FTB allowed a Series LLC with a plurality of series registered or operating in California to pay one state franchise tax and one LLC annual tax for all of the California-registered series, and to file one Form 568 Liability Company Return of Income. But, in 2005, in a transparent effort to protect fee revenues, the FTB reconsidered its position and decided to treat each series of a Series LLC as a separate entity requiring separate payments of an $800 franchise tax, separate annual LLC fees, and separate state tax returns in most situations.[108]

One year later, however, state officials reversed direction and began to slowly back away from the hard line position of treating each California-registered series of a Series LLC as a separate entity.[109] The following example suggests one reason why state authorities might want to rethink this issue.

Consider a Series LLC situation analogous to the *Lanco* case recently decided by the New Jersey Supreme Court.[110] In a modified version of the *Lanco* fact pattern, a Delaware-based Series LLC comprises series A, which operates only in Delaware, and series B and series C which register to do business in California by paying separate registration fees. Series A holds intellectual property rights (patents, trademarks, copyrights, trade secrets, know-how, or other intangible rights) that it

[107] *See* Sheldon I. Banoff & Richard M. Lipton, *California Takes a Stand on Delaware Series LLCs But There's No New From IRS*, J. OF TAXATION (May 2006); Clark Allison, *Series LLCs—California FTB Reconsidering Tax?* Allison Consulting (Jan. 8, 2007), *available at*, http://www.allisonconsulting.com/business-entities-corps-llcs-partnerships-sole-proprietors-250-series-llcs-california-ftb-reconsidering-tax.html; and Debbie Newcomb, *What is FTB's Position on Delaware Series LLCs?* Developments in Asset and Wealth Protection (Fall 2006), *available at*, http://www.assetprotectionbook.com/Dev_Fall2006.htm#series LLC.

[108] *Id.*

[109] *Id.*

[110] *See supra* note 8.

licenses to series B and series C in return for hefty (perhaps, extravagant) royalty payments. Will series B and series C then be entitled to deduct those royalty payments to series A from their net business profits in California in order to reduce their California income taxes? After treating series B and series C as separate entities for registration/annual fees and tax return purposes, would California find it more difficult to take the seemingly inconsistent position that series A, series B and series C are part of a "unitary" enterprise and therefore should be subject to a "unitary" California income tax on at least a portion of the system-wide income?[111]

Here again, there is no controlling case law, and the relevance of superficially analogous precedent with respect to corporations and regular LLCs is questionable because Series LLCs are essentially *sui generis*. As with regard to liability and jurisdictional shield issues, the success of using a Series LLC structure to shelter profits from state taxation may turn on whether the series of a Series LLC are treated as vertically-affiliated, sideways-affiliated, or, perhaps, as a third distinct organizational form that requires its own unique treatment.

D. When a Series LLC May be Preferable to a Corporation / Regular LLC

The key open questions about the legal treatment of Series LLCs eventually will be answered, although no attorney wants his or her client to be the unfavorable test case. Pending resolution of these open questions, therefore, Series LLCs will primarily be used in situations where the risks and/or costs of an unfavorable outcome are relatively low compared to the other options reasonably open to the client. A few of those situations are outlined below.

Series LLCs can be useful for holding portfolios of relatively low-value real estate with below-average risk, such as portfolios of office condominiums. As the value of the underlying real estate and/or the risk based on use of the real estate increases, however, cautious practitioners will urge their clients to form separate stand-alone LLCs for the property.

Series LLCs may also prove useful in higher-risk businesses which engage in readily-compartmentalizable projects, such as real estate developers. In such cases, the developer would likely have had to personally guarantee any obligations of the business in any event, but each individual series of a Series LLC would provide some protection from "slip-and-fall" type liability. One potential risk of using Series LLCs in this type of situation is that the developer may not properly

[111] *See* Halper, *supra* note 94.

capitalize each series and/or may commingle, funds from several series, thereby giving a court an easy reason to "pierce" the series wall.

Series LLCs may additionally prove useful to businesses that frequently engage in joint ventures—such as research centers and laboratories that do contract work. Many such businesses receive government and other grants and are required to keep their financial records open for inspection. In this type of situation, the requirement to maintain separate books and records would be an advantage as it would allow the books and records for one project to be available to the project sponsor, while preserving the privacy of the books and records of other projects.

Practitioners, always looking for a way to give their clients a legal advantage, will doubtless identify many other business situations that are ripe for the use of a Series LLC structure. As the rules applicable to this new business organizational form are clarified, and the statutory provisions refined, the number of such uses can be expected to grow dramatically. Series LLCs have added an important new dimension of business organization flexibility to the traditional organizational choices.

CONCLUSION

Series LLCs represent the latest evolutionary step in the progressive development of business organizations to accommodate new economic/social conditions and to better exploit emerging business opportunities. By facilitating the segregation of business risk-taking at minimal cost and with minimal paperwork, Series LLCs may be perfectly suited to a modern, developed-country economy that is increasingly financial/services/electronic commerce-based rather than the historic manufacturing/bricks-and-mortar business model.

But, so far, the potential of Series LLCs to revolutionize at least certain sectors of the U.S. economy is being held in check by the slow spread of Series LLC legislation to other states and by troublesome liability, jurisdiction, taxation, and bankruptcy questions. Until these issues are gradually settled by the spread of Series LLC statutes and judicial decisions interpreting and applying those statutes, the full panorama of opportunities for creatively using Series LLCs will not be realized. Practitioners should remain cautious and skeptical about recommending the Series LLC form to their clients until the applicable legal rules become firmer.

NORTH CAROLINA'S VICIOUS DOG LAW IS ALL BARK AND NO BITE

by LOUIS ALFRED TROSCH, SR.*

I. INTRODUCTION

Big Dogs, little dogs, red dogs, blue dogs, yellow dogs, green dogs, black dogs, and white dogs are all at a dog party! What a dog party![1] Since becoming the first animal to be domesticated over 15,000 years ago,[2] the dog has always enjoyed a unique and special relationship with man.[3] Unlike many other forcibly domesticated animals, dogs voluntarily linked themselves to humans.[4] Over the intervening

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1 P.D. EASTMAN, GO DOG GO 61 (1961).

2 "By 15,000 years ago, people around the world were raising dogs . . . the earliest fossil called a dog comes from Obercassel, Germany, and dates to 14,000 years ago, the late Pleistocene or upper Paleolithic." MARK DERR, DOG'S BEST FRIEND: ANNALS OF THE DOG-HUMAN RELATIONSHIP 26 (1997); *see also* MARY RANDOLPH, DOG LAW: A LEGAL GUIDE FOR DOG OWNERS AND THEIR NEIGHBORS 1/3 (3d ed. 1997). In contrast, cats were not domesticated until about 4,000 years ago. PAUL D. PION & GINA SPADAFORI, CATS FOR DUMMIES 22 (2d ed. 2000).

3 Dogs have been known as "Man's Best Friend" for eons and have always maintained a special place in the lives of mankind. Keith A. Cutler, *When Man's Best Friend Bites*, 54 J. MO. B. 24, 24 (Jan.-Feb. 1998).

4 Since the earliest appearance of Homo Sapiens, fossil records show that wolves frequently and voluntarily shared time, space, food and shelter with humans. DERR, *supra* note 2, at 19. Over time, "the wolves who became the tamest and lingered around the camps were those who were in personality the most social and least fearful." *Id.* at

centuries these descendants of wolves have been selectively bred by their masters, until today they truly resemble P.D. Eastman's colorful description, literally coming in all shapes, sizes, and colors.[5] Likewise, the partnership between man and dog can and does, in many respects, resemble a big party. Dogs share our homes, protect our property, work alongside us, assist the disabled, help us fight crime, and generally provide companionship to millions.[6] They truly have become man's best friend among the animal kingdom. Unfortunately, parties sometimes get ugly and there has always existed a dark underbelly to this man-dog relationship.[7] Over the last twenty years, for example, a crisis of serious dog attacks on humans has developed.[8] The number and severity of dog attacks upon humans has risen to epidemic levels, causing the public to demand that legislatures and courts take action.[9]

Highly publicized attacks by aggressive dogs began emerging in the 1980s and have continued to both fascinate and horrify Americans.[10] The most publicized recent example of this phenomenon occurred in San Francisco on January 26, 2001, when police found a thirty-three year old teacher, Dianna Whipple, fatally injured after an unprovoked attack by two Presa Canario dogs.[11] Ms. Whipple suffered seventy-seven bite

21. Man began to purposefully breed these wolfdogs to reinforce desirable characteristics, ultimately creating *Canis Lupus familiaris*, the dog. *Id.* at 16-28.

[5] *Id.* at 28-29 (noting that dogs range in size from 2 pound chihuahuas to 220 pound mastiffs and also vary widely in color, head shape, coat texture, and behavior traits).

[6] There are approximately 68 million dogs kept as pets in the United States. Safia Gray Hussain, Note, *Attacking the Dog-Bite Epidemic: Why Breed-Specific Legislation Won't Solve the Dangerous-Dog Dilemma*, 74 FORDHAM L. REV. 2847, 2849 (2006).

[7] *Id.* at 120-49, 223-229 (documenting the damage that selective breeding can have upon the physical health of dogs, along with the creation of extreme behavioral traits that make some dogs prone to viciousness).

[8] Man has brought an unfortunate plethora of problems ranging from mistreatment to genetic deformities through selective breeding to his supposed best friend. *See generally* DERR, *supra* note 2. In large part these attacks result from the misdeeds of irresponsible breeders, who intentionally reinforce aggressive traits in certain dog breeds. *Id.* at 131-35. Owners, in turn, reinforce these characteristics through maltreatment, seeking to create fearsome attack dogs. *Id.* at 140. "Some dogs are vicious by birthright, but the majority are made that way by human action and inaction." *Id. See also* Larry Cunningham, *The Case Against Dog Breed Discrimination by Homeowners' Insurance Companies*, 11 CONN. INS. L.J. 1, 35-36 (2004) (describing the desire of dog-fighting enthusiasts, drug dealers, gang members , and others to create dogs that are vicious weapons and the "revolting and painful techniques used to bring the animals to the verge of bloodlust.").This article, however, will examine the recent rise in dog attacks upon humans and legal solutions to this specific problem.

[9] *See* Cunningham, *supra* note 10, at 8.

[10] *Id.*

[11] Heather Pratt, Comment, *Canine Profiling: Does Breed-Specific Legislation Take a Bite out of Canine-Crime?*. 108 PENN. ST. L. REV. 855, 855 (2004). Presa Canarios are bred specifically for dog fighting and are muscular, tenacious, and large, weighing

wounds and died five hours later in a San Francisco hospital.[12] Sadly, this type of attack is becoming an all too common occurrence across the country.[13] In fact, "[e]ach year, an estimated 4.49 million people in the United States are bitten by dogs . . . and [these] bites can inflict serious physical harm as well as emotional harm on victims."[14]

Traditional legal approaches to owner liability for dog bites simply have not adequately imposed just penalties or discouraged irresponsible dog owners.[15] Into this breach many state legislatures and courts have stepped, establishing comprehensive and well reasoned owner liability laws.[16] Other states and municipalities have reacted in a knee-jerk fashion, passing ill conceived laws, not only poorly suited to remedy the problem, but destined to create a whole series of new problems.[17] Most tragically, still other states have largely ignored the problem altogether, or addressed it in a haphazard manner. North Carolina exemplifies this latter approach and its laws related to owner liability resemble a hodge-podge of legal theories that fail to establish a sensible framework for owner liability in dog bite cases. This article examines traditional approaches to owner liability for dog bites along with recent developments in this area of the law and then discusses the resulting confusing state of affairs surrounding dog bite liability. Finally, using North Carolina as an example, the author recommends several reforms that would not only clarify dog bite liability issues, but would also fit

upwards of over 100 pounds. *Id.* *See* Canary Dog, at http://www.dogbreedinfor.com/canarydog/htm (last visited January 10, 2007).

[12] *Id.*

[13] On January 8, 2007 a ten year old boy in Kings Mountain, North Carolina was "mauled by a pit bull, a pit-bull mix, and American bulldog . . . . Officials say Anthony Davis has more than 90 puncture wounds on his body." Melissa Martin, Boy in Serious Condition After Attack by Dogs, http://www.wcnc.com/news/topstories/stories/wcnc-010807-al-boyattacked.1d8603d7.html (last visited February 20, 2007). These cases are "chilling and extreme example(s) of what can happen when dogs 'go bad.'" Pratt, *supra* note 13, at 856.

[14] Sandra D. Dawson, Note, *Protecting A Special Class of Animal: An Examination of and Recommendations for Enacting Dog Guide Protection Statutes*, 37 CONN. L. REV. 569, 570 (2004).

[15] *Id.* at 857.

[16] *See* Harold W. Hannah, *Survey of Illinois Law: Animal Control Law: Liability for Animal Inflicted Injury*, 24 S. ILL. U.L.J. 693 (2000) (discussing Illinois comprehensive approach to creating a consistent system for determining owner liability and assisting efforts to reduce the number of dog bites in the state).

[17] For example, Breed Specific Laws (BSL), which impose specific regulations including outright bans for certain breeds of dogs, have been uniformly criticized by legal scholars, veterinary groups, animal advocates, and dog breeding associations. *See* Devin Burstein, *Breed Specific Legislation: Unfair Prejudice & Ineffective Policy*, 10 ANIMAL L. 313 (2004); Cunningham, *supra* 10, at 40; Karyn Grey, Comment, *Breed-Specific Legislation Revisited: Canine Racism or the Answer to Florida's Dog Control Problems?*, 27 NOVA L. REV. 415, 416 (2003); Hussain, *supra* note 6, 2855; Pratt, *supra* note 13, at 855.

into a more comprehensive legal framework designed to reduce the number of dog bite victims.

II. HISTORICAL DEVELOPMENT OF THE LAW

A. *Evolution of the Law Surrounding Dog Bites*

Dogs have lived alongside people for eons. In fact, fossil evidence demonstrates that wolves and man lived closely together as long as 500,000 years ago.[18] Over time, modern man developed a close relationship with wolves, eventually domesticating them. Through selective breeding, men created the modern dog, *Canis lupus familiaris*.[19] Dogs proved uniquely valuable to mankind over the years. Domesticated dogs are, therefore, found in virtually every human culture across the globe.[20] They have remained steadfastly loyal.[21] Their loyalty has been rewarded and dogs remain a vital part of modern life. In the United States alone, up to forty percent of all households keep dogs as pets.[22] For the most part these 68 million dogs[23] enrich the lives of the families that keep them, and dogs continue to be lauded as "man's best friend."[24]

Even best friends, however, sometimes mistreat one another. Mankind's mistreatment and outright abuse of domesticated dogs is both tragic and undeniable.[25] Likewise, dogs also sometimes attack

[18] DERR, *supra* note 2, at 19.

[19] *Id.* at 21-28.

[20] *Id.* at 26.

[21] "'[I]n the Garden of Eden every animal obeyed Man willingly. But we blew it, and after the Fall, all the animals lived as they pleased and paid us no heed. Except for dogs, who liked comradeship and loyalty enough to give us another chance.'" Grey, *supra* note 20, at 416 (quoting Timothy Foote, *That is Not a Bad Dog—That's a Splendid Dog*, Smithsonian, Apr. 1992, at 60, 69).

[22] RANDOLPH, *supra* note 2, at 1/2; *see also* Grey, *supra* note 20, at 419 (citing The Animal Assistance League, Facts: Dog Bite Statistics, http://www.animalassistanceleague.com/facts.htm (last visited March 22, 2003)).

[23] Hussain, *supra* note 6, at 2849.

[24] Cutler, *supra* note 3, at 25. "To the Ancients, the dog was more than a pet in the household, a servant in the field, and an assistant in the hunt. He was an object of ceremony, reverence and veneration as well. . . . [D]own through the ages, the dog has earned and has merited acceptance as man's best friend . . . ." *Id.*

[25] "No one can deny that ours is a unique relationship, with both positive and negative aspects. There is a long and bloody history of our use of dogs . . . . There are within many of the world's cultures, including our own, strong biases against dogs, which have periodically led to their slaughter." DERR, *supra* note 2, at 9. A visitor to the Humane Society's web page can read graphic depictions of the rampant mistreatment of dogs at the hands of their owners, including: owner cruelty and neglect; puppy mills; dog fighting; greyhound racing; pet hoarding; and abandonment of unwanted dogs. *See* The Humane Society of the United States, http://www.hsus.org/pets (last visited Feb. 20, 2007).

human beings.[26] Though they left the forests, plains, and steppes of their ancestors, dogs remain virtually genetically identical to wolves.[27] Thus, "'man's best friend' may still possess some of the characteristics of the wolf, including the exhibition of territorialism and suspicion of strangers."[28] Biting is an innate response that wolves have to certain stimuli and remains necessary to their survival in the wild.[29] Dogs share this "biting response" and may bite in response to several distinct situations.[30] While this behavior might be expected in wolf packs, such attacks are not tolerated in human cultures. Thus, legal codes dating back to the earliest recorded history have rules pertaining to liability when dogs attack human beings.[31] In ancient Babylon, for example, laws promulgated by a ruler named Dadusha provided monetary penalties for fatal dog or ox bites.[32]

Lawsuits demanding recovery for dog bite injuries continued to appear under the Anglo-American Common Law system. Over time, courts across the United States adopted the so-called "one-bite rule."[33] This rule was adapted from strict liability laws for wild animals, which were presumed to be abnormally dangerous. If someone chose to own

[26] Grey, *supra* note 20, at 419 (noting that "[d]espite their popularity, a significant number of dogs bite people every year").

[27] DERR, *supra* note 2, at 15.

[28] Pratt, *supra* note 13, at 859 (citing Rebecca Kodat, Evolution of Dogs, http://ny.essortment.com/dogsevolution<uscore>rlpr.htm (last visited Dec. 30, 2003)).

[29] *See generally* DERR, *supra* note 2, at 20-40 (discussing the various situations that lead both wolves and dogs to attack and/or bite).

[30] *See* Lynn Epstein, *There Are No Bad Dogs, Only Bad Owners: Replacing Strict Liability with a Negligence Standard in Dog Bite Cases*, 13 ANIMAL L. 129, 137 (2006) (listing seven distinct situations when dogs are likely to attack).

[31] In ancient Greece and Rome the laws created by Solon in 594 B.C. included a penalty for dog bites that involved the owner giving over his animal, which then had to wear a large wooden collar. M. Stuart Madden, *The Graeco-Roman Antecedents of Modern Tort Law*, 44 BRANDEIS L.J. 865, 886 (2006); *see also Exodus* 21:28, 29 (King James) (listing the penalties when oxen attack and kill humans).

In many cultures animals were actually prosecuted and held liable at special trials. This practice lasted well into the 19th century. EDWARD P. EVANS, THE CRIMINAL PROSECUTION AND CAPITAL PUNISHMENT OF ANIMALS 140 (1987).

[32] The penalty for killing a free man was forty shekels, while the penalty for killing a slave was only fifteen shekels. Symposium, *Ancient Law, Economics and Society, Part II: Ancient Rights and Wrongs: Measuring the Value of Slaves and Free Persons in Ancient Law*, 71 CHI.-KENT. L. REV. 149, 163 (1995).

[33] Epstein, *supra* note 33, at 132-34. "One-bite rule," or as it is sometimes known "first-bite rule," is something of a misnomer. The terminology arose from the mistaken belief that dogs got one free bite before they were considered abnormally dangerous. In fact, the requirement that the owner have reason to know that his dog is abnormally dangerous can be demonstrated, whether or not the dog had previously bitten others. In other situations dogs that have previously bitten may not be found to be abnormally dangerous. *Id.* at 132-34.

a wild animal, he was deemed responsible for any damage caused by that animal.[34] Unlike wild animals,

> [dogs] were considered harmless; and if they did, in fact, possess dangerous characteristics, it was considered abnormal. Consequently, the owner of a dog was not held strictly liable for a dog bite, unless he had reason to know the dog was abnormally dangerous. Being abnormally dangerous was often characterized as having a tendency to attack human beings, whether the attack was in anger or in play. The owner's liability was in keeping a dog after gaining knowledge of its propensity for abnormally vicious behavior. Thus, the requirement of scienter, determining whether a dog's conduct prior to the biting incident was vicious and thus put the owner on notice, often proved difficult.[35]

Even when dog bites were not common occurrences, the application of the "one-bite rule" proved difficult for courts.[36] Inconsistencies abounded[37] and the law was clearly slanted towards dog owners.[38] In the latter half of the twentieth century some states abandoned the "one-bite rule," but most muddled along with the common law precedent.[39] After all, dog bites just didn't seem to be that big of a problem. Occasional tragedies caused by dog bites certainly were not perceived to be a serious public health crisis.[40]

B. The Dog Bite Epidemic Since the 1980s

Almost overnight everything changed in the 1980s, with the appearance of numerous well publicized and particularly vicious attacks

[34] *Id.* at 131.

[35] *Id.* at 132.

[36] *Id.* at 134.

[37] *Compare* Barger v. Jimerson, 276 P.2d 744, 744 (Colo. 1954) (finding owner of German shepherd had knowledge/scienter that his dog was vicious based on the dog barking and lunging when people passed by its fenced in yard) *with* Sinclair v. Okata, 874 F. Supp. 1051, 1059 (D. Alaska 1994) (finding that previous four biting incidents involving the defendant's German shepherd did not establish the owner had knowledge that his dog was vicious). For additional analysis of these widely divergent cases, *see* Epstein, *supra* note 33, at 132-34.

[38] "The [one-bite rule] premise was that if the dog had previously bitten, it was abnormally dangerous, and the owner had the requisite knowledge (scienter) about the danger. Yet [even] this terminology was a misnomer. Often, courts found that a previous bite did not indicate viciousness, or that other dangerous characteristics, in the absence of a previous bite, were sufficient to determine a dog's character and an owner's knowledge of that character." *Id.*

[39] Even today, about one half of the states still follow some form of the "scienter requirement" from the one bite rule. Epstein, *supra* note 33, at 134.

[40] Hussain, *supra* note 6, at 2848-50.

by pit bulls.[41] As a result, the pit bull's wholesome image as an all American dog was tarnished beyond repair.[42] "America has a four-legged problem called the American Pit Bull Terrier . . . . [S]omething has happened to the pit bull in the last decade that says as much about the nature of American society as it does about the nature of this aggressive animal. . . . [T]he American pit bull terrier has become a reflection of ourselves that no one cares very much to see. . . . The horror stories involving pit bulls are voluminous."[43] Now the pariahs of the dog world, pit bulls have become the snarling, foaming face of what many experts call a "dog bite epidemic."[44]

The numbers are staggering. Of the 4.5 million estimated dog bites each year,[45] almost 800,000 of them are serious enough to require medical attention,[46] a thirty-seven percent increase in non-fatal dog bites since 1986.[47] Every forty seconds someone in America is bitten severely enough that they seek medical attention.[48] Even when they are not fatal, dog bites are especially traumatizing, "because the dog in these cases appears to betray our trust and reveal itself as a sneaky wild animal that will turn on the very people who care for it."[49] When

[41] *See* Brian C. Anderson, *Scared of Pit Bulls? You'd Better Be!*, CITY J., Spring, 1999, at 60-61. *But cf.* Judy Cohen & John Richardson, *Pit Bull Panic*, 36.2 J. POP. CULTURE 285, 308 (2002)(bad reputation of pit bulls is in some ways created by the media's fixation with them and noting that prior to the recent pit bull frenzy, Doberman pinschers and German shepherds were demonized).

[42] The Little Rascal's sidekick, Pete, was a pit bull. E.M. Swift, *The Pit Bull: Friend and Killer*, Sports Illustrated, July 27, 1987, at 77-78. "These were the salad days of the pit bull terrier. The dog was the envy of the canine world. Buster Brown's floppy eared pal in the popular comic strip of that era was his pit bull, Tige. Theodore Roosevelt had a pit bull in the White House . . . .The pit bull was America's dog and was depicted as such . . . ." *Id.* at 77.

[43] *Id.* at 74.

[44] *See* Kenneth M. Phillips, Dog Bite Statistics, http:11www.dogbitelaw.com/PAGES/statistics.html, (last visited February 20, 2007).

[45] Jeffrey J. Sacks, Marcie-Jo Kresnow & Barbara Houston, *Dog Bites: How Big a Problem?*, 2 INJURY PREVENTION 52, 54 (1996).

[46] Harold B. Weiss, Deborah Friedman & Jeffrey H. Coben, *Incidence of Dog Bite Injuries Treated in Emergency Departments*, 279 JAMA 51, 53 (1998).

[47] Daniel M. Sosin, et al., *Causes of Nonfatal Injuries in the United States*, 1986, 24:6 ACCIDENT ANALYSIS & PREVENTION 685, 686 (1992).

[48] Weiss et. al., *supra* note 49, at 52.

[49] Swift, *supra* note 45, at 74-75 (detailing both the terror involved during a dog attack and the resulting severe physical injuries). While everyone is at significant risk of being bitten by a dog, children and the elderly are much more likely to be victimized. Phillips, *supra* note 47. "Children are the most frequent bite victims, representing more than fifty percent of the total number of cases. Nearly half of all American children have been bitten before the age of twelve." Hussain, *supra* note 6, at 2849 (citing Phillips, *supra* note 47 and Anderson, *supra* note 44, at 60). The elderly are also disproportionately victimized. DERR, *supra* note 2, at 127. In fact, dog bites are now the second leading

combined, dog attacks cost Americans upwards of $1 billion per year.[50]

The exact causes of the emerging dog bite epidemic are widely debated, but most experts agree that three factors have contributed to the rise in dog bites: behavioral traits that dogs have inherited from their wolf ancestors; selective breeding that has emphasized aggressive tendencies in certain dog breeds; and mistreatment at the hands of irresponsible owners. As the direct descendants of wolves, dogs maintain certain traits that, while necessary for survival in the wild, can contribute to aggressive behavior.[51] When human beings accentuate certain dog traits through multi-generational selective breeding,[52] the resulting dogs can be prone to aggression and capable of savage attacks.[53] Mankind has bred dogs to emphasize certain characteristics considered desirable to human culture at the time.[54] Today's over 350 dog breeds, therefore, exhibit a variety of traits that humans throughout history have valued.[55] Thus, there are dogs designed to exhibit superior physical skills, to display certain behavior traits, or simply to appear in a certain way.[56]

cause for emergency room visits by children. Weiss et. al., *supra* note 49, at 52. Fortunately, most dog bite victims survive their attack, but many are severely physically and/or emotionally scarred. Over four separate studies conducted by the Centers for Disease Control and Prevention (CDC) between 1979 and 1998 demonstrated that the number of fatalities from dog bites had held fairly steady at approximately 7 deaths per year per 100 million people. Cunningham, *supra*, note 10, at 17-19.

50 DERR, *supra* note 2, at 127; *see* Phillips, *supra* note 47, (citing R. Voelker, *Dog Bites Recognized as Public Health Problem*, 277 JAMA 278, 280 (1997)).

> The societal costs of dog bites are quite high. Hospital costs for dog-bite related visits to emergency rooms are estimated to be 102.4 million dollars annually. This, however, represents only a fraction of the overall costs to society. Other costs include health insurance and workers' compensation claims for lost pay and/or lost time from work. Insurance companies reportedly pay out 310 million dollars annually for dog bite claims, which comprises roughly one-third of total claims paid on homeowners' and renters' insurance policies nationwide.

Pratt, *supra* note 13, at 856-57.

51 *See supra* notes 29-35 and accompanying text. "In general, the differences in behavior between wolves and dogs—and breeds of dogs—are of degree, or emphasis, not kind." DERR, *supra* note 2, at 32.

52 J.P. SCOTT & JOHN L. FULLER, GENETICS AND THE SOCIAL BEHAVIOR OF THE DOG 25 (1965).

53 *See* Grey, *supra* note 20, at 435-46 (arguing that pit bulls are more likely to attack and more capable of doing damage than other breeds).

54 RANDOLPH, *supra* note 2, at 1/3.

55 *Id.*

56 For example, "The Chinese *Book of Rites* (A.D. 800) mentioned three classes of dogs: hunting dogs, watch dogs, and food dogs. By A.D. 1,000, another category had been added—that of pampered pet." DERR, *supra* note 2, at 43.

Certain dogs were bred to accentuate aggressive tendencies or exclusively for fighting.[57] Though there are many breeds of this type, the pit bull represents the modern epitome of the fierce fighting dog.[58] Not surprisingly, it stands at the center of an ongoing debate regarding whether some dog breeds are inherently vicious.[59] When the media began reporting a surge in attacks by pit bulls, many rushed to demonize pit bulls as inherently vicious beasts.[60] The reality is far more complicated, however. Researchers have been unable to establish a direct correlation between dog breeds and the number of attacks.[61] Scientists have also been unable to isolate any so-called "viciousness gene" in pit bulls or any other dog breed.[62] At most, one can conclude that certain breeds can have a basic propensity towards aggressiveness.[63]

On the other hand, virtually all experts agree that dog owners play a central role in the creation of vicious dogs.[64] With proper training and control, owners can virtually eliminate the dangerousness of any dog, regardless of breed.[65] At the same time, irresponsible owners can heighten the danger posed by even the most docile dog.[66]

[57] DERR, *supra* note 2, at 132-33.

[58] Pit bull is really a generic term for three related dog breeds, the American Staffordshire Terrier, the Staffordshire Bull Terrier, and the Bull Terrier. DERR, *supra* note 2, at 131-32. These breeds were originally created by combining bull-baiting dogs, probably Mastiffs, and aggressive terriers. *Id.* at 133; *see* DAWN M. CAPP, AMERICAN PIT BULL TERRIERS: FACT OR FICTION 9 (2004). The resulting dogs were meant to emphasize strength, fearlessness, brutal aggressiveness, tenacity and agility. DERR, *supra* note 2, at 134. Pit bulls were prized as fighting dogs for their incredible bite strength, their bite and hold attack style, and, most of all, their gameness, which is defined as a determination not to quit fighting, even in the face of serious injury and pain. CAPP, *supra* note 67, at 46.

[59] *Compare* Phillips, *supra* note 47 (arguing that certain breeds including, pit bulls, Rottweillers, and Presa Canarios are responsible for more attacks than other dogs) *with* Cunningham, *supra* note 10 (arguing that there are no reliable statistics that demonstrate certain breeds are more vicious than others).

[60] *Id.* at 135.

[61] Cunningham, *supra* note 10, at 17-35 (analyzing various dog bite studies conducted over the last twenty years and concluding that there is no currently verifiable correlation between dog breed and proportion of attacks).

[62] DERR, *supra* note 2, at 135. Indeed, "researchers [have] observed more genetic variation between individual dogs than between breeds of dogs or even between dogs and wolves." *Id.*

[63] *Id.*

[64] *See* Burstein, *supra* note 20, at 323; Cunningham, *supra* note 10, at 35; Epstein, *supra* note 33, at 138; Phillips, *supra* note 47.

[65] Burstein, *supra* note 20, at 323.

[66] Cunningham, *supra* note 10, at 35-36; *see also* Swift, *supra* note 45, at 82-83 (detailing the abusive practices utilized by pit bull owners to make them more violent and aggressive).

Pit bulls are currently favored among gang members, drug dealers, pimps, and criminals, but at some point they will likely give way to another breed, believed to be even more vicious.[67] In fact, over the last twenty years the fierce dog of choice has changed from German shepherds, to dobermans, to pit bulls and rottweillers, to the newest chic vicious breed the wolfdog.[68] Of particular concern are irresponsible breeders, who intentionally mate their most aggressive animals in order to enhance vicious tendencies.[69] The core of the dog bite epidemic, therefore, has more to do with owners, who glorify violence and aggression, than it does with specific dog breeds. In the end, it also says more about ourselves and our culture than the dogs we demonize.

III. HOW STATE LAWS AND COURTS ATTEMPT TO DEAL WITH THE VICIOUS DOG PROBLEM: REFORMING THE ONE-BITE APPROACH

Regardless of the root cause of the dramatic rise in dog attacks, the public began to demand that the legal system take some action to solve the dog-bite epidemic. In the seminal case of *Sentell v. New Orleans & Carrollton R.R.*,[70] the Supreme Court held that states could regulate dogs as a proper exercise of their police power.[71] Since the *Sentell* decision, states have enjoyed fairly broad leeway with respect to the regulation and protection of animals.[72] Over the last two decades states

> [A] small percentage of pet owners breed and use their pets for illicit purposes. They intentionally seek out vicious dogs that will attack and maim humans and other animals. Dog-fighting enthusiasts, gang members, and drug dealers will purposely select, breed, and train dogs to be vicious. The purpose may be to intimidate rivals . . . defend illegal drugs . . . or to make money . . . . For some, having a vicious dog is simply a status symbol. In order to make dogs into vicious weapons they use 'revolting and painful techniques to bring the animals to the verge of bloodlust.'

Id. The recent allegations that NFL star quarterback Michael Vick is, himself, involved in training and fighting pit bulls have made clear that an inhumane subculture surrounding dog fighting continues unabated in this country. *Meeting set for case involving Vick home*, CHARLOTTE OBSERVER, May 17, 2007, at C2. "A prosecutor, sheriff and investigators are to meet Monday to review evidence collected in the weeks since dogs and equipment associated with dog fighting were seized in April from a home owned by Michael Vick." *Id.*

[67] DERR, *supra* note 2, at 137.

[68] *Id.* The wolfdog is literally a cross between a dog, such as a German shepherd, and a wolf. There is actually a move under way to establish an American Kennel Club recognized wolfdog breed along with an Amerindian breed, which is a coyote-to-dog hybrid. *Id.* at 147-48.

[69] *See id.* at 135.

[70] 166 U.S. 698 (1897).

[71] *Sentell*, 166 U.S. at 701.

[72] *See* Nicchia v. New York, 254 U.S. 228 (1920) (upholding state licensure requirements for dog owners).

have taken a variety of steps to implement a new body of law surrounding many animal law issues.[73] Across the board, "[a]nimal law is in that fragile state of becoming, endeavoring to make the transition from movement to bona fide practice area; from traditional, archaic views to modern, enlightened views. . . . [A]nd a body of law is beginning to emerge through the concerted efforts of institutions, organizations, professional associations, and practitioners."[74] Legislation and court decisions surrounding dog-bites are no exception to this pattern, evolving with considerable variety from state to state.[75]

A. *Replacing the One-Bite Rule with Strict Liability*

Although some states continue to exclusively follow the common law "one-bite rule,"[76] the recent trend has been towards true strict liability.[77] The major difference between the common law system and modern strict

[73] In fact, "[t]he body of law governing our use of and relationship to animals is one of the fastest growing areas of legal studies. Despite the existence of federal statutes concerning animals, animal law did not gain significant notice in legal education programs until the 1980s. Today the subject is taught in several law schools, and leading animal law experts have published a casebook." Michael Schau, *Animal Law Research Guide*, 2 BARRY L. REV. 147, 147 (2001) (citing PAMELA D. FRASCH, BRUCE A. WAGMAN & SCOTT BECKSTEAD, ANIMAL LAW (2000)).

[74] Merry B. Guben, *What the General Practitioner Needs to Know About Pennsylvania Animal Law: Animal Law Litigation: On the Road to a Modern View with Some Landmarks Along the Way*, 77 PA BAR ASSN. Q. 58, 58 (2006).

[75] *Compare* Cutler, *supra* note 3, 24-26 (discussing Missouri's dog bite precedents, which continue to rely upon the common law approach to liability) *with* Hannah, *supra* note 19 (analyzing Illinois comprehensive approach to dog-bite law, including true strict liability for owners, dangerous dog laws, and animal fighting provisions) *and* Cindy Andrist, *Is There(and Should There Be) Any "Bite" Left in Georgia's "First Bite" Rule?*, 34 GA. L. REV. 1343 (analyzing the Georgia Court of Appeals' attempt to modify the common law "first bite" rule in Thurmond v. Saffro, 520 S.E.2d 43 (Ga. Ct. App. 1999) and concluding that this case only served to muddy the waters with respect to owner liability) *and* Anna Sibylle Ehresmann, Note, *Smith v. Ruidoso: Tightening the Leash on New Mexico's Dogs*, 32 N.M.L. REV. 335 (2002) (analyzing the New Mexico Court of Appeals decision in Smith v. Village of Ruidoso, 128 N.N. 470, 994 P.2d 50 (Ct. App. 1999) , which expanded the traditional common law rules to allow plaintiffs to utilize general negligence theories to recover in dog bite cases) *and* Grey, *supra* note 20 (reviewing Fla. Stat. § 767 et. seq. (2001) and their creation of a strict liability system for dog bite liability along with a prohibition against ordinances that target specific breeds of dogs).

[76] Only a handful of states do not have any dog-bite liability statutes. These states include Alaska, Arkansas, Connecticut, Maryland, Missouri, Mississippi, Tennessee, Wyoming, and New Mexico. *See* Ehresmann, *supra* note 84.

[77] Common law "one-bite rules" were often referred to by courts as strict liability, but they were really a modified form of strict liability. To be liable owners had to have scienter, prior knowledge that the dog was vicious. This requirement favored dog owners and led to extremely inconsistent results. *See supra* notes 36-43 and accompanying text; *see also* Epstein, *supra* note 33, at 132-37 (comparing common law modified strict liability to modern true strict liability).

liability surrounds the concept of scienter or knowledge. At common law an owner had to have reason to know that a dog was abnormally dangerous before being held responsible. Under modern strict liability statutes, the scienter requirement has been eliminated entirely. South Carolina's law is illustrative of modern strict liability laws:

> Whenever any person is bitten or otherwise attacked by a dog while the person is in a public place or is lawfully in a private place, including the property of the owner of the dog or other person having the dog in his care or keeping, the owner of the dog or other person having the dog in his care or keeping is liable for the damages suffered by the person bitten or otherwise attacked. For the purposes of this section, a person bitten or otherwise attacked is lawfully in a private place, including the property of the owner of the dog or other person having the dog in his care or keeping, when the person bitten or otherwise attacked is on the property in the performance of any duty imposed upon him by the laws of this State, by the ordinances of any political subdivision of this State, by the laws of the United States of America, including, but not limited to, postal regulations, or when the person bitten or otherwise attacked is on the property upon the invitation, express or implied, of the owner of the property or of any lawful tenant or resident of the property. If a person provokes a dog into attacking him then the owner of the dog is not liable.[78]

In fact, over half of all states have moved to a system of true strict liability.[79] Strict liability statutes require four elements for recovery: (1) injury caused by the owner's dog; (2) peaceable conduct by the victim; (3) presence of the injured person in a place where he is legally entitled or invited; and (4) lack of provocation.[80] Strict liability statutes put the onus squarely on the shoulders of the owner and make it far easier for victims to recover damages. At the same time, these statutes give owners adequate defenses when plaintiffs were not lawfully on the property or provoked the dog.

[78] S.C. CODE ANN. § 47-3-110 (1986).

[79] The following states have adopted a modern strict liability statute that removes the scienter requirement: Alabama, Arizona, California, the District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Kentucky, Louisiana, Massachusetts, Michigan, Minnesota, Nebraska, New Hampshire, New Jersey, New York, Ohio, Oklahoma, Rhode Island, South Carolina, South Dakota, Texas, Utah, Virginia, Washington, Wisconsin, and West Virginia. Ehresmann, *supra* note 84, at 347 n.131. In reality, these laws are modified versions of strict liability, since certain actions of the victim can provide a defense to the dog owner. At the same time, they are not pure contributory negligence statutes either. Thus, the dog owner cannot utilize any negligence of the victim as a defense. Rather, only a narrow range of activities designed to provoke the animal serve as a defense to liability. *Id.*

[80] Restatement (Third) of Torts § 23 (2000).

B. *Combining General Negligence with the One-Bite Rule*

In other states, courts have allowed recovery pursuant to general negligence theories to supplement the common law "one-bite rule."[81] For example, in *Smith v. Village of Ruidoso*, the New Mexico Court of Appeals expanded the allowable theories of recovery in dog bite cases to include a negligence claim.[82] As in modern strict liability jurisdictions, plaintiffs can recover pursuant to a negligence claim, even when the defendant did not have actual prior knowledge of the dog's dangerousness. Likewise, the focus shifts from the side issue of scienter to a determination whether the conduct of the owner was reasonable to prevent foreseeable harm.[83] "Negligence . . . puts the responsibility on dog owners to supervise and control their pets."[84] Unfortunately, allowing negligence claims in addition to the common law "one-bite rules" can confuse the issues for litigants and subsequent courts.[85] The case of *Russell v. Rivera*[86] exemplifies this confusion. In *Russell* the trial court dismissed the common law liability claim, because the plaintiff failed to demonstrate that the owner knew of the dog's dangerous propensities.[87] The plaintiff also sued based on a negligence theory. In dismissing the negligence claim, the court relied on the finding that the dog had not demonstrated prior dangerous tendencies in determining that no foreseeable risk existed.[88] As long as both common law "one-bite" precedent and negligence theories are considered good law, inconsistencies are likely to increase as courts mix and match theories.[89]

[81] *See* Epstein, *supra* note 33, at 138-40; Ehresmann, *supra* note 84, at 350.

[82] *Smith*, 128 N.M. at 475, 994 P.2d at 55.

[83] Professor Epstein argues forcefully that a negligence standard should form the basis of dog bite liability claims. She notes that the common law "one bite rules" were too heavily weighted to the dog owners, while the modern strict liability standard is conversely too weighted to the victim. Negligence, in her opinion forms a good middle ground, that puts the onus on the conduct of the owner rather than on the dog's behavior (either prior vicious conduct or in relation to provocation defenses). Epstein, *supra* note 33, at 141-45.

[84] *Id.* at 141.

[85] *See infra* notes 127-53 and accompanying text.

[86] 780 N.Y.S.2d 699 (N.Y. App. Div. 1st Dept. 2004).

[87] *Russell*, 780 N.Y.S.2d at 700.

[88] *Id.*

[89] In another case where the majority allowed a negligence claim after the common law claim failed, the dissent focused on the scienter requirement to argue that absent a finding of prior viciousness the owner has no duty to supervise or control his presumably gentle dog. Drake v. Dean, 19 Cal. Rptr.2d 325, 337 (1993). For a discussion of similar confusion by North Carolina appellate courts *see infra* notes 128-34 and accompanying text.

C. Supplementing Traditional Civil Liability Laws: Dangerous Dog Statutes, Breed Bans, and Criminal Penalties

In addition to the standard claims for owner liability, regardless of the state's civil liability theory, most states have passed dangerous dog statutes.[90] These laws define specific categories of dogs that are deemed abnormally dangerous. Typically there are three categories: (1) dogs that have killed or inflicted serious injury on a person; (2) dogs that have been deemed potentially dangerous by a local animal control board after a hearing; or (3) dogs that are kept or trained for dog fighting.[91] Once their dog is deemed abnormally dangerous, owners must take several statutorily enumerated steps to control the animal.[92] Because these

[90] Hussain, *supra* note 6, at 2855 n.71 (citing state dangerous dog laws in the following states: Arizona, ARIZ. REV. STAT. ANN. 11-1029 (Supp. 2005) (vicious animal law); California, CAL. FOOD & AGRIC. CODE 31601-03, 31641-46 (West 2001); Colorado, COLO. REV. STAT. 18-9-204.5 (2004); Delaware, DEL. CODE ANN. TIT. 7, 1732-40 (2001 & Supp. 2004); District of Columbia, D.C. CODE ANN. 8-1901 to 8-1907 (LexisNexis 2004); Florida, FLA. STAT. ANN. 767.11-767.13 (West 2005); Georgia, GA. CODE ANN. 4-8-21 to -30 (1995 & Supp. 2005); Hawaii, HAW. REV. STAT. 142-74 to -75 (Supp. 2004); Idaho, IDAHO CODE ANN. 25-2805 (2000); Illinois, 510 ILL. COMP. STAT. ANN. 5/2.19b, 5/15-15.3 (West 2004); Kentucky, KY. REV. STAT. ANN. 258.235 (LexisNexis Supp. 2005); Louisiana, LA. REV. STAT. ANN. 14:102.14-.18 (2004); Maine, ME. REV. STAT. ANN. TIT. 7, 3952 (2002 & Supp. 2005); Maryland, MD. CODE ANN., CRIM. LAW 10-619 (LexisNexis 2002); Massachusetts, MASS. ANN. LAWS CH. 140, 157 (LexisNexis 1995 & Supp. 2005); Michigan, MICH. COMP. LAWS ANN. 287.321-323 (West 2003); Minnesota, MINN. STAT. ANN. 347.50-.51 (West 2004); Montana, MONT. CODE ANN. 7-23-2109 (2005); Nebraska, NEB. REV. STAT. 54-617 to -624 (2004); Nevada, NEV. REV. STAT. ANN. 202.500 (LexisNexis 2001); New Hampshire, N.H. REV. STAT. ANN. 466:31-:31a (Supp. 2005); New Jersey, N.J. STAT. ANN. 4:19-17 to -36 (West 1998 & Supp. 2005); New Mexico, N.M. STAT. ANN. 77-1-10 (LexisNexis 1978) (vicious animal law); New York, N.Y. AGRIC. & MKTS. LAW 107, 108 (McKinney 2004 & Supp. 2006); North Carolina, N.C. GEN. STAT. 67-4.1 to -4.5 (2003); North Dakota, N.D. CENT. CODE 42-03-01 (1999) (regulating nuisance dogs); Ohio, OHIO REV. CODE ANN. 955.11 (LexisNexis 2004); Oklahoma, OKLA. STAT. ANN. TIT. 4, 44-47 (West 2003); Oregon, OR. REV. STAT. ANN. 609.095 (West 2003) (regulating nuisance dogs); Pennsylvania, 3 PA. CONS. STAT. ANN. 459-502-A to -507-A (West 1995 & Supp. 2005); Rhode Island, R.I. GEN. LAWS 4-13.1-1 to 4-13.1-15 (Supp. 2005); South Dakota, S.D. CODIFIED LAWS 47-3-710 to -770 (2004); Tennessee, TENN. CODE ANN. 44-17-120 (2000); Texas, TEX. HEALTH & SAFETY CODE ANN. 822.041-.047 (Vernon 2003); Vermont, VT. STAT. ANN. TIT. 20, 3546 (Supp. 2005) (vicious domestic pet law); Virginia, VA. CODE ANN. 3.1-796.93:1 (Supp. 2005); Washington, WASH. REV. CODE ANN. 16.08.070-100 (West Supp. 2006); West Virginia, W. VA. CODE ANN. 19-20-20 to 19-20-21 (LexisNexis 2004); Wyoming, WYO. STAT. ANN. 11-31-301 (2005)).

[91] N.C. GEN. STAT. § 67-4.1 (1989) exemplifies a typical dangerous dog statute.

[92] Under North Carolina's law owners of "dangerous dogs" must not:

(1) Leave a dangerous dog unattended on the owner's real property unless the dog is confined indoors, in a securely enclosed and locked pen, or another structure designed to restrain the dog;

(2) Permit a dangerous dog to go beyond the owner's real property unless the dog is leashed and muzzled or is otherwise securely restrained and muzzled.

laws establish strict liability for dogs defined as abnormally dangerous, they can be helpful to victim lawsuits in states that still rely on the common law "one-bite rule."[93] Further, owners also face criminal liability if their dangerous dog attacks and injures anyone.[94] Most importantly, these laws can actually help prevent future attacks from aggressive dogs. Civil lawsuits by their very nature only offer redress after the damage has been done. Dangerous dog laws, when properly applied and enforced, allow citizens to cooperate with local authorities to identify and regulate potentially dangerous dogs.[95]

Finally, at least one state[96] and many local jurisdictions[97] have imposed breed specific laws that vary from tight regulations for owners to outright bans of certain breeds. These laws began to appear in the late 1980s in response to the increased media coverage of dog attacks upon humans and have continued to proliferate.[98] "Breed-based enactments generally follow on the heels of a highly publicized serious or fatal dog attack by a particular breed and are proposed by the legislature in response to public outcry and fear."[99] These laws do not

N.C. GEN. STAT. § 67-4.2 (1989).

[93] Hussain, *supra* note 6, at 2854-55.

[94] In North Carolina, for example, the owner of a dangerous dog faces criminal liability for a Class 1 misdemeanor. N.C. GEN. STAT. § 67-4.3 (1989).

[95] Without money to enforce these laws or a commitment from local authorities dangerous dog laws become meaningless. Hussain, *supra* note 6, at 2875.

[96] Ohio is the only state that has currently enacted a breed specific law statewide. Its statute added a provision to the dangerous dog code law defining:

> (3) (a) "Vicious dog" means a dog that, without provocation and subject to division (A)(4)(b) of this section, meets any of the following:
> (i) Has killed or caused serious injury to any person;
> (ii) Has caused injury, other than killing or serious injury, to any person, or has killed another dog;
> (iii) Belongs to a breed that is commonly known as a pit bull dog. The ownership, keeping, or harboring of such a breed of dog shall be prima-facie evidence of the ownership, keeping, or harboring of a vicious dog.

OHIO REV. CODE ANN. 955.11 (2006).

[97] *See e.g.* Burstein, *supra* note 20, at 315 n.11 (citing the following examples of breed specific legislation: MIAMI-DADE CODE (Fla.) 5-17-5-17.6 (2003) (requiring all pit bull owners to meet strict confinement and registration requirements, as well as prove their ability to cover $50,000 in liability for injury caused by their dogs); IOLA CODE (Kan.) 10-181-10-184 (2003) (requiring pit bull owners to follow special confinement, leash, and muzzle requirements); MANHATTAN CODE ORDIN. (Kan.) 6-25 (2003) (holding pit bull owners to a higher standard of care regarding their knowledge of the propensity of their dogs to cause injury, and in effect creating strict confinement requirements for pit bulls); OAK HARBOR MUN. CODE (Wash.) 7.32.010-7.32.130 (2003) (defining all pit bulls as potentially dangerous dogs, and providing for strict confinement and leash requirements).

[98] *See* Cunningham, *supra* note 10, at 7. Professor Cunningham forcefully argues that breed specific laws and resulting breed specific policies of insurance companies are not supported by statistics and are misguided attempts to prevent dog bites. *Id.* at 5.

[99] Husaain, *supra* note 6, at 2859.

attempt to regulate either all dogs or individual dogs deemed dangerous. Rather, they label dogs of a specific breed as vicious or dangerous and then set forth regulations for owners of these breeds or ban them outright.[100] Although Constitutional,[101] these ordinances have a whole host of practical problems that make them more trouble than they're worth.

First and foremost, breed specific laws and ordinances are opposed by many powerful groups ranging from animal advocates to Veterinary Associations to the American Kennel Club to Legal Scholars.[102] In fact, the very scientists who authored many of the studies that lawmakers pointed to as proof positive that some breeds should be banned "cautioned against using their incomplete data on attacks to make knee-jerk legislative policy decisions based solely on breed."[103] Second, breed specific laws are incredibly difficult to enforce. Most dogs are not registered with any Kennel Club, and there exists no reliable way to determine an unregistered dog's breed.[104] Furthermore, the majority of dogs are mixed breeds, which raises a whole new set of challenges to enforcing breed specific laws.[105] Finally, if one breed is banned or restricted, irresponsible owners will likely switch to an unregulated

[100] Animal advocates refer to this practice as "breed discrimination," a term brought to the mainstream media by Dan Rather during a report on June 3, 2003. *CBS Evening News with Dan Rather: Insurance Industry Discriminates Against Dogs* (CBS television broadcast June 3, 2003).

[101] Breed specific laws have faced numerous Constitutional challenges, including equal protection, substantive due process, and vagueness, but have almost universally been upheld by courts as Constitutional. Burstein, *supra* note 20, at 323.

[102] *See e.g.*, Cunningham, *supra* note 10, at 35-36 (listing numerous animal rights groups, medical professionals, scientists, and academics opposed to breed specific laws). Numerous recent law review articles have analyzed breed specific laws and independently concluded that they are misguided attempts to satisfy public outrage and fear over publicized dog attacks. *See* Burstein, *supra* note 20, at 326; Cunningham, *supra* note 10, at 65-66; Grey, *supra* note 20, at 447-48; Hussain, *supra* note 6, at 2883; Pratt, *supra* note 13, at 878.

[103] Researchers repeatedly urge against extrapolating their studies to justify the targeting or banning of any specific breed of dog. *See* Jeffrey J. Sacks et. al., *Fatal Dog Attacks, 1989-1994,* 97 PEDIATRICS 891, 894 (1996); Centers for Disease Control, *Dog Bite Related Fatalities: United States, 1995-1996,* 46 MORBIDITY & MORTALITY WKLY. REP. 463 (1997).

[104] There is tremendous difficulty for anyone, even veterinary experts, to visually determine the breed of a dog without examining its pedigree. Furthermore, no reliable genetic test can identify whether a dog is a particular breed. Grey, *supra* note 20, at 439-40; *see also* Cunningham, *supra* note 10, at 33 (noting that even under low stress situations people simply cannot accurately identify dogs by breed).

[105] "The problem of mixed breed complicates the issue even further." How much pit bull blood is required before a dog is considered a pit bull for the purposes of breed regulations?

breed of dog in their quest to create fierce dogs.[106] Pit bulls are not uniquely dangerous.[107] "What the proponents of bans of specific breeds fail to recognize is that a given breed is incidental to the curder human impulse it made to serve: The illicit thrill of bloody fighting rings, or of simply having the baddest dog on the block. Ban one breed and there will be another to take its place."[108] In the end breed specific laws may give lawmakers and the public a false sense of security, but they are unlikely to have any real impact on the overall number of dog attacks.[109]

Beyond reforming their civil liability laws, some states have also adopted stiffer criminal penalties for practices such as dog fighting.[110] They can also enforce existing leash and other dog control laws.[111] As

[106] "Even if pit bulls are banned, individuals who participate in dog fighting will likely not turn their backs on this lucrative profession. Other dogs can be trained to be vicious or to be used for fighting." Grey, *supra* note 20, at 438.

[107] *See supra* notes 63-78 and accompanying text.

[108] Burstein, *supra* note 20, at 324.

[109] "It is understandable that people want to feel safe, and dog attacks, especially the most gruesome ones, often make the news. Breed bans may make individuals feel better, but politicians eager to please their constituents often impose bans as a knee-jerk reaction to constituent concerns. . . . But, such bans may be ineffective." Pratt, *supra* note 13, at 861.

[110] Although most states have some dog fighting laws on the books, they vary widely in both scope and available penalties. Illinois provides an excellent example of a comprehensive dog fighting statute, which clearly defines prohibited conduct and contains severe penalties for violations. § 720 Ill. Comp. Stat. 5/26-5 (2007). On the other hand, New Jersey is illustrative of states that only briefly outline the type of conduct prohibited and provide minor criminal sanctions. N.J. STAT. ANN. § 4:19-19 (2007).

[111] Most states have statutes permitting local authorities to pass and enforce dog control ordinances, or leash laws. Rhode Island's statute is representative:

> § 4-13-15.1. Ordinances concerning unrestricted and vicious dogs prohibited -- Leash laws
>
> (a) City or town councils may make any ordinances concerning dogs in their cities or towns as the councils deem expedient, pertaining to the conduct of dogs, which ordinances shall include regulations relating to unrestricted dogs, leash laws, confinement, and destruction of vicious dogs. Those ordinances may provide as follows:
>
> (1) Every owner or custodian of a dog shall cause that dog not to run unrestricted anywhere in the city or town. This section does not apply to any person who uses a dog under his or her direct supervision while lawfully hunting, while engaged in a supervised formal obedience training class or show or during formally sanctioned field trials.
>
> (2) It is unlawful for any owner of a dog to place that dog or allow it to be placed in the custody of any other person not physically capable of maintaining effective control of restricting the dog.
>
> (3) The city or town dog officer is empowered to seize and impound any dog found off the property of its owner or custodian when that dog is unrestricted.
> (4) Any person violating the provisions of this section shall be fined not exceeding two hundred and fifty dollars ($ 250).

R.I. GEN. LAWS § 4-13-15.1 (2006). Some states prohibit dogs running-at-large statewide, with strict liability for dog bites, "[d]og fighting, leash, and at-large laws address the root of the problem, which is irresponsible dog ownership."[112] Thus, many options exist, some clearly more effective than others, to assist state attempts to address the dog bite crisis. Some states have utilized the most effective of these options to implement a comprehensive set of laws designed to impose liability on irresponsible owners and to prevent future attacks.[113] Unfortunately, many states have taken an "a la carte" approach to dog-bite law reform, adopting a reform here and an amendment there without regard to how these laws fit together. As the following section reveals, North Carolina is a representative example of this hodge podge approach to dog-bite laws.

IV. THE NORTH CAROLINA EXPERIENCE: DEMONSTRATING THE NEED FOR A UNIFORM AND STRATEGIC APPROACH TO DOG-BITE LIABILITY

In 1850, like most other jurisdictions, North Carolina courts, adopted the "one-bite" common law precedents with respect to damages caused by domesticated animals.[114] "When the owner knows or has reason to believe that an animal is dangerous, on account of a vicious propensity in him, from nature or habit, it becomes his duty to take care, that no injury is done; and he is liable for any injury, which is likely to be the result of this known vicious propensity."[115] North Carolina courts

rather than leaving the decision to local officials. For example, in Ohio:

> (B) No owner, keeper, or harborer of any female dog shall permit it to go beyond the premises of the owner, keeper, or harborer at any time the dog is in heat unless the dog is properly in leash.
>
> (C) Except when a dog is lawfully engaged in hunting and accompanied by the owner, keeper, harborer, or handler of the dog, no owner, keeper, or harborer of any dog shall fail at any time to do either of the following:
>
> (1) Keep the dog physically confined or restrained upon the premises of the owner, keeper, or harborer by a leash, tether, adequate fence, supervision, or secure enclosure to prevent escape;
>
> (2) Keep the dog under the reasonable control of some person.

OHIO REV. CODE ANN. 955.22 (2006). The penalties range widely for violations of these laws, but for the most part they are not onerous. Even in Ohio, known for the toughest dog control laws in the country, criminal penalties and fines are minimal. *See e.g.*, OHIO REV. CODE. ANN. § 955.99(E)(1)(2006) (providing a twenty five dollar fine for first offenders and a fine between seventy five and two hundred and fifty dollars for subsequent violations along with up to thirty days in jail). Stiffer penalties and more stringent enforcement would get the attention of dog owners and likely, result in fewer dog bites. *See* Lyn Marmer, Comment, *The New Breed of Municipal Dog Control Laws: Are They Constitutional?*, 53 U. CIN. L. REV. 1067, 1080 (1984).

112 Cunningham, *supra* note 10, at 61.

113 *See* note 19 for a discussion of Illinois comprehensive statutory framework.

114 Cockersham v. Nixon, 33 N.C. 269, 271 (1850).

115 *Id.*

referred to their version of the common law rule as the "vicious propensity rule."[116] It held sway over the next 150 years in actions involving dogs and other domesticated animals.[117] The "vicious propensity rule" was based upon strict liability, with the condition precedent that the plaintiff had to demonstrate that the owner knew or should have known of the animal's vicious propensities.[118] The law seemed fairly well settled,[119] but then the dog-bite epidemic hit the state in the late 1970s. In the absence of any real direction from North Carolina's legislature and in the face of a growing number of cases, the appellate courts began to drastically change their approach to animal injury liability cases. The resulting case law is a morass of confusion and misapplied theories.

[116] Peculiarly, the term vicious propensity did not actually require viciousness. Courts repeatedly held that "[t]he propensity is vicious if it tends to harm, whether manifested in play or in anger . . . ." Hill v. Moseley, 220 N.C. 485, 489, 17 S.E.2d 676, 678 (1941).

[117] *See Id.* at 485, 487, 17 S.E.2d at 678 (1941); Plumidies v. Smith, 222 N.C. 326, 329, 22 S.E.2d 713, 716 (1942); Pegg v. Grey, 240 N.C. 548, 550, 82 S.E.2d 757, 758 (1954); Swain v. Tillett, 269 N.C. 46, 51, 152 S.E.2d 297, 301 (1967); Pharo v. Pearson, 28 N.C. App. 171, 172, 220 S.E.2d 359, 360 (1975).

[118] "To recover for injuries inflicted by a domesticated animal . . . plaintiff must allege and prove: (1) that the animal was dangerous, vicious, mischievous, or ferocious, or one termed in law as possessing a vicious propensity: and (2) that the owner or keeper knew or should have known of the animal's vicious propensity, character, and habits. . . . The gravamen of the cause of action in this event is not negligence, but rather the wrongful keeping of the animal with knowledge of its viciousness; and thus both viciousness and scienter are indispensable elements to be averred and proved." *Swain*, 269 N.C. at 301, 152 S.E.2d at 51. This language has been repeatedly quoted in subsequent decisions surrounding animal liability cases, as recently as 2002. Lee v. Rice, 154 N.C. App. 471, 474, 572 S.E.2d 219, 222 (2002).

[119] The case of *Sams v. Sargent* is fairly instructive of the approach taken by North Carolina courts with respect to dog bite cases. 25 N.C. App. 219, 212 S.E.2d 559 (1975). In *Sams* the Court of Appeals addressed injuries caused to the plaintiff after the defendant's dog ran into the road and collided with a motorcycle. After determining that in the absence of a local leash law the plaintiff could not recover via a negligence per se theory, the court turned to the plaintiff's assertion of a negligence claim:

> Absent such a showing [of an applicable leash ordinance] the owner of a dog is not required to keep his dog under restraint unless it can be shown under common law rules that "(1) that the animal was dangerous, vicious, mischievous, or ferocious, or one termed in law as possessing a vicious tendency; and (2) that the owner or keeper knew or should have known that the animal's vicious propensity, character, and habits." . . . Even if plaintiff had shown that a dog belonging to defendant frequently dashed into the street to bark at and pursue motor vehicles, that fact standing alone, would not be sufficient to justify classifying the dog as a vicious animal.

Id. at 221, 212 S.E.2d at 559 (quoting Hall v. Moore, 267 N.C. 344, 349, 148 S.E.2d 265, 270 (1966) and citing *Plumidies*, 222 N.C. at 326, 22 S.E.2d at 713). North Carolina courts appeared to strictly limit damage claims for domesticated animals to negligence per se and the vicious propensity rule. Other negligence actions were routinely dismissed. *Id.*

The first hint that the appellate courts intended to broaden the acceptable claims for relief in domesticated animal injury cases, came in the case of *Griner v. Smith.*[120] In a case involving an injury to a breed mare after an attack by another horse,[121] the court unveiled an entirely new approach to liability. Implying that the "vicious propensity" rule was really just another form of a negligence action, the court allowed the plaintiff to proceed in the absence of a showing that the defendant's horse was vicious or dangerous.[122] "The owner of a domestic animal is chargeable with knowledge of the general propensities of certain animals and he must exercise due care to prevent injury from reasonably anticipated conduct. Therefore, not all actions seeking recovery for damage caused by a domestic animal need involve the vicious propensity rule."[123]

From this decision forward, North Carolina courts have continued to drift back and forth from negligence analysis to strict liability analysis in animal liability cases, including dog-bites. Sometimes courts demand adherence to the old "vicious propensity rule" and sometimes they embrace broader negligence claims, classifying the "vicious propensity rule" as merely one form of negligence.[124] Not only is this mixing and matching of theories confusing, but it is entirely wrong. The "vicious propensity rule" is a strict liability construct, which also requires the plaintiff to show scienter as a foundational element for the claim.[125] It was never intended to be based on negligence theory.

> Accordingly the courts must be keen to distinguish the basis for the action. If negligence is the basis reasonable conduct in keeping an animal is required. If the conduct is unreasonable in light of whatever danger the animal posed, liability will be imposed even when the animal may not have had a dangerous propensity to injure. If strict liability is being imposed based on the owner's keeping of a domestic animal that the owner knows of should know has a vicious disposition, then liability is imposed without proof that the owner was unreasonable. Determining what the owner knew or should have known is judged by the reasonable person standard, even though the

[120] 43 N.C. App. 400, 259 S.E.2d 383 (1979).

[121] *Id.* at 402, 259 S.E.2d at 385.

[122] *Id.* at 407, 259 S.E.2d at 388.

[123] *Id.*

[124] In his article Professor Daye highlights the dangers of courts merely reciting boiler plate language in support of their decisions. The confusion arising from the misapplication and misunderstanding of the "vicious propensity rule" serves as a prime example in his article. Charles E. Daye, *Judicial Boilerplate Language as Tort Decisional Litany: Four Problem Areas in North Carolina*, 18 CAMPBELL L. REV. 359, 384-89 (1996).

[125] "This strict liability rule first emerged in North Carolina in 1850 . . . . Unfortunately, the courts have often mixed the language of fault-based liability when considering cases that appear to be based on strict liability." *Id.* at 385-86.

liability is strict. Thus, the courts must be careful to avoid boilerplate language of prior opinions and in the opinion at hand.[126]

Unfortunately, the courts did not heed this advice and, as Professor Daye predicted, things continued to grow ever more unsettled. To make matters worse, the North Carolina Court of Appeals subsequently allowed breed specific theories to be added to the mix in *Hill v. Williams*.[127] The plaintiff failed to demonstrate that the specific dog in question, a 120 pound Rottweiler, had prior vicious tendencies known by the owner.[128] Nevertheless, the Court of Appeals ruled that evidence establishing the Rottweiler breed as an abnormally dangerous breed allowed the plaintiff to recover on a general negligence theory, regardless of knowledge of the vicious tendencies of the individual dog in question.[129] Practical problems of proving that specific breeds are vicious aside,[130] the difficulty in applying these mismatched theories to any set of facts is monumental.

The confused state of the law became abundantly clear two years later in *Thomas v. Weddle*.[131] *Thomas* arose from injuries caused by a kitten that scratched the plaintiff's child.[132] After a heroic, yet tortured, attempt to create sense from the previous tangle of prior rulings,[133] the court announced yet another twist. Specifically, the court stated that all liability theories for animal injuries arise from negligence.[134] It then proceeded to announce different "tests for liability" for each of these negligence theories, some of which still seemed to include strict liability

[126] *Id.* at 389.

[127] 144 N.C. App. 45, 547 S.E.2d 472 (2001).

[128] In fact, the trial court dismissed the plaintiff's "vicious propensity rule" claim at the close of the plaintiff's evidence. *Id.* at 49, 547 S.E.2d at 475. The trial court, however, allowed the plaintiff to proceed with a general negligence claim. *Id.*

[129] *Id.* at 55, 547 S.E.2d at 478 (citing Williams v. Tysinger, 328 N.C. 55, 56, 399 S.E.2d 108, 109). In *Williams* the Supreme Court reversed the Court of Appeals, which had held that absent demonstration of prior knowledge of "vicious propensities" the plaintiff could not recover for injuries sustained from a domesticated animal. *Williams*, at 60, 399 S.E.2d at 112. The case involved injuries caused by a previously gentle horse that kicked the plaintiff, a seven year old boy, who tried to pet it. *Id.* at 56, 399 S.E.2d at 109. The Supreme Court held the defendant's should have been aware that any horse might kick a child and allowed recovery based solely on negligence. *Id.* at 60, 399 S.E.2d at 112.

[130] *See supra* notes 103-176 and accompanying text.

[131] 167 N.C. App. 283, 605 S.E.2d 244 (2004).

[132] *Id.* at 285, 605 S.E.2d at 245.

[133] The court reviewed the entire history of animal liability and attempted to fashion various liability theories in a negligence framework. "In the context of injuries caused by animals, the parameters of reasonable foreseeability will vary according to the breed, species, or known individual temperament of the animal." *Id.* at 287, 605 S.E.2d at 247.

[134] *Id.*

concepts.[135] Kittens, since they are by nature ordinarily harmless and docile, fall into an apparently entirely new class; gentle or tame domestic animals. The "test for liability" for these newly christened "gentle or tame domestic animals" is ordinarily application of the "vicious propensity rule."[136] Unless, of course, the plaintiffs can show that the particular animal in question was of a species or breed known to be inherently dangerous. Then the *Hill* precedent applies and the plaintiff can recover, whether or not he demonstrates that the defendant owner knew of the individual animal's vicious tendencies.[137] In addition, each species also has some inherent characteristics, such as a horse kicking people, which a reasonably prudent person should guard against. Knowledge of vicious tendencies of the individual animal would not be necessary in this type of general negligence action.[138] This is to say nothing about wild animals, which the *Thomas* court said are also covered by negligence theories rather than strict liability.[139] Merely having a wild animal at all violates the duty to prevent reasonably foreseeable injuries.[140] Although it sounds like strict liability, it looks like strict liability, and it walks like strict liability, to the appellate courts of North Carolina it is not strict liability but negligence. Essentially, in order to reconcile this line of cases the court had to pound round pegs into square holes and created new artificial concepts, such as "gentle and tame animals" or "large domestic animals".

The incongruence is readily apparent each time the courts make a ruling in this area of the law. The *Thomas* decision aside, the courts no longer even bother to reconcile inconsistent decisions.[141] Instead, they

[135] *Id.* at 288, S.E.2d at 247-48. This mixing of theories makes it extremely difficult for trial courts and litigants, not to mention animal owners, to determine what elements exist for the plaintiff to prevail. Daye, *supra* note 133, at 389.

[136] *Thomas,* 167 N.C. App. at 288, 605 S.E.2d at 247. This "gentle or tame domestic animal" distinction had not previously appeared in North Carolina law.

[137] *Id.* "[D]efendants in a negligence action were 'chargeable with the knowledge of the general propensities of the Rottweiler animal where evidence showed the breed to be very strong, aggressive and temperamental, suspicious of strangers, protective of its space and unpredictable." *Id.*at 287, 605 S.E.2d at 247 (quoting *Hill,* 144 N.C. App. at 55, 547 S.E.2d at 478 (2001)).

[138] "Also, with regards to large domestic animals or certain domestic animals of known danger, the owner or keeper will also be charged with knowledge of the general nature of the species or breed." *Id.* Again, the "large domestic animal" and "certain domestic animals of known danger" are brand new concepts.

[139] *Id.* Thus, the court announced another heretofore unknown theory surrounding "wild animals" to fit everything into a negligence construct.

[140] *Id.*

[141] *See also* Lee v. Rice, 154 N.C. App. 471, 572 S.E.2d 219 (2002) (throwing all the theories, negligence, negligence per se pursuant to dangerous dog statute, and strict liability, into one pot without explanation before issuing its ruling, which appeared to be based on the old "vicious propensity rule").

just throw around some boilerplate language from previous decisions and then issue a decision, which may or may not be consistent with prior holdings.[142] In *Holcomb v. Colonial Associates, L.L.C. and John Olson*[143] a divided Supreme Court reversed the Court of Appeals also divided ruling[144] and extended negligence liability for dog-bites to landlords.[145] The ruling made the obligatory references to some past decisions, ignored others, and then proclaimed that the "vicious propensity rule" is a form of strict liability after all. According to this opinion at least, strict liability is once again completely distinct from a negligence claim and has no bearing on claims based in negligence.[146]

To complicate matters further the legislature passed a dangerous dog statute in 1989.[147] The wording of the statute is similar to laws enacted by other states across the country and can be a very helpful tool to prevent dog bites. It also includes strict civil liability for attacks by dogs classified as "dangerous."[148] Unfortunately, the state legislature failed to explain how the dangerous dog law would fit into the overall body of law surrounding dog-bite liability. Instead of using this opportunity to clarify domestic animal liability and to provide some guidance to the courts, lawmakers simply added another disconnected piece to an already jumbled puzzle. Courts, by routinely using "dangerous" and "vicious" interchangeably, fail to recognize the significant differences in these terms and the liability theories attached to them.[149] When various local leash and licensing laws, which enable negligence per se lawsuits are added to the pot,[150] a complicated picture emerges for trial courts and litigants, not to mention pet owners, who have no clear guidance regarding what expectations the legal system has for dog owners.

[142] *Id.*

[143] 358 N.C. 501, 597 S.E.2d 710 (2004)

[144] *Holcomb,* 153 N.C. App. 413, 570 S.E.2d 248 (2002), *rev'd* 358 N.C. 501, 597 S.E.2d 710 (2004).

[145] *Holcomb*, 358 N.C. at 507, 597 S.E.2d at 714.

[146] *Id.* In her dissent Justice Parker recognized the tenuous logic the court utilized to extend liability to landlords and the potential ramifications. "Notwithstanding the majority's overture to dogs, today is, I fear, a sad day for Fido and Rover. Accordingly, I respectfully dissent." *Id.* at 512, 597 S.E.2d at 717 (Parker J., dissenting).

[147] N.C. GEN. STAT. § 67-4.1 to 4.4 (2006); *see supra,* notes 98-102 and accompanying text.

[148] *See supra,* notes 98-99 and accompanying text.

[149] *Lee,* 154 N.C. App. at 473-74, 572 S.E.2d at 221-22.

[150] *Pharo,* 28 N.C. App. at 174, 220 S.E.2d at 361 (holding that "cities are justified in adopting stricter regulations for dogs and violations open the door for negligence per se).

IV. RECOMMENDATIONS AND CONCLUSIONS

Not only have North Carolina's courts and legislature created a difficult theoretical framework for dog bite liability, but they have created a system focused entirely on the animals instead of the owners. For all of their disagreements, animal law scholars uniformly agree that dog bite laws should center upon the conduct of owners rather than trying to get inside the minds of animals.[151] Under the current precedents, the bulk of trial evidence necessarily must now address animal behaviors: Is this individual dog vicious, based on its habits and prior conduct? Does this species of animal have inherent dangerous characteristics that a reasonable owner should be aware of? Is this breed of animal inherently vicious or dangerous? Is this class of animal generally perceived to be gentle and docile? and so forth.[152] The enormous practical problems of proving the answers to these questions aside, the questions themselves are the wrong ones to ask. Instead, the courts should focus attention upon animal owners and their conduct. This is the lynchpin of any effective dog-bite law.[153] The solution to the twisted system in North Carolina, or in any other state that lacks clear owner focused dog-bite laws, will require the state legislature to create a comprehensive set of laws to replace the current piecemeal approach. The author recommends that a comprehensive system include the following elements:

1) OWNER LIABILITY—First and foremost, the legislature needs to clarify the theory of liability for injuries caused by domesticated animals. A strict liability statute, which removes the requirement for knowledge of prior viciousness, would immediately eliminate the bulk of confusion inherent under the current system. A majority of states have already adopted this approach.[154] The focus shifts then from dog to man and the basis for claims becomes clear. If you own a dog, you are responsible for any unprovoked injuries that dog causes. All dog owners, therefore, have a strong incentive to responsibly control their dogs.
2) DANGEROUS DOG LAWS—North Carolina's dangerous dog statute

[151] *See supra*, notes 73-78 and accompanying text.

[152] This author foresees a parade of so-called animal experts testifying about the mindset or character of this species or that one of this breed or that one of this specific animal or that one. For a discussion of the difficulties surrounding animal behavior and breed characteristics *see supra*, notes 64-73 and accompanying text.

[153] "Proper containment can nullify the danger posed by even the most aggressive dog, and strict liability for failure to properly confine will convince owners to be vigilant and responsible, or to forsake ownership of aggressive dogs." Burstein, *supra* note 20, at 327.

[154] *See supra*, note 87.

should remain in effect as a vital part of any comprehensive dog-bite framework. Although the civil liability provisions may no longer be required, the ability of citizens in cooperation with local animal authorities to identify and regulate the control of specifically identified dangerous animals is needed. Again, this statute encourages responsible ownership and penalizes owners who act irresponsibly. Criminal penalties,[155] which should be strengthened further, speak loudly to dog owners regarding the seriousness with which the state takes the prevention of dog-bite injuries.

3) DOG FIGHTING LAWS—North Carolina currently makes it a felony offense to engage in any conduct related to dog fighting, including participating as a spectator at a dog fighting exhibition.[156] This is an important deterrent and should be maintained. The state legislature should also ensure that adequate monies are provided to law enforcement agencies and animal control authorities. This applies equally to all dog control laws. Enforcement without funding is impossible and unenforceable laws are meaningless.
4) LOCAL LEASH AND LICENSING LAWS—It is important that local governments continue to have the ability to establish dog control ordinances tailored to their particular needs. The state legislature should formally encourage this practice across the state. Local dog control laws are critical elements in any dog-bite prevention strategy. The state should work closely with local authorities to ensure enforcement of these ordinances.
5) BAN BREED SPECIFIC LAWS—While local authorities should be encouraged to pass leash and licensing ordinances, breed specific regulations should be disallowed. Laws targeted at specific breeds are simply more trouble than they are worth. Not only are they opposed by many advocacy groups, but they are difficult to enforce, have numerous practical problems, and do not adequately penalize irresponsible owners. Several states have already banned breed specific laws and North Carolina should follow their lead.[157]

For too long many states, North Carolina being but one example, have failed to address dog-bite law in any systematic meaningful way.

[155] *See e.g.*, N.C. GEN. STAT. § 67-4.2 (2006) (violating precautions required for all dangerous dogs is a class 3 misdemeanor); N.C. GEN. STAT. § 67-4.3 (2006) (holding owner of dangerous dog that attacks and caused serious physical injuries criminally liable for a class 1 misdemeanor).

[156] Not only do participants, trainers, and organizers face felony sentences up to thirty months in prison, but so do spectators. N.C. GEN. STAT. § 14-362.2 (2006). The liability for spectators has been upheld as Constitutional. State v. Arnold, 147 N.C. App. 670, 557 S.E.2d 119 (2001).

[157] Cunningham, *supra* note 10, at 8; Grey, *supra* note 20, 425-27.

Instead, many states have allowed their laws to meander through a series of disjointed piecemeal laws and case decisions. Given the tremendous societal costs each year resulting from animal inflicted injuries, the time has come to create a comprehensive body of law to address when dog bites man. By systematically focusing on the conduct of owners, states just may be able to take a real bite out of the dog-bite epidemic.

EMPLOYEE RETALIATION CLAIMS UNDER THE SUPREME COURT'S *BURLINGTON NORTHERN & SANTA FE RAILWAY CO. V. WHITE* DECISION: IMPORTANT IMPLICATIONS FOR EMPLOYERS

by DAVID P. TWOMEY[*]

I. INTRODUCTION

Not only does Title VII of the Civil Rights Act of 1964 forbid employment discrimination against any individual based on the individual's "race, color, religion, sex or national origin," as set forth in Section 703(a) of the Act[1], but a separate section of the Act, Section 704, makes it unlawful for an employer "to discriminate against" an employee or job application because the individual "opposed any practice" made unlawful by Title VII or "made a charge, testified, assisted, or participated in" a Title VII proceeding or investigation.[2] Because federal circuit courts of appeals had reached different conclusions about the scope of Section 704 —the so-called anti-retaliation provision of the Civil Rights Act—and the appropriate legal standard to be applied as well as the level of seriousness the harm must rise to in order to be actionable retaliation, the U.S. Supreme Court was called upon to resolve these splits in the circuits in its *Burlington Northern & Santa Fe Railway Co. v. White*

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[1] Pub. L. No. 88-352, § 703(a), 78 Stat. 257 (1964) (current version at 42 U.S.C. § 2000e-2(a) (2006)).

[2] Pub. L. No. 88-352, § 704, 78 Stat. 257 (1964) (current version at 42 U.S.C. § 2000e-3(a) (2006)).

decision.[3] The article presents the factual background of the case; the Court's reasoning and resolution of the "reach" of the Act's anti-retaliation provision; the Court's standard for actionable retaliation; and the application of the actionable retaliation standard to the *Burlington Northern* case. The article concludes with an evaluation of the impact the decision will have on Title VII jurisprudence and recommendations for employers.

II. FACTUAL BACKGROUND

Shelia White was hired by the Burlington Northern & Santa Fe Railway as a "track laborer" at the Carrier's Tennessee Yard.[4] She was the only woman working in the track department. Soon after she was hired she was given the job of forklift operator, as opposed to the ordinary track laborer tasks, which involve track and switch maintenance work, cutting brush and clearing litter from the right-of-way[5]. Three months after being hired she complained to company officials that her foreman treated her differently than male employees, and twice made inappropriate remarks to her. The foreman was suspended without pay for ten days and ordered to attend sexual harassment training.[6] Also at that time the Roadmaster, a company supervisor who investigated the matter, reassigned the forklift duties to the former operator who was "senior" to White, and assigned White to track laborer duties. He explained that the reassignment reflected co-worker complaints that in fairness "a more senior man" should have the "less arduous and cleaner job."[7] Six months into her employment White refused to ride in a truck as directed by a different foreman, and she was suspended for insubordination.[8] A grievance was filed on her behalf by her union; and some thirty seven days later she was reinstated by the railroad with full backpay and the discipline was removed from her record.[9] White filed a complaint with the EEOC claiming the reassignment to track laborer duties was unlawful gender discrimination and retaliation for her complaint about her treatment by the foreman. The 37 day suspension led to an additional retaliation charge.[10] A jury

[3] 126 S. Ct. 2405 (2006).

[4] *Burlington N.*, 126 S. Ct. at 2409.

[5] *Id.*

[6] *Id.*

[7] *Id.*

[8] *Id.* For more factual development on this incident see White v. Burlington N. & Santa Fe Ry. Co., 364 F.3d 789, 793 (6th Cir. 2004) (en banc) [hereinafter White II], and White v. Burlington N. & Santa Fe Ry. Co., 310 F.3d 443, 448 (6th Cir. 2002) [hereinafter White I].

[9] *Burlington N.*, 126 S. Ct. at 2409.

[10] *Id.* at 2410.

rejected her gender discrimination claim and awarded her compensatory damages of $43,500, including $3250 in medical expenses on the retaliation claims.[11] BNSF appealed contending that Ms. White was hired as a track laborer and it was not retaliatory to assign her to do the work she was hired to do. And, it asserted that the suspension of 37 days was corrected and she was made whole for her loss. A divided Sixth Circuit Court of Appeals panel reversed the judgment.[12] The full Court of Appeals vacated the panel's decision and voted to uphold the District Court's judgment in White's favor, but differed as to the proper standard to apply.[13]

III. THE "REACH" OF THE ANTI-RETALIATION PROVISION

Because the Courts of Appeals had reached different conclusions about the scope of the Section 704 anti-retaliation provision, particularly the reach of the phrase "discriminate against" as used in that section, the Supreme Court was required to resolve the issue of whether Section 704 confines actionable retaliation only to activity that affects the terms and conditions of employment in the workplace itself as opposed to harm caused both in the workplace and outside the workplace.[14] Further, the Court was required to determine the appropriate standard as to how harmful must the adverse actions be to fall within the scope of Section 704.[15] The Third, Fourth and Sixth Circuits required a plaintiff to show an "adverse employment action," applying the same standard for retaliation that is applied to a substantive discrimination offense under Section 703(a).[16] The District of Columbia Circuit and the Seventh Circuits applied a broad view requiring a plaintiff to show that the "employer's challenged action would have been material to a reasonable employee" and would likely have "dissuaded a reasonable worker from making or supporting a charge of discrimination."[17]

Burlington Northern argued that the Sixth Circuit majority in its disposition of the *Burlington Northern* case was correct to require a link between the challenged retaliatory action and the terms, conditions, or status of employment as set forth in Title VII's core anti-discrimination

[11] *Id.*

[12] *White I,* 310 F.3d 443.

[13] *White II,* 364 F.3d 789.

[14] *Burlington N.*, 126 S. Ct. at 2408.

[15] *Id.*

[16] Robinson v. City of Pittsburgh, 120 F.3d 1286, 1300 (3rd Cir. 1997); Von Gunten v. State of Maryland, 243 F.3d 858, 866 (4th Cir. 2001); White II, 364 F.3d at 795.

[17] Rochon v. Gonzales, 438 F.3d 1211, 1217-1218 (D.C. Cir. 2006), *rehearing denied,* 2006 U.S. App. LEXIS 17535 (D.C. Cir. July 11, 2006); Washington v. Department of Revenue, 420 F.3d 658, 662 (7th Cir. 2005).

provision, Section 703(a).[18] In its analysis, the Court focused on the language of the Act itself underscoring key terms, as follows:

Section 703(a)

It shall be an unlawful employment practice for an employer—

> "(1) *to fail or refuse to hire or to discharge* any individual, or otherwise to discriminate against any individual *with respect to his compensation, terms, conditions, or privileges of employment*, because of such individual's race, color, religion, sex, or national origin; or
> (2) to limit, segregate, or classify his employees in any way *which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee*, because of such individual's race, color, religion, sex, or national origin." § 2000e-2(a) (emphasis added).

Section 704(a) sets forth Title VII's anti-retaliation provision in the following terms:

> "It shall be an unlawful employment practice for an employer to *discriminate against* any of his employees or applicants for employment... because he has opposed any practice made an unlawful employment practice by this subchapter, or because he has made a charge, testified, assisted, or participated in any manner in an investigation, proceeding, or hearing under this subchapter." § 2000e-3(a) (emphasis added).[19]

The Court refused to conclude that the different words used by Congress in Section 703(a) and Section 704 should be read to mean the same thing, as asserted by Burlington Northern and the Sixth Circuit majority. The underscored words in Section 703(a) limit the scope of that provision to the workplace.[20] No such limitations appear in Section 704, the anti-retaliation provision.[21] The Court pointed out that the anti-discrimination provision seeks a workplace where individuals are not discriminated against because of their racial, ethnic, religious, or gender-based status.[22] And the anti-retaliation provision seeks to secure the anti-discrimination provision's objective by preventing an employer from interfering through retaliation with an employee's efforts to secure or advance enforcement of the Act's basic guarantees.[23] Since an employer can effectively retaliate against an employee by taking actions not directly related to his employment, or causing harm outside the

[18] *Burlington N.*, 126 S. Ct. at 2411.
[19] *Id.*
[20] *Id.* at 2411-2412.
[21] *Id.* at 2412.
[22] *Id.*
[23] *Id.*

workplace, the court concluded that Title VII's anti-retaliation provision extends beyond workplace-related or employment-related retaliatory acts and harms.[24]

IV. THE STANDARD FOR ACTIONABLE RETALIATION

Focusing on the employer's challenged retaliatory act, and not the underlying conduct that forms the basis of the Title VII complaint, the Supreme Court set forth a standard to resolve the differing language used by the circuit courts to describe the level of seriousness to which the harm must rise before it becomes actionable retaliation. The Court concluded that a plaintiff must show that a reasonable employee would have found the challenged action materially adverse, "which in this context means it well might have dissuaded a reasonable worker from making or supporting a charge of discrimination."[25] The Court stated that by focusing on the materiality of the challenged action and the perspective of a reasonable person, it believes that this standard will screen out trivial conduct while capturing those acts that are likely to dissuade employees from complaining or assisting in complaints about discrimination.[26]

V. APPLICATION OF THE *BURLINGTON NORTHERN V. WHITE* STANDARD

The jury found that two of BNSF's actions amounted to retaliation: the reassignment of White from forklift duty to standard track laborer tasks and the 37-day suspension without pay. The Court reviewed each action under its anti-retaliation standard.

[24] *See* Rochon v. Gonzales, 438 F.3d at 1213 (concerning employer-FBI retaliation against employee in "the form of the FBI's refusal, contrary to policy, to investigate death threats a federal prisoner made against [the agent] and his wife"); Berry v. Stevinson Chevrolet, 74 F.3d 980, 984, 986 (10th Cir. 1996) (finding actionable retaliation claim as to employer who filed false criminal charges against a former employee who complained about discrimination). The *Burlington Northern* Court did not have to address the issue of the "reach" of Section 704 beyond the workplace, to harm caused outside the workplace, as the employer actions at issue taken against Ms. White were both workplace-related actions. Rather than wait for a case involving an outside-the-workplace employer action, the Court took the opportunity to settle the issue and policy questions regarding Sections 703(a) and 704 as a foundation for its settling the standard for actionable retaliation claims under Section 704.

[25] *Burlington N.*, 126 S. Ct. at 2415 (quoting *Rochon*, 436 F.3d at 1219; *Washington*, 420 F.3d at 662) (citing with approval the formulation set forth by the Seventh and District of Columbia Circuits).

[26] *Burlington N.*, 126 S. Ct. at 2416.

A. The Reassignment of Duties.

Burlington Northern argues that a reassignment of duties cannot constitute retaliatory discrimination where both the former and present duties fall within the same job designation.[27] The Court disagreed. While the reassignment of job duties is not automatically actionable, the Court stated whether a particular reassignment is materially adverse depends upon the circumstances of the particular case, and should be judged from the perspective of a reasonable person in the plaintiff's position, considering all the circumstances.[28] The Court quoted the following evidence of record the jury had before it:

> ...the jury had before it considerable evidence that the track laborer duties were "by all accounts more arduous and dirtier"; that the "forklift operator position required more qualifications, which is an indication of prestige"; and that "the forklift operator position was objectively considered a better job and the male employees resented White for occupying it."[29]

The Court concluded that based on this record, a jury could reasonably conclude that the reassignment of White's responsibilities would have been materially adverse to a reasonable person.[30]

B. The 37-Day Suspension

BNSF argues that the 37-day suspension without pay lacked statutory significance because the railroad ultimately reinstated White to service with full backpay. The Court did not find their argument to be convincing. The Court stated that a reasonable employee facing the choice between retaining her job (and paycheck) and filing a discrimination complaint might well choose the former.[31] Thus an indefinite suspension without pay could well act as a deterrent, even if the suspended employee eventually received backpay.[32] The Court determined that the jury's conclusion that the 37-day suspension without pay was materially adverse was a reasonable one.[33]

[27] *Id.*
[28] *Id.*
[29] *Id.* at 2417 (quoting *White II*, 364 F.3d at 803).
[30] *Burlington N.*, 126 S. Ct. at 2417.
[31] *Id.*
[32] *Id.*
[33] *Id.* at 2418.

VI. IMPACT AND IMPLICATIONS OF THE *BURLINGTON NORTHERN* STANDARD

In the second sentence of his opening statement in the oral argument before the Supreme Court of the United States, counsel for Burlington Northern stated:

> …As the Solicitor General's brief and a couple of the other *amici* briefs point out, the number of—the number of these claims has increased by more than 100 percent over the course of the last decade, more than 30 percent of the EEOC's docket is now made up of retaliation claims, and the cost of an average contested retaliation claim exceeds $130,000 per case….[34]

Implicit in such an opening remark was a warning to the Court that a broad anti-retaliation standard would add significant burdens to employers and the federal courts.[35] In fact Title VII charges alleging retaliation have been relatively constant since FY 2000, with 19,753 charges filed in that period, with a high of 20,615 in FY 2003 and a decline to 19,429 in FY 2005 and 19,560 in FY 2006.[36] The Court was not persuaded by employer assertions that a broad anti-retaliation standard would open floodgates to retaliation claims.[37] Rather, in order to protect the goal of achieving equal opportunity in employment in our society, the Court focused instead on implementing a standard—"materially adverse" from the perspective of a "reasonable worker"—that would screen out trivial conduct while effectively capturing those acts

[34] Transcript of Oral Argument at 35, *Burlington N.*, 126 S. Ct. 2405 (No 05-259), http://www.supremecourtus.gov/oral_arguments/argument_transcripts/05-259.pdf.

[35] *See generally* Brief for Equal Employment Advisory Council and the Chamber of Commerce as Amici Curiae Supporting Petitioners at 10-11 & n.3, Burlington N. & Santa Fe Ry. Co. v. White, 126 S. Ct. 2405 (2006) (No. 05-259), *available at* http://www.uschamber.com/NR/rdonlyres/exvrdlkptb6qt5rkpbefir5mr4zthvzscbnvvxq2y34hkb3esm3utkcdcuch4cwokyyzbxfvuyop573x4caemth7fna/BurlingtonNorthernSantaFeRailroadv%2eWhite.pdf. The Brief summarized EEOC statistical data as follows: "The statistics reported on EEOC's website show that Title VII charges alleging retaliation increased from 10,499 in Fiscal Year 1992 to 20,240 in Fiscal Year 2004 and, during that same period, grew from 14.5 percent to 25.5 percent of all Title VII charges filed with the agency." *Id.* The Amici acknowledge that Section 704(a) is designed to assure that employees who exercise their Title VII rights do not suffer discrimination as a result, but then conclude in off-putting language that, "[i]t is not, however, designed to vaccinate such employees against legitimate discipline or supervisory controls." *Id.* at 8.

[36] *See* EEOC Charge Statistics, *available at* http://www.eeoc.gov/stats/charges.html.

[37] *Burlington N.*, 126 S. Ct. at 2415-16. *See also White II*, 364 F.3d at 809-17 (Clay., J., concurring) (stating that "there are no indications that the broad rules still employed in the Ninth, Tenth, and Eleventh Circuits have opened unmanageable floodgates to aggrieved Title VII plaintiffs").

that are likely to dissuade employees from complaining or assisting in complaints about discrimination.[38]

VII. CONCLUSIONS AND RECOMMENDATIONS

Employers must be aware that the *Burlington Northern* decision extends the reach of Section 704 protections beyond the workplace and employment related retaliatory acts and harms, widening the range of employer conduct subject to the Act. The standard, involving questions of "materiality" of the employer action and how the action would influence a "reasonable worker," will result in an increase in litigation involving issues of fact for juries to resolve as opposed to the resolution through the summary judgment process as was appropriate in some retaliation cases. The time-consuming pre-trial procedures for building cases for jury trials and the trials themselves will add significant costs to employers and employees, with the employers responsible for their attorneys' fees, damages and attorneys' fees for the employees should the employees be successful in their litigation. Accordingly employers must develop and implement effective anti-retaliation policies and procedures for its supervisors and employees. With the wide notoriety of the *Burlington Northern* decision, employers should expect to have to deal with an increase in the number of claims of alleged retaliation.

Employers should develop and implement an anti-retaliation preventative action plan. It should:

- Post as part of its anti-discrimination and harassment policies a broad anti-retaliation policy that will be strictly enforced!
- Establish ongoing educational programs for all levels of supervision to ensure that managers understand actions that may be construed as retaliation and the possible consequences to the employer of retaliatory litigation. The plan should set forth the disciplinary consequences to company officials found responsible for retaliatory actions.
- Make certain that complainants of race, color, religion, sex, national origin, age and disability know that there will be no retaliation for filing a complaint, and each individual who may be interviewed or who may testify regarding such a complaint shall also be informed of the company's no-retaliation policy.[39]

[38] *Burlington N.*, 126 S. Ct. at 2416.

[39] As set forth in Section 704 of the Civil Rights Act, employees and applicants are protected from employer discrimination for opposing any practice made an unlawful employment practice by this subchapter—that is discrimination based on race, color, religion, sex or national origin. 42 U.S.C. section 2000e-3(a) (2006). The Age Discrimination in Employment Act also explicitly prohibits practices made unlawful by that act. 29 U.S.C. § 623(d) (2006). The EEOC's position is that claims may be filed for

- Human Resource specialists should be assigned to scrutinize any employer action against an employee who has previously complained about discrimination. Supervisors proposing disciplinary or "other" actions against a complainant must be able to demonstrate to the HR specialist that legitimate nondiscriminatory reasons exist for the proposed employer actions. As examples from the *Burlington Northern* case, when the roadmaster (company supervisor) concluded that Ms. White's foreman was in violation of the company's sexual harassment policy and should be disciplined and be required to attend a sexual harassment training session,[40] the concurrent timing of his reassigning the victim to less desirable duties would have signaled a clear anti-retaliation violation to a Human Resources specialist, which proposed action would have been overruled by the specialist and litigation avoided. So also when the track foreman and the roadmaster agreed to suspend Ms. White for insubordination without pay believing that she had refused a direct order to ride with another foreman,[41] mandatory consultation with a Human Resources specialist could have initially resulted in an immediate suspension "with pay" and an expedited investigation by the employer to ascertain the true facts of the incident, rather than a thirty seven day period without a paycheck, which was a materially adverse action, even though the employer ultimately determined the discipline was not warranted and she eventually received full backpay and benefits and the discipline was removed from her record.

retaliation under the Americans with Disabilities Act and the Equal Pay Act. *See* EEOC Directives Transmittal, No. 915.003 (May 20, 1998), *available at* http://www.eeoc.gov/policy/docs/retal.html (providing guidance and instructions for investigating and analyzing claims of retaliation under the statutes enforced by the EEOC). Finally, corporate whistleblowers are protected from retaliation under Section 806 of the Sarbanes-Oxley Act. *See* 18 U.S.C. § 1514A (2006) (providing protections for employees from employer retaliation against employees who provide evidence of fraud).

[40] *Burlington N.*, 126 S. Ct. at 2409.

[41] *See White II*, 364 F.3d at 793; *White I*, 310 F.3d at 448.

ABROGATING PUBLIC EMPLOYEES' RIGHT TO DISSENT: FREE SPEECH IN THE PUBLIC SECTOR AFTER *GARCETTI* V. *CEBALLOS*

by MARY ELLEN WELLS

INTRODUCTION

While acknowledging that various measures have been adopted which protect public employees from supervisor misconduct, the Supreme Court held last year in *Garcetti v. Ceballos*[1] that such measures do not include First Amendment protection of all statements of public employees in the course of their work. The Supreme Court reversed the Ninth Circuit decision in *Ceballos v. Garcetti*[2] which held that allegations made in a memo written by a deputy district attorney constituted protected speech. In reversing *Ceballos* the Supreme Court rejected an opportunity to clearly provide whistleblowing protection to public employees as citizens under the First Amendment in situations when their citizen speech is made in the course of their employment duties. Since that time, a number of circuit courts have addressed the application of *Garcetti* in a variety of settings.[3] This article examines

[1] Garcetti v. Ceballos, 126 S. Ct. 1951 (2006).

[2] Ceballos v. Garcetti, 361 F.3d 1168 (9th Cir. 2004), *rev'd and remanded by* Garcetti v. Ceballos, 126 S. Ct. 1951 (2006).

[3] *See, e.g.,* Green v. Bd. of County Comm'rs, 472 F.3d 794 (10th Cir. 2007) (holding former county juvenile justice center drug lab employee Green's speech as an employee not protected under the First Amendment in light of *Garcetti* even though her conduct was "not explicitly required as part of her day-to-day job responsibilities" and was condemned by her supervisors), Freitag v. Ayers, 468 F.3d 528 (9th Cir. 2006) (remanding

the history of whistleblower protection before analyzing the most recent restriction on employee speech that is being imposed in the form of the Court's decision in *Garcetti* and its progeny involving the First Amendment rights for public employee whistleblowers.

WHISTLEBLOWER DEFINED

Among the myriad definitions of "whistleblower" is one set forth in the Senate committee report (accompanying the Civil Service Reform Act)[4] which defined whistleblowers as federal employees who disclose illegal or improper government activities.[5] Another source defines the term as an employee who discloses to the government or to the press that his/her employer is engaged in dangerous, illegal, or improper activities.[6] The Merit Systems Protection Board, the body charged with adjudicating whistleblower allegations by government employees, states that "whistleblowing means disclosing information that you reasonably believe is evidence of a violation of any law, rule or regulation, or gross mismanagement, a gross waste of funds, an abuse of authority, or a substantial and specific danger to public health or safety."[7] None of the definitions offer any indication of the maelstrom that can be created for employees that choose to embark down the road of disclosure of

former corrections officer Freitag's § 1983 claim to the district court for consideration in light of *Garcetti*), Piggee v. Carl Sandburg College, 464 F.3d 667 (7th Cir. 2006) (acknowledging that *Garcetti* was "not directly relevant" to this case since the former part-time instructor Piggee's speech was "not related to her job of instructing students", however noting that *Garcetti* "does signal the Court's concern that courts give appropriate weight to the public employer's interests"), Mayer v. Monroe County Cmty School Corp., 474 F.3d 477 (7th Cir. 2007) (holding that since former public school teacher Mayer acknowledged that her speech was part of her official job duties, *Garcetti* applies and prohibits "primary and secondary teachers, when conducting the education of captive audiences, to cover topics, or advocate viewpoints, that depart from the curriculum adopted by the school system;" distinguishing its holding in *Piggee* by arguing that *Garcetti* was not relevant in *Piggee* because in *Piggee* the speech to which the student objected was not part of Piggee's teaching duties), Battle v. Bd. of Regents for the State of Georgia, 468 F.3d 755 (11th Cir. 2006) (holding that university employee who reported improprieties in a supervisor's handling of federal financial aid funds was acting within the scope of her dues because, as a financial aid worker, the employee had a duty under federal guidelines to report any suspected fraud associated with federal financial aid funding), Fuerst v. Clarke, 454 F.3d 770 (7th Cir. 2006) (holding *Garcetti* inapposite due to the fact that the comments that precipitated the adverse employment action were not made in the course of employment but rather in the employee's capacity as a union representative).

4 Civil Service Reform Act, Pub. L. 95-454, 92 Stat. 1111 *et seq* (codified, as amended, in various sections of 5 U.S.C. (1982 ed. and Supp. IV)).

5 S. REP NO. 969, at 7, *as reprinted in* 1978 U.S.C.C.A.N. 2723, 2730.

6 ROBERT W. EMERSON, BUSINESS LAW 694 (4th ed. 2004).

7 U.S. Merit Systems Protection Board, Questions and Answers About Whistleblower Appeals, available at http://www.mspb.gov/q&awhistlebloweaug01.html

employer transgressions.[8] The disclosure can unleash retribution in many forms including harassment, demotion or termination of the employee. In the event of such retribution, the employee often seeks redress in the court system.

OVERVIEW OF WHISTLEBLOWER PROTECTION

Employees initially relied on the U. S. Constitution First Amendment right of free speech to obtain protection from adverse employment actions. Employees argued that such right protected their freedom to criticize their government employers.[9] Until *Garcetti,* employees' right of free speech was weighed against the interests of the government in efficient administration in accordance with the balancing test set forth in *Pickering v. Board of Education.*[10] Employees had to prove that the balance of those interests favored the employee's speech in order to obtain First Amendment protection.[11] In addition to the First Amendment's protections, employees have tried to avail themselves of the protections of various federal and state statutory provisions which have been introduced, as well as enacted, over the last forty or so years.

Early federal statutory whistleblower protection for employees can be found in legislation such as the Water Pollution Control Act,[12] the Civil Service Reform Act of 1978,[13] the False Claims Act,[14] and the Whistleblowers Protection Act.[15] A variety of public concerns culminated in the passage of statutory protection for whistleblowers. For example, the Civil Service Reform Act established "protection of employees from reprisal for protected activity, in particular 'whistleblowing,'"[16] in part because the public sentiment surrounding the Viet Nam War and the Watergate scandal helped create an atmosphere conducive to legislative response directed at providing protections against corrupt government policies and personnel.[17] Watergate itself drew increasing attention to

[8] *See* Charles S. Clark, *Whistleblowers*, 7 CQ RESEARCHER 1057 (1997) (citing a 1986 survey indicating that more than three-quarters of the whistleblowers surveyed lost sleep or experienced feelings of powerlessness, increased anxiety, anger and increased alcohol use).

[9] *See* Robert G. Vaughn, *Statutory Protection of Whistleblowers in the Federal Executive Branch*, 1982 U. ILL. L. REV. 615, 618.

[10] *See*, Pickering v. Bd. of Educ., 391 U.S. 563 (1968).

[11] *See, id.*

[12] *See* Water Pollution Control Act Amendments of 1972, 33 U.S.C. §1367 (1972).

[13] Pub. L. No. 95-454.

[14] False Claims Act, 33 U.S.C. §§ 3729 (1988).

[15] Pub. L. No. 101-12, 103 STAT. 16 (effective July 9, 1989) (codified as amended in scattered sections of 5 U.S.C.).

[16] Bruce D. Fong, *Whistleblower Protection and the Office of Special Counsel: The Development of Reprisal Law in the 1980's*, 40 AM. U. L. REV. 1015, 1016 (1991).

[17] Vaughn, *supra* note 9, at 618.

the plight of the whistleblower as whistleblowing was such an integral component of the scandal. The protective legislation enacted by Congress after these events "expanded whistleblowing activities to include disclosures which evidenced mismanagement, a gross waste of funds, an abuse of authority, or a specific danger to public health and safety."[18]

More recently, additional whistleblower protection was enacted through federal legislative response to private sector scandals such as WorldCom and Enron. The Sarbanes-Oxley Act of 2002[19] (SOX) specifically protects internal official duty speech of private sector employees[20]. The whistleblower protections included in SOX have also been incorporated in a number of federal statutes providing whistle-blower protection in specific industries. For example, the Energy Policy Act incorporated whistleblower protection language for covered Federal employees as was included for private sector employees under SOX.[21]

In addition to the federal statutory protections, numerous states began passing whistleblower protection acts in the 1980s. However, some states such as Delaware, New Mexico, Vermont, Virginia and Wyoming, have no whistleblower protection.[22] Other states, such as Alabama,[23] Connecticut,[24] and Iowa[25] have protection, but the protection applies only explicitly to employee speech made outside of the workplace rather than internal, official duty, speech and provides only limited administrative review.

There is currently no national whistleblower protection although there is a proposed uniform federal whistleblower protection law which would provide "a consistent safety net to all public and private sector

[18] Fong, *supra* note 16, at 1018.

[19] Sarbanes Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified at 28 U.S.C. § 1658(b)).

[20] *What Price Free Speech? Whistleblowers and the Ceballos Decision: Hearing before the House Government Reform Committee*, 109th Cong. (2006) [hereinafter *Whistleblower Hearings*] (statement of Stephen M. Kohn, Chair, National Whistleblower Center).

[21] Sarbanes Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified at 28 U.S.C. § 1658(b)).

[22] *WhistleblowerHearings*, *supra* note 20 (statement of Stephen M. Kohn, Chair, National Whistleblower Center) (citing data compiled from Practicing Law Institute; Victoria L. Donati and William J. Tarnow, *Whistleblower and other Retaliation Claims*, 729 PLI/LIT 1095, 1108 (2005), references from *Garcetti*, Westlaw search of terms "whistleblower," conscientious employee, and employee/10 protect!, Robert G. Vaughn, *State Whistleblower Statutes and the Future of Whistleblower Protection*, 51 ADMIN. L. REV. 481 (1999)).

[23] ALA. CODE § 36-26A to -27 (2007).

[24] CONN. GEN. STAT. § 31-51m (2007).

[25] IOWA CODE § 70A.29 (2006).

employees who report violations of federal laws and regulations."[26] Therefore, in the states either completely without whistleblower protection, or without internal speech whistleblower protection, the only available protection for a whistleblower is the First Amendment to the U.S. Constitution. After *Garcetti*, that protection is significantly curtailed.

FIRST AMENDMENT PROTECTION

We have progressed significantly since Justice Holmes' declaration in *McAuliffe v. Mayor of New Bedford,*[27] that "the petitioner may have a constitutional right to talk politics, but he has no constitutional right to be a policeman. There are few employments for hire in which the servant does not agree to suspend his constitutional right of free speech, as well as of idleness, by the implied terms of his contract."[28] Many years after Holmes' opinion, the court in *Keyishian* v. *Board of Regents*[29] ruled that public employees can not be compelled to "relinquish their First Amendment rights as a condition of public employment."[30] After *Keyishian* the question became, to what extent, and under what conditions, do public employees retain their First Amendment rights?

The following year, in *Pickering* v. *Board of Education*[31], the U.S. Supreme Court ruled that in certain situations the First Amendment protects a public employee's right to speak as a citizen on matters of public concern. The standard articulated in *Pickering* regarding protected speech of public employees requires a balancing of the rights of both the employee and the public in determining whether an employee's speech was protected under the First Amendment, but the Court cautioned that such interests be weighed against the interests of the government's need for efficient administration.[32] The court held that the First Amendment should protect the employee's speech only when such balance weighs in favor of the employee's speech.[33]

In 1975, the Supreme Court noted in *Bigelow v. Virginia*[34] that "[t]he guarantees of freedom of speech and press were not designed to prevent the censorship of the press merely, but *any action of the government* by

[26] *Whistleblower Hearings, supra* note 20 (statement of Stephen M. Kohn, Chair, National Whistleblower Center).

[27] McAuliffe v. Mayor of New Bedford, 29 N.E. 517 (Mass. 1892), *abrogated by* Shelton v. Tucker, 364 U.S. 479 (1960).

[28] *Id.* at 517-18.

[29] Keyishian v. Bd. of Regents, 385 U.S. 589 (1967).

[30] *Id.* at 605-06 (1967).

[31] Pickering v. Bd. of Educ., 391 U.S. 563 (1968).

[32] *See, id.*

[33] *Id.* at 568.

[34] Bigelow v. Virginia, 421 U.S. 809 (1975).

means of which it might prevent such free and general discussion of public matters as seems absolutely essential."[35] The term "any action of the government" was not limited by any qualifiers such as "against any private citizens". The focus was on the general discussion of public matters rather than on the speaker. It was not until later that the focus of rights provided under the guarantees of freedom of speech and press narrowed to the rights of private citizens versus the rights of public employees who also happen to be citizens and the drawing of distinctions between the purposes of the speech made by the two types of individuals.

The holdings in *Pickering* and *Bigelow* left room for some interpretive problems, such as the question of exactly which speech is protected, the question of how it is determined whether an individual is acting as a citizen or an employee, and the question of whether the individual may ever act as both? Some of these interpretive issues, as well as the question of whether there is constitutional protection of internal official duty speech for public employees, were recently litigated in *Garcetti*.

THE ROAD TO THE SUPREME COURT FOR CEBALLOS

Gil Garcetti was the Los Angeles County District Attorney from 1992 through 2000. Richard Ceballos became a deputy district attorney for the Los Angeles County District Attorney's Office in 1989. He was promoted in 1999 to calendar deputy with supervisory responsibilities over two to three deputy district attorneys. A defense attorney on a case in Ceballos' jurisdiction contacted him in late February 2000 and asked him to investigate a situation involving an arresting deputy sheriff who the defense attorney believed had lied in his affidavit in support of a search warrant.[36] Ceballos acknowledged that this type of request is fairly common.[37] Ceballos investigated and determined that the affidavit contained serious misrepresentations which resulted in a finding of probable cause to issue the search warrant.[38] Ceballos called the arresting deputy sheriff and questioned him about the affidavit. Dissatisfied with the results of the conversation, Ceballos "relayed his

[35] *Id.* at 829 (1975) (emphasis added).

[36] Ceballos v. Garcetti, 361 F.3d 1168, 1171 (9th Cir. 2004), *rev'd and remanded by* Garcetti v. Ceballos, 126 S. Ct. 1951 (2006).

[37] Garcetti v. Ceballos, 126 S. Ct. 1951, 1955 (2006) ("According to Ceballos, it was not unusual for defense attorneys to ask calendar deputies to investigate aspects of pending cases.")

[38] *Id.* Mr. Ceballos investigated the location specified in the affidavit and determined that where the affidavit described a long driveway it appeared to be a separate roadway. *Id.* He also concluded that the statement regarding tire tracks was not supported by the evidence since the composition of the roadway was not conducive to retaining tire tracks. *Id.*

findings to his supervisors....and followed up by preparing a disposition memorandum."[39]

Ceballos' memorandum recommended dismissal of the case. According to Ceballos, it was the first time in his 12 year career at the Los Angeles County District Attorney's Office that he had made such a recommendation for dismissal.[40] Ceballos acknowledged that he was following orders when he prepared the memorandum. He also acknowledged following orders when he documented his investigation, legal analysis, opinions and recommendations.[41] Finally, he acknowledged following orders when he channeled his memorandum to his supervisors through the regular chain of command in accordance with office policies.[42] Ceballos, his immediate supervisor Carol Najera, and her supervisor, the then Head Deputy District Attorney, Frank Sundstedt, all agreed that the veracity of the affidavit was questionable.[43]

As a result of Ceballos' statements and memorandum, a meeting was convened on March 9th with Ceballos, his supervisors Carol Najera and Frank Sundstedt, the warrant affiant and other employees from the Sheriff's office. According to Ceballos, the meeting became contentious and the Sheriff's department officials demanded that Ceballos' supervisors remove him from the case. Following the meeting, Sundstedt decided to proceed with the prosecution pending the disposition of a defense motion to contest the search warrant affidavit. Ceballos contacted defense counsel and relayed his belief that the affidavit contained false statements.[44] Upon request by Najera, Ceballos revised his memorandum to reduce the accusatory tone and provided it to the defense.[45] Ceballos was called by the defense to testify at the hearing on the motion but defense's motion was denied and the prosecution of the case moved forward.[46] As a result of having testified for the defense in the case, Ceballos was removed from the prosecution team.[47]

Ceballos maintained that Garcetti, Sundstedt and Najera (the "defendants") retaliated against him for submitting the memorandum

[39] *Id.*

[40] *Whistleblower Hearing, supra* note 20 (Statement of Richard Ceballos, Deputy District Attorney).

[41] *Id.*

[42] *Id.*

[43] Ceballos v. Garcetti, 361 F.3d 1168, 1171 (9th Cir. 2004), *rev'd and remanded by* Garcetti v. Ceballos, 126 S. Ct. 1951 (2006).

[44] *Id.*

[45] *Id.* Ceballos told Najera that pursuant to Brady v. Maryland and other case law, he was obligated to turn over to the defense the memoranda he had prepared regarding his opinion. *Id.*

[46] *Id.*

[47] *Id.*

to defense counsel and for testifying truthfully for the defense. Ceballos claimed that defendants retaliated by, among other things, demoting him from his position of calendar deputy to that of trial deputy; "threatening" him when he told Najera that he would testify truthfully at the hearing; giving him a choice of either transferring to the El Monte Branch, or, if he wanted to remain in the Pomona Branch, accepting reassignment to filing misdemeanors, a position usually assigned to junior deputy district attorneys; reassigning one of the murder cases he was handling at the time to a deputy district attorney with no experience trying murder cases; barring him from handling any further murder cases;[48] and, finally, denying him a promotion.[49]

Ceballos filed a civil complaint[50] in the United States District Court for the Central District of California alleging deprivation of his First Amendment right to free speech. Ceballos maintained that defendants took adverse employment action against him for exercising his right of free speech by writing his disposition memorandum. The defendants maintained that Ceballos' memo was not protected by the First Amendment and moved for summary judgment The District Court granted summary judgment in favor of Garcetti.[51]

The Court of Appeals for the Ninth Circuit reversed and held that Ceballos's speech alleging that the deputy sheriff included false statements in his affidavit addressed a matter of public concern and was protected by the First Amendment.[52] The court in *Ceballos* held that the fact "that Ceballos prepared his memorandum in fulfillment of a regular employment responsibility does not serve to deprive him of the First Amendment protection afforded to public employees. Not only our own precedent, but sound reason, Supreme Court doctrine, and the weight of authority in other circuits support our rejection of a per se rule that the First Amendment does not protect a public employee simply because he expresses his views in a report to his supervisors or in the performance of his other job-related obligations. Such speech, like all other public employee speech, is subject to the full two-part *Connick* test...."[53] The court in *Ceballos* recognized that the Supreme Court has "distinguished between 'speech as a citizen upon matters of public concern' at one end and speech 'as an employee upon matters only of

[48] *Id.* at 1172. (noting that Ceballos claims that the denial of the opportunity to prosecute murder cases further reduced his opportunities for promotion).

[49] *Id.* at 1171-72.

[50] 42 U.S.C. § 1983 (1979).

[51] Ceballos v. Garcetti, No. CV 00-11106, 2002 U.S. Dist. LEXIS 28039 (summary judgment granted on the ground that the Eleventh Amendment barred the action).

[52] *Ceballos*, 361 F.3d at 1180.

[53] *Id.* at 1178.

personal interest' at the other"[54] and concluded that "it is only 'when it is clear that . . . the information would be of *no* relevance to the public's evaluation of the performance of governmental agencies' that speech of government employees receives no protection under the First Amendment."[55] Having decided that Ceballos' speech constituted a matter of public concern, the Ninth Circuit court turned to the *Pickering* balancing test[56] and determined that Ceballos' interest in the speech out-weighed the government's interests in promoting workplace efficiency and avoiding workplace disruption.[57]

The Supreme Court, in a 5-4 decision, reversed the holding of the Ninth Circuit Court of Appeals and held that Ceballos' speech was not protected by the First Amendment, determining that "[r]estricting speech that owes its existence to a public employee's professional responsibilities does not infringe any liberties the employee might have enjoyed as a private citizen."[58]

APPLICATION OF *PICKERING* IN GARCETTI

As stated previously, whistleblowing means disclosing information that the individual reasonably believes is evidence of a violation of any law, rule or regulation, or gross mismanagement, a gross waste of funds, an abuse of authority, or a substantial and specific danger to public health or safety.[59] It is clear from this definition that Ceballos was engaged in whistleblowing due to his disclosure of information in his memorandum that he reasonably believed was evidence of a violation of laws and rules and possibly a danger to public safety. At first blush it would appear that, as a public employee, Ceballos' disclosure would be protected by the First Amendment provided that Ceballos' interest in disclosing the alleged lie in the search warrant affidavit was greater than the effect on the government's interest in maintaining an efficient workplace under the balance test required under *Pickering* as previously set forth.[60]

However, the Supreme Court did not analyze whether the employee's or the government's interest were greater in the *Garcetti* case under a *Pickering* balance test, having first determined that there was no First Amendment protection to be weighed under such test. In arriving at

[54] *Id.* at 1173 (quoting Connick v. Myers, 461 U.S. 138, 147 (1983)).

[55] *Id.* at 1174 (quoting Ulrich v. City & County of San Francisco, 308 F.3d 968, 978 (9th Cir. 2002)).

[56] *See*, Pickering v. Bd. of Educ., 391 U.S. 563 (1968).

[57] *Ceballos*, 361 F.3d at 1178.

[58] Garcetti v. Ceballos, 126 S. Ct. 1951, 1960 (2006).

[59] U.S. Merit Systems Protection Board, Questions and Answers About Whistleblower Appeals, *available at* http://www.mspb.gov/q&awhistlebloweaug01.html

[60] *See, Pickering*, 391 U.S. 563.

this conclusion, the Court first conceded that a citizen who works for the government is nonetheless still a citizen and "public employees do not surrender all their First Amendment rights by reason of their employment.[61] The court then proceeded to the first prong of the *Pickering* test to determine whether Ceballos spoke as a citizen on a matter of public concern because if he didn't then there would not be any First Amendment right to uphold.[62] The Court held that, since Ceballos acknowledged that his speech, in the form of the memorandum, was prepared in the course of his employment, Ceballos was acting as an employee rather than as a citizen when he spoke.[63] As examined below, the Court did not entertain the possibility of Ceballos acting as both an employee and a citizen who would have allowed the Court to pass the first prong of the *Pickering* test and rest its holding on the balancing aspect of *Pickering*. Had the Court advanced to the *Pickering* balancing test it would have at least entertained the possibility that in some circumstances employee speech in the course of the employee's duties could be protected by the First Amendment.

Instead, the Court relied on the undisputed fact that Ceballos spoke as an employee fulfilling his employment duties to hold that "when public employees make statements pursuant to their official duties, the employees are not speaking as citizens for First Amendment purposes, and the Constitution does not insulate their communications from employer discipline."[64] The Court incorporated the rationale that "government employers, like private employers, need a significant degree of control over their employees' words and actions."[65] The validity of such rationale is suspect given that many private employers, while admittedly needing such significant degree of control over their workers, are subject to a variety of statutory whistleblowing protections[66] for their employees. In contrast to the Court's statement, as discussed above, employees of private employers maintain protection of their right to blow the whistle on their employer without suffering adverse employment actions in the course of their employment due to various statutory protections such as those provided under SOX.[67] Obviously both private and government employers need a significant degree of control over the words and actions of their employees, but that

[61] *Garcetti*, 126 S. Ct. at 1957.
[62] *See* Connick v. Myers, 461 U.S. 138 (1983).
[63] *Garcetti*, 126 S. Ct. at 1959-60.
[64] *Id.* at 1960.
[65] *Id.* at 1958.
[66] *See supra*, text accompanying notes 12-15.
[67] *See* Sarbanes Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified at 28 U.S.C. § 1658(b)).

control need not extend to stifling speech that is critical of lies and abuse.

The Court in *Garcetti* objected to constitutional protection for employment duty speech because it would "commit state and federal courts to a new, permanent, and intrusive role, mandating judicial oversight of communications between and among government employees and their superiors in the course of official business....To hold otherwise would be to demand permanent judicial intervention in the conduct of governmental operations to a degree inconsistent with sound principles of federalism and the separation of powers."[68] Contrary to the Court's assertion, there is no showing that providing protection of employee speech results in a rush of litigation which would overwhelm the court and require the court system to oversee every employment disagreement.[69] In fact, as will be discussed herein, a review of lower court decisions published since *Garcetti* validates Justice Souter's concern, voiced in his dissent in *Garcetti*, that "the majority's position comes with no guarantee against fact bound litigation over whether a public employee's statements were made 'pursuant to official duties.'"[70]

As stated above, employees historically relied on the First Amendment to obtain redress of employer retaliation. It was understood to be well settled that as long as employees are speaking as citizens about matters of public concern they would face only those restrictions necessary for their employers to operate efficiently and effectively.[71] In *Pickering* the Court recognized that the public employees involved were the "most likely to have informed and definite opinions" about the expenditures at issue and that "there is a necessity for informed vibrant dialogue in a democratic society."[72] Ceballos is clearly one of the most likely to have an informed opinion on the issue of the truthfulness of the search warrant affidavit due to his unique ability to investigate the situation. Stifling Ceballos' ability to discredit the process without jeopardizing his career will do much to strip employees' desire for doing the right thing in similar situations. The Court, in rejecting Ceballos' right to free speech in this situation, was placing greater weight on the employment position held by Ceballos and the context in which his speech was made than the necessity for informed vibrant dialogue in a democratic society in furtherance of governmental principles.

[68] *Garcetti*, 126 S. Ct. at 1962.
[69] *Id.* at 1968 (Souter, J. dissenting)
[70] *Id.* (quoting *Garcetti,* 126 S. Ct. at 1959 (Kennedy, J., majority opinion)).
[71] *See Connick*, 461 U.S. 138.
[72] *Garcetti,* 126 S. Ct. at 1959.

CITIZEN SPEECH VERSUS SPEECH MADE IN THE COURSE OF EMPLOYMENT

The Court's opinion segments speech into two categories; speech given in the course of a public employee's duties and speech given as a citizen. The Court's segmentation leaves no room for speech which is given with both motives. A conservative interpretation of the Court's holding requires that as long as such speech is made in the course of a public employee's duties the speech does not enjoy First Amendment protection even if such speech was also made by the individual as a citizen. In contrast, Justice Souter's dissent queries whether anyone would "deny that a prosecutor like Richard Ceballos may claim the interest of any other citizen in speaking out against a rogue law enforcement officer, simply because his job requires him to express a judgment about the officer's performance?"[73] Contrary to the Supreme Court's majority's interpretation, a reasonable interpretation of employee speech

While acknowledging that Ceballos' speech was made pursuant to his employment duties, it can be argued that it was also made pursuant to his citizen status. It is arguable that Ceballos likely interpreted the requirements of his job in a manner consistent with his ethics and values as well as a desire to provide the public with both a legal procedure for prosecution, as well as an ethical procedure for prosecution. The legal procedure aspect would be required by his employment duties while the ethical component would more likely arise from his personal values, his status as a citizen. The Court dismissed this argument by stating that "Ceballos wrote his disposition memo because that is part of what he, as a calendar deputy, was employed to do. It is immaterial whether he experienced some personal gratification from writing the memo; his First Amendment rights do not depend on his job satisfaction."[74] The issue, however, is not job satisfaction but whether public employees will retain the motivation to do the right and difficult thing in the face of potential adverse job actions in the wake of the Court's holding in this case.

After *Garcetti* a public employee who discovers government fraud, waste or abuse and reports it in the course of his or her employment duties is not protected from adverse employment action. In contrast, if an employee, engaged in duties other than those which would require him to report wrong doing, makes the same discovery such employee's speech may very well be protected from adverse employment action. The apparent differentiation of the Court in this case does little to

[73] *Id.* at 1966-67 (Souter, J., dissenting).

[74] *Id.* at 1960.

protect the stated goals of informed vibrant dialogue in a democratic society.

DUTY SPEECH AND PUBLIC POLICY

In addition to the issues raised by the possibility that Ceballos' speech was made both in the course of his duties and as a citizen lies an issue with fact that Ceballos was convinced that he was required by law to turn his memorandum over to the defense.[75] Such compulsion places Ceballos and other employees in the untenable position of being required by law to speak but, in the Court's interpretation, unable to take advantage of the First Amendment to protect such speech from adverse employment actions because it was incumbent upon them in the course of their duties to make such speech. Going forward, every public employee who witnesses fraud, waste or illegality will be faced with the same predicament in contravention of public policy.

It does not appear that repeating the whistleblowing speech in another context will solve an employee's dilemma. The Court in *Garcetti* made it clear that the fact that Ceballos' speech was in an internal memo rather than to the press was not dispositive of the case in their view.[76] The fact that his speech was made pursuant to his duties was the controlling factor in the Court's decision rather than the fact that he made the speech internally.[77]

The wisdom of silencing duty speech in furtherance of a restrictive interpretation of the First Amendment is highly questionable. If Ceballos had not written his memorandum and disclosed his conclusion about the veracity of the search warrant affidavit, "the judicial system for that prosecution could have been fatally compromised. Coerced silence could thwart the public's right to know information essential for democratic legitimacy in government actions. The consequences could be disastrous for silencing mandatory reports of dangerous products such as contaminated meat and poultry, environmental spills, nuclear safety violations or defective military equipment. Taxpayers could be defrauded billions of dollars, if government auditors are silenced from performing their duties."[78]

Employees who realize that procedures are not being followed or that the procedures themselves are faulty, for example in the case of hospital

[75] Ceballos v. Garcetti, 361 F.3d 1168, 1171 (9th Cir. 2004), *rev'd and remanded by* Garcetti v. Ceballos, 126 S. Ct. 1951 (2006).

[76] *Garcetti,* 126 S. Ct. at 1959.

[77] *Id.*at 1960.

[78] Brief for Gov't Accountability Project, et al. as Amici Curiae Supporting Respondent at 15, Garcetti v. Ceballos, 126 S. Ct. 1951 (2006) (No 04-473) [hereinafter *GAP Brief], available at* http://www.whistleblower.org/doc/C/Ceballos%20amicus%20GAP%20NELA%20ATLA.pdf.

lab procedures for HIV tests or mammograms, should not have to report such conclusions to the press in order to have any hope of obtaining First Amendment protection and, in fact, such report may still not be successful in obtaining First Amendment protection if a conservative reading of the *Garcetti* case prevails.

In contrast to the position that the court took, an argument could be sustained that duty speech is as worthy of protection as speech not made in the course of an employee's duties. As concluded in a 1978 Senate Governmental Affairs Committee study, "The code of silence thwarts management's ability to effectively manage and actually removes the burden of accountability from their shoulders. Fear of reprisal renders intra-agency communications a sham, and compromises not only the employee, but also the Constitutional function of congressional oversight itself."[79] The ramifications stemming from the Court's decision could actually make it harder for managers to manage rather than easier if the fear of reprisal stifles speech that management needs to hear to effectively accomplish their goals.

It is not credible to make a distinction between (i) providing First Amendment protection for speech even though the information in the speech is obtained because of the whistleblower's employment but the speech itself is not made in the course of the speaker's employment and (ii) <u>not</u> providing First Amendment protection for speech that is made in the course of an employee's duties regardless of the source of the information. In other words, it is not credible to provide First Amendment protection for speech made by one employee whose duties do not include making such speech, but not provide such protection for the same speech if it is made by an alternate employee in the "course of his or her duties". If flawed laboratory procedures in the hypothetical HIV test or mammogram set forth above are reported by a lab worker whose position does not require the reporting of such results, the knowledge that the test procedures are flawed is knowledge obtained in the course of his or her duties. Under *Garcetti,* the lab worker could obtain First Amendment protection against adverse employment action for reporting the flawed procedures. Conversely, if the reporting was done by a different employee whose job requirements do not require the making of such report; it seems clear under *Garcetti* that lab worker would not obtain First Amendment protection from any adverse employment action resulting from such report. Clearly, it is not in furtherance of public interest in trustworthy lab procedures to treat the two cases differently depending upon the job functions of the employee

[79] *Id.* at 13 (quoting *The Whistleblowers: A Report on Federal Employees Who Disclose Acts of Government Waste, Abuse and Corruption Prepared for the Senate Comm. on Governmental Affairs*, 95th Cong. 49 (1978)).

making the report. However, that is precisely the type of distinction that the Court appears willing to make under the *Garcetti* decision.

Such differentiation could create a situation where job descriptions are written to require employees to report waste, fraud and abuse. The job descriptions would then abrogate the First Amendment rights of all employees who are the subject of such job descriptions. The Court attempted to forestall this problem with its statement that "[w]e reject, however, the suggestion that employers can restrict employees' rights by creating excessively broad job descriptions....Formal job descriptions often bear little resemblance to the duties an employee actually is expected to perform, and the listing of a given task in an employee's written job description is neither necessary nor sufficient to demonstrate that conducting the task is within the scope of the employee's professional duties for First Amendment purposes."[80] Unfortunately, not only can the aforementioned quote can be read to try to forestall the broad writing of job descriptions; it can also be interpreted to result in a finding that employment duties not enumerated in a job description are nonetheless required by the employee's duties. Therefore, reports made in the "course of an employee's duties" that are not made in conjunction with an action specifically enumerated in such job description, may still be interpreted to fall within such job description because, according to the Supreme Court, job descriptions "often bear little resemblance to the duties an employee is actually expected to perform."[81] The question then remains whether it makes sense that regular reports prepared in the course of an employee's employment are not protected under the Constitutional right to free speech while special reports of knowledge gained in one's employment in conjunction with service that is not required by such employee's job description are protected under such right of free speech.

CONSIDERING *PICKERING* TOGETHER WITH THE DISTINCTION BETWEEN INTERNAL AND DUTY SPEECH

This rationale that the holding in *Garcetti* is based upon the distinction between speech made during the course of an employee's duties and speech made outside of an employee's duties is also difficult to reconcile with the *Pickering* case. In *Pickering,* the relevant speech consisted of a teacher's published letter to a newspaper criticizing the school board's allocation of school funds between academic programs and athletics as well as the Board's methods of informing the public of the reasons for requests for additional funds.[82]

[80] *Garcetti,* 126 S. Ct. at 1961.
[81] *Id.*
[82] *See, Pickering*, 391 U.S. 563.

In comparing *Pickering* with *Garcetti*, the Court makes the distinction that the teacher's speech was not made pursuant to the teacher's duties. In order to agree with such distinction, it must be believed that a teacher's duties consist of little more than teaching in the classroom. It must not be believed that a teacher's duties include being concerned about the quality and level of education provided which quality is due partly to the level of funding that the school receives for resources. Although it was acknowledged by all parties that Ceballos' speech was made pursuant to his duties, a similar argument can be made that the teacher's speech in *Pickering* was similarly made pursuant to employee duties if such duties are broadly construed to include concern for the level and quality of education that is available given the school district's budget. If such broader interpretation is accepted, it is possible that both incidents of speech involved both motives (speech as an employee and speech as a citizen) rather than the single motive that was ascribed to each. It would then follow that both cases should have proceeded to the balancing test set forth in *Pickering* which did not occur in the *Garcetti* case. The employees were speaking both as citizens and as employees in the course of their employment duties. However the Court rejected this interpretation of First Amendment rights in favor of a finding that speech made in the course of a public employee's duties is not speech that is protected by the First Amendment.[83]

In contrast to its holding in *Garcetti*, the Court found First Amendment protection for a public employee in the *Givhan v. Western Line Consolidated School District*.[84] *Givhan* involved a teacher's speech in complaining to her principal about employment practices and policies of the school district as a whole and, in particular, the school at which she was then assigned. The U.S. Supreme Court stated that "[e]mployees in some cases may receive First Amendment protection for expressions made at work."[85] The distinction that was made between *Givhan* and *Garcetti* is that "[q]uestioning the legality of the district's employment practices was not interpreted to be in the teacher's line of duties as contrasted with Ceballos' admission that he prepared the memo in the course of his employment duties."[86] Although, as stated previously, the court professed to be concerned that it does not want to agree to a position which "would commit state and federal courts to a new, permanent, and intrusive role, mandating judicial oversight of communications between and among government employees and their

[83] *Garcetti,* 126 S. Ct. at 1961.
[84] Givhan v. Western Line Consol. School Dist., 439 U.S. 410 (1979).
[85] *Id.* at 414 (1979).
[86] *Whistleblower Hearings, supra* note 20 (Statement of Lisa E. Soronen Staff Attorney, National School Boards Association).

superiors in the course of official business"[87] the Court seems to have opened an alternate door in committing the courts to judicial oversight of the determination of whether specific actions are "pursuant to employment responsibilities"[88] in cases in which the employee denies that the speech was made pursuant to such responsibilities.

In *Garcetti* the Court acknowledged that the question of when an employee is acting within the scope of his/her duties is an open question that was not addressed in the *Garcetti* case.[89] It is very likely that the question will be the subject of future litigation.[90]

TREATMENT OF SPEECH REQUIRED OUTSIDE OF JOB DESCRIPTIONS

Under the Standards of Ethical Conduct for Employees of the Executive Branch, employees are required to "disclose waste, fraud, abuse and corruption to appropriate authorities."[91] As recently as 2001 this obligation was reiterated by President Bush in order to assure "the highest standards of integrity in Government."[92] Similarly, some employees are obligated to report official malfeasance as part of their employment requirements.[93] Clearly there is a professed desire to compel disclosure on the part of federal administrators and many state administrators. However, it appears from *Garcetti* that the Supreme Court is not willing to insulate employees from employer retaliation for such disclosures through the use of the broad protections of the First Amendment.

There are a number of cases in which public employees have discovered waste, fraud, or abuse in the course of their employment and who, like Ceballos, were required to convey that discovery up the chain of command to their employers pursuant to the course of their duties. After Ceballos, such employees who fulfill their ethical obligations will not be protected under the First Amendment for their disclosure speech.

For example, Dr. David Graham, a scientist with the Food and Drug Administration (FDA) conducted a study which resulted in his

[87] *Garcetti*, 126 S. Ct. at 1961.

[88] *Id.*

[89] *Id.*

[90] *Id.* at 1968 (Souter, J., dissenting).

[91] 5 C.F.R. § 2635.101(b)(11) (2007)

[92] *GAP Brief, supra* note 78, at 7 (quoting *Memorandum from President George W. Bush to the Heads of Executive Departments and Agencies on Standards of Official Conduct* (Jan. 20, 2001).

[93] *See* D.C. CODE § 1-615.58(7) (2005) ("Each employee of the District government shall make all protected disclosures concerning any violation of law, rule, or regulation, contract, misuse of government resources or other disclosure enumerated in § 1-615.52(a)(6), as soon as the employee becomes aware of the violation or misuse of resources.").

concluding that there were dangerous side effects of the pain drug Vioxx. According to Dr. Graham, he was pressured to restate his conclusions less definitively. The FDA ostracized and threatened Dr. Graham's work due to his study[94]. Eventually Vioxx was withdrawn from the market by the drug manufacturer after a study not conducted by the FDA confirmed Dr. Graham's conclusions.[95] The public interest in full and complete medical information would be better served by Dr. Graham's protected disclosure of the study in contravention of his employer's wishes.

In another example in 2002, John Fitzgerald, an environmental analyst with the U.S. Agency for International Development, was responsible for monitoring compliance on certain overseas development projects. He "attempted to report to Congress legal violations and environmental mismanagement regarding questionable energy projects in Africa, South America and Eastern Europe, but Treasury officials removed the information from his report before it reached Congress. His position was subsequently eliminated."[96] In Fitzgerald's case his speech was made only to his employer even though he attempted to make it to Congress. It seems clear that Fitzgerald's speech is precisely the type of speech that the public would want to know and should be protected by the First Amendment regardless of the fact that his knowledge and initial disclosure came about in the course of his employment duties.

In the course of his employment duties, Richard Foster, Medicare's chief actuary, was responsible for providing cost estimates to Congress regarding several Medicare proposals under debate. Foster's cost estimates included his determination that the actual cost of the proposed legislation would be 25% to 50% higher than Medicare's estimate disseminated to the public. Foster was not permitted to forward his findings to Congress. A Health and Human Services investigation determined that the then Administrator of the Centers for Medicare and Medicaid Services had "warned Foster that he would be disciplined if he released his disfavored findings."[97] Under *Garcetti*, Foster would not have any First Amendment protection if he had made his disclosures to Congress. Again, removing that protection serves to provide a significant disincentive to properly perform employment duties when

[94] *Withdrawal from the market of Vioxx arthritis pain medication: Hearing before the Senate Finance Committee*, 108th Cong. (2004) (Testimony of David J. Graham, MD, MPH, Associate Director, Science, Office of Drug Safety, Center for Drug Evaluation and Research).

[95] *Whistleblower Hearings, supra* note 20 (Statement of Barbara Atkin, Deputy General Counsel for the National Treasury Employees Union).

[96] *Id.*

[97] *Id.*

the speech required to properly perform such duties is not protected from ramifications by the First Amendment.

PUBLIC'S CONCOMITANT RIGHT TO HEAR

In addition to a citizen's right to free speech, there is a concomitant right of the public to hear matters that affect its interest. The First Amendment is designed to protect not only the speaker, but the rights of individuals to hear the speech.[98] "This right takes on special significance, however, for speech concerning governmental affairs."[99]

In a Supreme Court case involving the right of a pharmacy to advertise, the Court noted that if there is a right to advertise, there is a concomitant right to receive such advertisements.[100] To extend that argument, if there is a right of private employees to speak, even if it is provided by separate statute, there is arguably a correlative right of the public to hear which should not be abrogated solely due to the fact that the employees now at issue are public employees. The fact that statutory protection exists for private employees may mean that there needs to be a statutory fix for public employees, but a broader solution would be to find First Amendment protection for the speech of public employees in the course of their duties provided that the speech satisfies the requirements of the *Pickering* balancing test.

FALLACY OF THE "NETWORK OF PROTECTIONS"

The issue of why Ceballos chose to utilize the First Amendment to challenge the defendants rather than avail himself of statutory protection was raised numerous times in the whistleblower hearings after *Garcetti*. The *Garcetti* decision referred to a "powerful network of legislative enactments available to those who seek to expose wrong-doing".[101] However, the network of legislative enactments currently in effect has proved to be anything but powerful when brought to the courts for enforcement.[102] In fact, in appellate decisions at the Federal Circuit Court of Appeals from October 1994 until September 1, 2003, whistleblowers had a 1-84 track record for decisions on the merits.[103]

[98] *See* Red Lion Broadcasting Co. v. FCC, 395 U.S. 367, 290 (1969)

[99] Mark Coven, *The First Amendment Rights of Policymaking Public Employees*, 12 HARV. C.R.-C.L. L. REV. 559 (1977).

[100] Virginia State Bd. Of Pharmacy v. Virginia Citizens Consumer Council, 425 U.S. 748, 756 (1976).

[101] Garcetti v. Ceballos, 126 S. Ct. 1951, 1962 (2006).

[102] *See* Huffman v. Office of Pers. Mgmt., 263 F.3d 1341, 1351-54 (Fed. Cir. 2001); Willis v. Dept. of Agric., 141 F.3d 1139, 1144 (Fed. Cir. 1998).

[103] *Special Counsel Nomination: Hearings on S. 1358 before the Senate Governmental Affairs Committee*, 108th Cong. (2003) (Testimony of Thomas M. Devine, Legal Director, Government Accountability Project).

Under the Whistleblower Protection Act ("WPA") "disputes over policy generally are specifically excluded, as are disagreements with the employee's supervisor and disclosures made in the course of the employee's duties. The WPA, as presently written and interpreted, provides no protection for employees whose speech the Supreme Court held in *Garcetti* was not protected by the First Amendment."[104]

The Court cites the Civil Service Reform Act[105] as one of the legislative enactments in the "powerful network available to those who seek to expose wrongdoing."[106] However, the case law under that legislation provides that such Act does not support internal/official duty whistleblowing as was the case in *Garcetti*."[107] In fact, a fifty state review of whistleblower protections provided by Stephen M. Kohn of the National Whistleblower Center provides evidence that 58% of state whistleblower laws do not explicitly protect internal/official duty whistleblowers.[108] Of those states that do provide protection for internal/official duty whistleblowers, such protection is not as great as that provided under that statute that Ceballos availed himself of in *Garcetti*. Obviously the current statutory provisions do not provide the protection from adverse employment action that the Supreme Court declined to provide Ceballos in *Garcetti*.

ADDITIONAL OPEN ISSUES

The fact that *Garcetti* made it to the Supreme Court is due in part to one of the open questions after *Pickering*. The Court in *Pickering* expressly declared that they had not laid down a standard against which "all such statements may be judged."[109] The *Garcetti* case sets forth further criteria employees can look to in order to determine the extent of presently protected First Amendment rights of free speech. One of the dangers after *Garcetti* is that employees will take one of two undesirable courses of action. First, they could keep silent and ignore evidence of corruption, waste, fraud or mismanagement in the workplace rather than risk adverse job action after reporting their evidence through the chain of command. Second, the employees could hold a public press conference to take their speech outside the context of that which occurs in the course of their duties in the hopes that a

[104] *Whistleblower Hearings*, *supra* note 20 (Statement of Barbara Atkin, Deputy General Counsel for the National Treasury Employees Union).

[105] Civil Service Reform Act, Pub. L. 95-454, 92 Stat. 1111 *et seq* (codified, as amended, in various sections of 5 U.S.C. (1982 ed. and Supp. IV)).

[106] *Garcetti,* 126 S. Ct. at 1962.

[107] Willis v. Dept. of Agric., 141 F.3d 1139, 1144 (Fed. Cir. 1998).

[108] *Whistleblower Hearings*, *supra* note 20 (Statement of Stephen M. Kohn, Chair, National Whistleblower Center).

[109] Pickering v. Bd. of Education, 391 U.S. 563, 569 (1968).

liberal court would provide First Amendment protection against any employment retaliation if the speech was not made pursuant to the employee's employment duties.

The open issue of the potential for lawsuits interpreting "pursuant to the employees' employment duties" has been addressed above as has the issue of potential cases involving the accuracy of broad job descriptions written by employers in order to curtail First Amendment protections provided to public employees. The Court also specifically left open the impact of the *Garcetti* case on the issue of academic freedom. The Court noted that "There is some argument that expression related to academic scholarship or classroom instruction implicates additional constitutional interests that are not fully accounted for by this Court's customary employee-speech jurisprudence. We need not, and for that reason do not, decide whether the analysis we conduct today would apply in the same manner to a case involving speech related to scholarship or teaching."[110] The full impact of this decision will not be determined until after a thorough analysis of lower court cases defining employees' scope of duties and defining more precisely the extent to which speech is made in the course of a public employee's duties. In addition, the lower courts and possibly the Supreme Court may well have to define the extent to which the First Amendment protection of employee speech applies to speech conducted in an academic forum.

JUDICIAL AND LEGISLATIVE RESPONSE

The Court noted the need for a legislative fix to provide protection for whistleblowers and various bills have been considered over the years. In 2005 the Federal Employee Protection of Disclosures Act[111] was introduced in the House to reinforce and extend protections for federal employees who blow the whistle on the improper actions that undermine our government. The Act was reintroduced in 2006 but was never enacted. Companion legislation in the Senate[112], Senate Bill 494, was approved unanimously by the Senate Government Committee on Homeland Security and Governmental Affairs on May 25, 2006. Although Senate Bill 494 was turned down for a vote on numerous occasions, on June 22, 2006, it was incorporated into the Senate defense authorization bill. The Senate defense authorization bill was never enacted. These bills would have provided adverse job action protection for government employees including protection against actions taken in retaliation for speech made pursuant to employment duties. Clearly the legislative fix required is not going to be easy to obtain.

110 *Garcetti,* 126 S. Ct. at 1962.
111 Federal Employee Protection of Disclosures Act, H.R. 3224, 109th Cong. (2006)
112 Federal Employee Protection of Disclosures Act, S. 494, 109th Cong. (2006).

Further action has been taken in 2007. On March 14, 2007 the House passed the Whistleblower Protection Enhancement Act (H.R. 985).[113] The Enhancement Act is being billed as "the first major reform of federal whistleblower laws in 18 years.... The Enhancement Act will: For the first time, provide most federal employees with a right to have their claims heard in federal court; Protect most federal employees who expose waste fraud and corruption through their chain of command; Provide a new remedy for federal contractors who expose fraud on the taxpayers."[114]

The remand of the *Garcetti* case has yet to be heard. One of the issues that could arise on remand is the fact that Ceballos gave his testimony in court in connection with the defense challenge to the warrant.[115] The lower court could still construe Ceballos' testimony as external speech resulting in First Amendment protections provided such speech is found to be outside the "ambit of utterances pursuant to official duties."[116] According to Justice Souter "When the Court of Appeals takes up this case once again, it should consider some of the following facts that escape emphasis in the majority opinion owing to its focus. Ceballos says he sought his position out of a personal commitment to perform civic work. After showing his superior, petitioner Frank Sundstedt, the disposition memorandum at issue in this case, Ceballos complied with Sundstedt's direction to tone down some accusatory rhetoric out of concern that the memorandum would be unnecessarily inflammatory when shown to the Sheriff's Department. After meeting with members of that department, Ceballos told his immediate supervisor, petitioner Carol Najera, that he thought *Brady* v. *Maryland,* obliged him to give the defense his internal memorandum as exculpatory evidence."[117] The remand of this case should shed further light on the interpretation of the First Amendment protection for the internal speech of public employees, especially compelled speech such as Ceballos felt bound to make in court.

There have already been a number of employer retaliation court decisions decided under the new post-*Garcetti* First Amendment jurisprudence. The circuit courts have yielded inconsistent results. Although the Ninth Circuit in *Freitag* v. *Ayers*[118] found that all of Freitag's internal communications to her employer were not

[113] Whistleblower Protection Enhancement Act of 2007, H.R. 985, 110 Cong. (2007)

[114] *Historic Victory for Whistleblower Protection: House Overwhelmingly Approves Whistleblower Enhancement Act Senate Action Needed to Finish the Job,* http://www.whistleblower.org (follow "press room" hyperlink).

[115] *Garcetti*, 126 S. Ct. at 1951.

[116] *Id.* at 1973 (Souter, J., dissenting).

[117] *Id.* at 1972-1973 (Souter, J., dissenting).

[118] Freitag v. Ayers, 468 F.3d 528 (9th Cir. 2006).

constitutionally protected speech after *Garcetti* and, as such, should not have been included in a lower court's jury instructions as protected speech, the court remanded Freitag's §1983 claim to the lower court after holding that Freitag's communication to a state senator regarding sexually hostile conduct at her place of employment was speech made as a citizen. The court found that it was "Freitag's responsibility as a citizen to expose such official malfeasance to broader scrutiny."[119] The court clearly made the distinction between internal and external speech and found that the external speech was to enjoy constitutional protection even though it was on the same subject matter as the internal speech.

The Eleventh Circuit case of *Battle* v. *Board of Regents*[120] involved the nonrenewal of an employee's contract after the employee reported improprieties in her supervisor's management of financial aid. Similar to the Ceballos' admission in *Garcetti*, the employee in *Battle* admitted she "had a clear employment duty to ensure the accuracy and completeness of student files as well as to report any mismanagement or fraud she encountered in student financial aid files."[121] The court held that she acted "pursuant to her official employment responsibilities" and her claim failed under Garcetti.[122]

In *Mills* v. *City of Evansville*[123] the Seventh Circuit heard a case involving a police officer employee's speech during an unofficial gathering while such officer was still in uniform and on duty. The unofficial gathering occurred immediately following an official employment gathering of police officers.[124] The court held that the communications in the unofficial gathering were not made as a citizen but, rather, were made "in her capacity as a public employee contributing to the formation and execution of official policy."[125]

Finally, the Tenth Circuit, in *Green* v. *Board of County Commissioners*[126] heard a case brought by a Ms. Green, a former county juvenile justice center employee whose job functions included the performance of drug screening tests. Green had become concerned that the center did not have a drug testing confirmation policy and relayed her concerns to a drug testing equipment manufacturer and the Department of Human Services.[127] Although Green's speech was made to third parties, the

[119] *Id.* at 545.
[120] Battle v. Bd. of Regents for the State of Georgia, 468 F.3d 755 (11th Cir. 2006).
[121] *Id.* at 761.
[122] *Id.* at 761-62.
[123] Mills v. City of Evansville, 452 F.3d 646 (7th Cir. 2006).
[124] *Id.* at 647-48.
[125] *Id.* at 648.
[126] Green v. Bd. of County Comm'rs, 472 F.3d 794 (10th Cir. 2007).
[127] *Id.* at 796.

Tenth Circuit court held that "even if not explicitly required as part of her day-to-day job responsibilities, her activities stemmed from and were the type of activities that she was paid to do"[128] and as such Green "did not speak or act in her capacity as a citizen, but as a government employee."[129] The court affirmed the district court's grant of summary judgment in favor of the justice center.

The preceding review of circuit court cases indicates that there is no clear consensus as to what constitutes speech "pursuant to an employee's official duties". According to *Freitag,* the Ninth Circuit court appears willing to accept that speech made to third parties, even if it such speech concerns the same subject matter as internal speech, is clearly speech not made pursuant to official duties. In contrast, the Tenth Circuit held in the *Green* case the even if speech is made to a third party and was not explicitly required as part of the employee's job responsibilities it still fell within the spirit of *Garcetti* and would not be provided with First Amendment protection.

The landscape does not appear any more protective of First Amendment rights when considering the issue that the *Garcetti* court intentionally left open of speech related to scholarship or teaching and academic freedom. The issue of whether employee speech in pursuant to employment duties did not seem unclear to the Seventh Circuit Court in *Mayer* v. *Monroe County Community School Corporation.*[130] Mayer, the teacher involved in the case, admitted that the current events session conducted during her class was part of her official duties[131] and the court found, therefore, that "*Garcetti* directly applied"[132] and held that the First Amendment does not entitle a teacher to advocate her viewpoint on an antiwar demonstration during a classroom session. The teacher had been trying to avail herself of the finding in *Piggee* v. *Carl Sandburg College*[133], that *Garcetti* was not directly relevant to the college instructor's speech.

Even district courts seem to be having similar trouble finding consistent analysis to use in applying *Garcetti* to the cases that come before them. The district court in *Pittman* v. *Cuyahoga Valley Career Center*[134] acknowledged that although "some legal analysts appear to be interpreting *Garcetti* as holding that statements made by public employees will never be protected if the employee is acting within the scope of his or her employment while making the statements, this Court

[128] *Id.* at 800-01.
[129] *Id.* at 801.
[130] Mayer v. Monroe County Community School Corp., 474 F.3d 477 (7th Cir. 2007).
[131] *Id.* at 479.
[132] *Id.* at 480.
[133] Piggee v. Carl Sandburg College, 464 F.3d 667 (7th Cir. 2006).
[134] Pittman v. Cuyahoga Valley Career Center, 451 F. Supp.2d 905 (N.D. Ohio 2006).

interprets *Garcetti* more narrowly. The preliminary analysis is one of "job relatedness." If the public employee's speech was required by his or her job, then *Garcetti* applies and the statements are not protected speech. If the speech, however, is not specifically job related, then the statements are reviewed under a traditional *Connick* analysis".[135] Also, in its own test of "job relatedness", a district court for the middle district of Louisiana held that a speech made at a Toastmaster's program was sufficiently job related to find that *Garcetti* applied and the employee's speech including a criticism of his employer's policy was not entitled to First Amendment protection.[136]

To further illustrate the lack of consistency, the district court in *Nolan* v. *Terry*[137] rejected the focus of the Seventh Circuit court's decision in *Mills*.[138] The *Mills* court determined that Mills' speech was not protected even if the topic was of public concern because she spoke as an employee. The *Terry* court focused instead "on the capacity of the speaker in relation to the speech…to answer two interrelated questions which ultimately determine whether the matter is one of public concern: did the dispute implicate the public interest in receiving the well-informed views of government employees engaged in civic discussion, and did the defendants' actions suppress the rights of public employees to participate in public affairs. If the answer to either or both of these questions is yes, then the court views the matter to be one of public concern."[139] The *Terry* court found that the speech in question was not a matter of public concern and therefore not protected by the First Amendment, but commented on the distinction between its reasoning and the reasoning of the *Mills* court. In its commentary the court noted that although "the differences in theoretical approaches are not outcome determinative here, those differences may have practical consequences in other contexts."[140] In other words, it remains to be seen whether a court's focus on the motive for the speech in question will ultimately be allowed to affect the First Amendment protection afforded the employee in a retaliation case.

CONCLUSION

Clearly the sharply divided court in *Garcetti* could have decided that the First Amendment can protect duty speech pursuant to a balance of employee and employer rights under *Pickering*. Such public employee

[135] *Id.* at 929.

[136] Levy v. Office of the Legislative Auditor, 459 F.Supp.2d 494, 497-499 (M.D. La. 2006).

[137] Nolan v. Terry, 2006 WL 2620002 (W.D.Va. 2006).

[138] *Mills,* 452 F.3d 646 (7th Cir. 2006).

[139] Terry, at *3.

[140] *Id.* at *5.

whistleblowing speech made in the course of the employee's employment duties, like all other public employee speech, should be subject to the *Pickering* balancing test upon a determination that the speech addresses a matter of public concern. To circumvent the *Pickering* balance test by imposing a new threshold requirement that employees can not be speaking as citizens if their speech occurs in the course of their duties unnecessarily restricts First Amendment rights in the public employment context. As evidenced by the review of just a few of the lower court cases decided since *Garcetti,* resolution of this issue and protection for public employees will most likely have to be by statute rather than judicial interpretation since the highest court of the land has interpreted the First Amendment of the United States Constitution to not protect employee speech in this context and the lower courts do not seem to have a consistent manner of applying the decision given the open issues. Although the lower courts have no choice but to follow *Garcetti* and dismiss First Amendment employment retaliation claims if the conduct that caused the retaliation came in the form of an employee's speech made pursuant to his or her official duties, the question of precisely which speech is made pursuant to such duties has proven itself to be open to varied interpretation.