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SPEAKING ENGLISH ONLY POLICIES IN THE WORKPLACE

by MALCOLM ABEL*

I. INTRODUCTION

Speaking English-only in the business workplace became more difficult in the latter part of the 20th Century, and all indications are that it will become even more difficult in the 21st Century. There has been, apparently, a significant increase in the number of workers who prefer to speak a language other than English. Spanish speaking employees have increased in the past two decades, and now constitute the largest minority group in the workforce.[1] For various reasons, employers have responded, ever more increasingly, by requiring English to be spoken on the job at differing times and places. While some courts seem to be in agreement on the limitation of speaking another language in the workplace other than English, there is not a complete agreement as to how English-only cases should be handled.

Although language is not protected under "human rights" legislation, many employers are finding themselves vulnerable to discrimination

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[1] *See* "Hispanics Now Largest U.S. Minority," CBS News, Washington, January 21, 2003, http://www.cbsnews.com/stories/2003/01/21/national/main537369.shtml (last accessed 26 March 2006).

lawsuits, generally in the form of national origin discrimination.[2] Many believe that diversity in the workplace brings many benefits to business, including a greater variety of skills and life experiences, however, it also brings with it many problems. These problems are varied and can include safety, customer relations, and employee harmony. Clearly, all employees need to understand each other, especially in emergencies or when handling dangerous equipment, but the extent to which an employer can require the speaking, understanding, and comprehension of English is somewhat limited. Some English speaking customers may feel uncomfortable with employees who are not speaking English, but accommodating customers' linguistic insecurities cannot be accomplished by discrimination in employment practices. There is some effective segregation of employees in the workforce by ethnic group when separate languages are spoken, but expressions of culture and ethnicity necessarily require language, and language is necessary in the social context of business and employment.

II. ENGLISH ONLY, YES

Garcia v. Spun Steak is the leading case on speaking English-only policies in the workplace. [3] Spun Steak did not require "applicants to speak or to understand English as a condition of employment."[4] Over 70 percent of Spun Steak's employees spoke Spanish, and spoke freely during work hours until Spun Steak started receiving complaints that "some workers were using their bilingual capabilities to harass and to insult other workers in a language that they could not understand."[5] The complaints were that two Hispanics, Garcia and Buitrago, made "derogatory, racist comments in Spanish about two co-workers, one of whom is African-American and the other Chinese-American."[6] Some employees who operated machinery claimed that they were distracted when others spoke Spanish, and the U.S.D.A inspector did not understand any Spanish.[7] Spun Steak concluded that an English-only

[2] These challenges begin with the national origin perspective of Title VII of the Civil Rights Act of 1964, 42 U.S.C.S. § 2000e et seq., pursued by way of a claimed filed with the Equal Employment Opportunity Commission.

[3] Garcia v. Spun Steak, 998 F.2d 1480, 1993 U.S. App. LEXIS 17599 (9th Cir. 1993). Prior to *Spun Steak*, the applicable case held that English-only rules did not violate an employee's rights if the employee could comply with the rule, and noncompliance was only one of preference by that employee. See Garcia v. Gloor, 616 F.2d 264 (5th Cir. 1980).

[4] *Id.* at 1483.

[5] *Id.*

[6] *Id.*

[7] *Id.*

rule would promote safety and harmony in the workplace.[8] Additionally, it "adopted a rule forbidding offensive racial, sexual, or personal remarks of any kind."[9] It was never clear that the rule was strictly enforced, but it was claimed that some workers were permitted to speak Spanish without disciplinary action.[10]

Garcia and Buitrago were, subsequently, given "warning letters for speaking Spanish during working hours,"[11] and physically separated from each other during work. Plaintiffs, including the union local representing the employees at Spun Steak, filed charges of discrimination with the U.S. Equal Opportunity Commission (EEOC).[12] The EEOC determined that it was reasonable to believe that Spun Steak had retaliated against the plaintiffs and that the English-only rule was a violation of Title VII of the Civil Rights Act of 1964.[13] Plaintiffs filed suit in federal district court, and both parties filed cross motions for summary judgment. The district court concluded that Spun Steak did not have a sufficient business justification for the English-only policy, and, as a result, violated Title VII.[14] Spun Steak appealed.

The Ninth Circuit Court of Appeals—after having addressed the question of whether the union local had standing in the case, and concluded that it did—considered whether the unintended consequences of Spun Steak's English-only policy on its employees "had a discriminatory impact on them because it imposes a burdensome term or condition of employment exclusively upon Hispanic workers and denies them a privilege of employment that non-Spanish-speaking workers enjoy."[15] The court first concluded, though, that the application of the disparate impact theory was not restricted to employment opportunities only, but could be applied when challenging a policy which significantly impacts the conditions of employment of a group protected under Title VII.[16]

[8] Spun Steak's policy was as follows: "It is hereafter the policy of this Company that only English will be spoken in connection with work. During lunch, breaks, and employees' own time, they are obviously free to speak Spanish if they wish. However, we urge all of you not to use your fluency in Spanish in a fashion which may lead other employees to suffer humiliation." *Id.*

[9] *Id.*

[10] *Id.* "Spun Steak issued written exceptions to the policy allowing its clean-up crew to speak Spanish, allowing its foreman to speak Spanish, and authorizing certain workers to speak Spanish to the foreman at the foreman's discretion." *Id.*

[11] *Id.*

[12] *Id.*

[13] *Id.* at 1483 and 1484.

[14] *Id.* at 1484.

[15] *Id.* at 1485.

[16] *Id.* at 1485 and 1486.

The making of a prima facie case of disparate impact requires more than alleging that a policy has caused harm to a protected group or class. The plaintiff need only show that she is in a protected class which is significantly impacted in an adverse manner by a policy or practice which appears on its face to be neutral for a discriminatory impact case.[17] However, the proof for disparate impact must be that (1) the adverse effects of the policy or practice exist, (2) the impact of the policy or practice affects the employment opportunities of the protected class, (3) the adversity of the policy or practice is significant, and (4) the policy or practice does not affect the general population of employees in the same degree.[18] If an English-only policy had any adverse effects, those effects would clearly be most adverse to those whose origin was other than that in which English was the primary language.[19] It would not matter if some of the Hispanic employees did not speak Spanish, or if some of the non-Hispanic employees could speak Spanish, as long as there were some significant adverse effects at all.[20]

The plaintiffs argued that an English-only policy denies them their right to cultural expression, that is, that Spanish is the primary format in which one is identified, in which one is linked to their ethnicity.[21] The court found, however, that private employers are not required to allow other types of self expression and Title VII does not require an exception for the expression of cultural identity.[22] The ability to converse with others at work is a privilege allowed an employee at work, but it is not a broad privilege.[23] Conversations in the workplace can be defined at the discretion of the employer, that is, the employer can prohibit certain topics, such as religion or politics, and prohibit certain words, such as profanity and sexual terms.[24] Because conversation can be so narrowly limited by the employer, an employee who is capable of complying with the restriction, that is, can speak English and another language, cannot be said to have been adversely affected.[25] Since, bilingual employees can comply with an English-only rule and non-English speakers cannot, only non-English speaking employees can be said to be adversely affected by the English-only rule.[26] There was only one Spun Steak employee who

[17] *Id.* at 1486.
[18] *Id.*
[19] *See id.*
[20] *Id.* at 1486.
[21] *Id.* at 1487,
[22] *Id.*
[23] *Id.*
[24] *Id.*
[25] *Id.*
[26] *Id.* at 1488.

could not speak English, and there was a material fact as to whether the English-only policy had an adverse impact on her.[27]

Lastly, the plaintiffs argued that an English-only rule created "an atmosphere of inferiority, isolation, and intimidation."[28] If an English-only rule were to create such an isolation and intimidation in the workplace, or to exacerbate existing workplace tensions, then the effect of such a rule would be to create a hostile work environment.[29] But, the court concluded, that the evidence was that the English-only rule was introduced to reduce tensions at Spun Steak, to "prevent the employees from intentionally using their fluency in Spanish to isolate and to intimidate members of other ethnic groups."[30] Thus, there was no hostile work environment created by Spun Steak's policy of speaking English-only as to bilingual employees.[31] A hearing en banc was subsequently denied.[32]

Several cases have followed and many have cited *Spun Steak*. The employees of Sephora's retail cosmetic store in Rockefeller Center were consultants and cashiers, also called cast members (the sales floor was known as the stage), who were bilingual in both Spanish and English.[33] The Human Resources Director made conference calls six to eight times a year addressing issues of a relevant nature to operating the retail stores. The September 2002 conference call focused on the expectation of speaking English in Sephora's stores, and was followed up with a memorandum addressing the expectations of English in the workplace at Sephora's.[34] The relevant language of the memorandum stated that Sephora's did not have a policy of speaking English-only, but emphasized that there was an expectation by the cast members to use English when clients were present and for business necessity, such as safety, but

[27] *Id.*

[28] *Id.*

[29] *See id.* at 1488 and 1489.

[30] *Id.* at 1489.

[31] *Id.* at 1489 and 1490. The court noted that there was an issue of material fact as to the number of employees who were limited in their ability to speak English and, consequently, adversely impacted by the English-only policy. Because the case was decided on the fact that the bilingual employees failed to make a prima facie case of discrimination to support the grant of summary judgment in favor of the plaintiffs, the court did not consider the business justification by Spun Steak.

[32] Garcia v. Spun Steak, 13 F.3d 296, 1993 U.S. App. LEXIS 33530 (9th Cir. 1993). The dissent from denial of rehearing en banc by Judge Reinhardt gives a good summary of the background of the case and arguments against the majority opinion in the original decision.

[33] E.E.O.C. v. Sephora, 419 F.Supp.2d 408, 2005 U.S. Dist. LEXIS 20014 (S.D. N.Y. 2005) at 410.

[34] *Id.* at 410.

generally left all other situations to employee's choice of language use.[35] Further, each employee was "fluent in English and capable of complying with Sephora's expectations concerning speaking English while on stage."[36]

The plaintiff-employees countered that they were unable to comply with Sephora's expectations because they were unable to express themselves in English as a result of code switching, the unconscious tendency to speak in one's native language, particularly in response to being addressed by another in that native language, and, then, to continue speaking the native language with those who were known native language speakers like themselves.[37] Further, the plaintiffs argued that the involuntary habit of speaking one's native language was a matter of necessity, not a matter of personal preference or convenience.[38]

The Court agreed that Sephora's policy was job related and a business necessity.[39] Sephora required English to be spoken only at certain times, when in the presence of clients or when there was a business need, such as where safety was involved.[40] The job descriptions of the cast members included the ability to communicate clearly, that is, for the business location, in English.[41] It is a valid business necessity to have employees speak English to customers because "the effects on helpfulness, politeness and approachability are real and not a matter of abstract preference."[42] Furthermore, the EEOC rules provide that English-only rules are justified when customers only speak English, when efficiency requires cooperation amongst those who speak the same language, when supervisory personnel who only speak English need to monitor those employees who communicate with each other or customers, and when common language is necessary to promote workplace safety.[43] Once the employer shows that a policy is job related and a business necessity, the plaintiff has the burden to establish a less discriminatory alternative to the complained of policy, and that alternative must address the material question of the policy, that is, when the employer can require the employees to speak English.[44]

[35] *Id.* at 411. Cast members were also permitted to speak a language other than English when communicating with a sales client, but only at the wish of the client to do so. *Id.*

[36] *Id.*

[37] *Id.*

[38] *Id.*

[39] *Id.* at 418.

[40] *Id.* at 411.

[41] *Id.* at 415. All of the plaintiffs responded in English and understood English during depositions, without interpreters. *Id.* at 416.

[42] *Id.* at 417.

[43] *Id.*

[44] *Id.* at 418.

English only policies do not have a disparate impact when the employee is bilingual and can comply with the rule without adversely affecting the conditions of employment. In *Kania v. Archdiocese of Philadelphia*, Father Barszczewski announced an English-only policy and barred the speaking of Polish during business hours at Sacred Heart Church.[45] Kania, a Polish-American, had been a housekeeper at the church for over five years, and while she spoke Polish while at work, she was also fluent in English.[46] Father Barszczwski's reasoning for the rule was that it was "offensive and derisive to speak a language which others do not understand."[47] The rule applied to all groups, councils, and organizations at Sacred Heart Church.[48] Kania subsequently complained about the policy, and stated that Father Barszczewski could not legally bar her from speaking Polish at work.[49] Shortly thereafter, Kania was fired for not cleaning Father Barszczewski's room at the church, and she claimed the reason was pretext for her being fired due to her complaining of the English-only policy.[50]

Kania relied on the EEOC guidelines to support her case and the Court, in agreeing with *Spun Steak*, disregarded those guidelines and ruled that the policy at Sacred Heart Church did not constitute national origin discrimination.[51] She was, admittedly, bilingual, was not protected in her ability to express her cultural heritage at work under Title VII, and was not adversely impacted by the policy in her employment as she could have easily complied with that policy.[52] Though the Court ruled that the English-only policy was not discriminatory, it also ruled that since Kania could have reasonably believed that the policy was discriminatory at the time she complained of it, that is, before she was terminated, she could proceed with her case for retaliatory discharge.[53]

English-only policies are not limited to the private sector of the economy. Employees of the City of Altus sued over the city's adoption of an English-only policy.[54] There were complaints that some employees for the Street Department were speaking Spanish on their radios and that other, non-Spanish speaking employees, who were working on a joint

[45] Kania v. Archdiocese of Philadelphia, 14 F.Supp. 2d 730, 1998 U.S. Dist. LEXIS 11511 (E.D. Pa. 1998) at 731.

[46] *Id.*

[47] *Id.*

[48] *Id.*

[49] *Id.* at 732.

[50] *Id.*

[51] *Id.* at 736. The court takes the position that it can disregard guidelines which exceed the authority of the statute it purports to interpret. *Id.* at 735.

[52] *Id.*

[53] *Id.* at 737.

[54] Sanchez v. City of Altus, 2004 U.S. Dist. LEXIS 3252 (W.D. Okla., Feb 20, 2004) at *2.

project with the Street Department, could not understand the radio communications in Spanish.[55] Other employees complained of being uncomfortable when other workers spoke Spanish in their presence.[56] The English-only policy provided that its purpose was to promote effective communications between employees, reduce misunderstandings in those communications, and "enhance safe work practices."[57] The policy did not apply to workers in non-business communications during breaks or mealtimes, during non-work hours while on city property, in private conversations which did not disrupt the work environment, and encouraged sensitivity to other employees, while in their presence, when speaking a language other than English.[58]

The *City of Altus* Court followed *Spun Steak*. It found that all of the Plaintiffs were bilingual and the policy only applied to work related communications during work hours only.[59] The Plaintiffs, then, failed to show that the English-only policy "imposed significant, adverse effects on the terms, conditions, or privileges of their employment, so as to create a prima facie case of disparate impact discrimination under Title VII.[60] The Court found that the policy was not overbroad, even though, unlike *Spun Steak*, it required deference to non-Spanish speaking employees when speaking Spanish in their presence.[61] Because the Plaintiffs failed to establish a prima facie case of disparate impact, the burden did not shift to the City to show that it had a legitimate business justification for the policy.[62] Nonetheless, the Court found that there was sufficient evidence to meet any burden the City would have had in demonstrating the business justification necessary.[63]

III. ENGLISH ONLY, NO

Some courts have reached the opposite result and distinguished *Spun Steak*. The federal district court in *E.E.O.C. v. Premier Operator Services, Inc.* ruled that an English-only policy with a blanket prohibition and lacking a legitimate business necessity would not

[55] *Id.* at *6.
[56] *Id.*
[57] *Id.* at *8.
[58] *Id.* at *8-*10.
[59] *Id.* at *24-*25.
[60] *Id.* at *27.
[61] *Id.* at *31.
[62] *Id.* at *32.
[63] *Id.* at *32-*33. "The Defendants have offered evidence that city officials had received complaints that some employees could not understand what was being said on the City's radio frequency because other employees were speaking Spanish. Further, the Defendants have shown that city officials received complaints from non-Spanish speaking employees who felt uncomfortable when their co-workers spoke Spanish in front of them." *Id.*

stand.[64] Premier enacted an English-only policy prohibiting the speaking of Spanish on company premises at all times, unless assisting a customer who could not speak English.[65] All plaintiffs were bilingual, hired as telephone operators because they spoke both English and Spanish, to assist customers who spoke Spanish in placing long distance phone calls. [66] In fact, the employees were tested during the hiring process to qualify their ability to speak and understand Spanish.[67] Working in a close work area in which everyone spoke Spanish, employees faced termination if they spoke Spanish with each other anywhere within the building.[68]

Premier required all bilingual employees to sign a memo as to the English-only rule as a condition of continued employment.[69] Six employees refused to sign the memo and were terminated immediately.[70] Two employees signed the memo under protest, filed EEOC charges of discrimination, and were fired within 24 hours after Premier received the charges from EEOC.[71] Soon thereafter, Premier laid off five employees, without notice, who had expressed opposition to the policy but had signed the memo, and within three months laid off more "Hispanic employees, while replacing them with 14 non-Hispanic operators."[72] Experts gave qualified, credible, and persuasive evidence that bilingual speakers unconsciously revert to their primary language during informal conversations and continue to speak in the same language when switching conversations.[73] This "code switching" is not a conscious act and cannot be "turned off" by a mere request or direction to do so.[74]

[64] E.E.O.C. v. Premier Operator Services, Inc., 113 F.Supp.2d 1066, 2000 U.S. Dist LEXIS 17057 (N.D. Tex. 2000).

[65] *Id.* at 1068 and 1069.

[66] *Id.* at 1068.

[67] *Id.*

[68] *Id.* at 1069.

[69] *Id.*

[70] *Id.*

[71] *Id.*

[72] *Id.*

[73] *Id.* at 1069 and 1070. "Bilinguals whose original language is a language other than English unconsciously switch from English to their original or primary language when speaking informally with fellow members of their cultural group. This switching back and forth, formally known as "code switching" can occur in conversation even within a sentence or between sentences." *Id.* at 1070.

[74] *Id.* at 1070. "[R]elevant to the facts of this case . . . bilingual speakers will generally tend to continue to speak in the language in which they most recently spoke, as in a case where an Operator turns to speak to a fellow worker immediately following a conversation with a Spanish speaking customer." *Id.*

There was no evidence that anyone other than Hispanics were disciplined under the rule.[75] No credible evidence was presented which supported implementation of the English-only rule as a necessity of business, in fact, "the speaking of Spanish was a job requirement."[76] The court had little trouble finding that Premier's policy was discriminatory, having disparate impact on its employees based "on their national origin, in violation of Title VII of the Civil Rights Act of 1964."[77] The Court distinguished *Spun Steak* because there were no exceptions to the speaking of English-only at Premier, thus affecting Spanish speakers more harshly than non-Spanish speaking employees.[78] It also found that Premier had retaliated against the employees and acted with malice or reckless indifference as to the rights of those employees as to justify punitive damages.[79] The court issued an injunction against further implementation of the English-only policy, and awarded compensatory and punitive damages of $650,000.00.[80]

Subsequent cases which followed or cited *Premier Operator Services*, also cited *Spun Steak*, and, generally, these cases turned on the scope of the policy and business necessity. *E.E.O.C v. Beauty Enterprises, Inc.* also focused on the burden shifting requirements of disparate impact discrimination.[81] Employees at Beauty worked in the warehouse and either picked out the cosmetics that were ordered, checked the order to make sure the packing of the order was correct, sent the package to shipping, or shipped the package of the products.[82] Beauty's policy required English-only at work and claimed a valid justification for the rule.[83] The employees countered that the policy denied the Hispanic employees "a privilege enjoyed by native English speakers – the opportunity to talk at work for either business or social purposes."[84] Beauty alleged that employees were not privileged to engage in small talk or social conversations, and that the nature of the work allowed little or no time to engage in conversations which were not work related.[85]

[75] *Id.*
[76] *Id.*
[77] *Id.* at 1073.
[78] *Id.* at 1074.
[79] *Id.* at 1077.
[80] *Id.* at 1078.
[81] E.E.O.C. v. Beauty Enterprises, Inc., 2005 U.S Dist. LEXIS 25869 (D. Conn., October 5, 2005).
[82] *Id.* at *3.
[83] *Id.* at *2.
[84] *Id.* at *3.
[85] *Id.* at *3 and *4.

The parties agreed to a three step burden shifting test requiring (1) plaintiff to show disparate impact by a prima facie case to shift the burden to the defendant, (2) defendant to show how the policy was consistent with the necessities of its business and that it was job related to shift the burden back to the plaintiff, and (3) plaintiff to show that there was a practice or a policy which would satisfy that same business necessity in the alternative.[86] The parties disagreed as to what constituted a prima facie case. The Plaintiffs wanted the Court to follow the EEOC's guideline and only have to show that an English-only rule existed in the workplace to show the prima facie case of discrimination.[87] Beauty opted for the *Spun* Steak test and argued that the EEOC's guideline was not supported in the context of Title VII of the Civil Rights Act of 1964.[88] The Court adopted, in part, the test in *Spun Steak*,[89] and found that the employees would have to prove a significant and adverse impact on them by Beauty's English-only rule.[90]

Lovelace Sandia Health Systems had a no-Spanish policy that was never enforced.[91] Several employees were uncomfortable when other employees spoke Spanish to each other, some complained when some employees spoke Spanish and laughed at patients or other employees, and a patient who spoke Spanish overheard employees speak about other employees and patients in a derogatory manner in Spanish.[92] Subsequently, several topics were discussed at departmental meeting held by the Clinic Manager, including the non-Spanish policy.[93] The manager asked that employees to refrain from speaking Spanish except when necessary to translate for a patient who spoke no English.[94] Plaintiffs stated that they were not told by the Clinic Manager that they could speak Spanish during non-work related times such as meals and breaks, and they felt intimidated by her.[95] Over the next several months after the meeting, the plaintiffs alleged a stressful workplace in which their individual activities were monitored and reported on by other employees to the Clinical Manager.[96] Charges were filed with the EEOC, and the EEOC issued Notice of Right to Sue letters to the Plaintiffs.[97]

[86] *Id.* at *4 and *5.
[87] *Id.* at *5.
[88] *Id.* at *5-*6.
[89] *Id.* at *7-*12.
[90] *Id.* at *37.
[91] Barber v. Lovelace Sandia Health Systems, 409 F.Supp.2d 1313, 2005 U.S. Dist. LEXIS 39135 (D. N.M. 2005).
[92] *Id.* at 1318.
[93] *Id.* at 1319.
[94] *Id.*
[95] *Id.*
[96] *Id.* at 1320-1323.
[97] *Id.* at 1324.

The *Lovelace Sandia* court decided that assuming a deference to the guidelines of the EEOC, a no-Spanish policy would only establish one element of disparate treatment necessary for a prima facie case. Further, although it noted the decision in *Premier Operator Services*, that a language specific policy which is applied at all times demonstrates significant adverse impact, the Court found that the *Lovelace Sandia* policy was never used to terminate an employee.[98] Allegations by the plaintiffs that they suffered negative employee actions for reasons other than speaking Spanish was not sufficient to show that the policy was a pretext for those actions.[99] Further, the Court determined that a no-Spanish policy is not distinguishable from an English-only to support a different conclusion on the issue of discrimination.[100]

IV. ANALYSIS

A policy of English-only or no-Spanish in the workplace, for the most part, results from a business decision to address either the perception of an existing problem or in anticipation of a problem with employees and/or customers. According to the EEOC guidelines—an attempt to change the traditional burden of proof standards in disparate impact cases—this type of policy is discriminatory as to national origin, and the mere existence of this policy shifts the burden to the employer to show that the English-only is not discriminatory. The relevant court decisions, however, disregard that attempt in burden shifting and hold that a language specific policy is not, on its face, discriminatory, but only makes up a part of a prima facie case, and that the plaintiff needs to show a significant and adverse impact to complete that prima facie case. This multipart test, then, must be satisfied before the employer may be required to show a business necessity.

An English-only policy can address when and where an employee can or cannot speak English or any other language. If that policy restricts the use of language at all times and on all parts of the premises of the workplace, then it is prima facie discriminatory and the business must show a business necessity. If the policy is limited in application to who, when, and where, then the employee retains the burden of further proof, such as a showing of significant and adverse impact. For example, the language restriction should apply only to bilingual speakers during actual work hours and during work related interactions; the policy should not apply to conversations between co-workers, or during employee breaks or mealtimes, or before of after actual work hours while employees are still on the premises of the business; and the policy should

[98] *Id.* at 1336.
[99] *Id.* at 1338-1339.
[100] *Id.* at 1339-1340.

allow the employee to converse with non-employees whose preference is a language other than English. If the policy is stated, but not enforced or not directly responsible for negative employee actions, the burden remains on the plaintiff to show that the policy was pretext for actions which amounted to a significant and adverse impact.

An English-only policy must not affect some employees more than others, but affect all in the same degree. For example, if the policy purports to restrict Spanish speaking employees from speaking Spanish, but does not restrict Vietnamese employees from speaking Vietnamese, the policy affects the Spanish speakers to a different degree than the rest of the employees and is discriminatory. If an employee is incapable of speaking English and cannot comply with the English-only policy, then the policy has a significant and adverse affect on the non-English speaking employee. Also, an English-only policy must not have the effect in the workplace such that the fluency of the English speakers can be used to intimidate and isolate those non-English speakers while restricting them to speaking English-only.

After the plaintiff makes a prima facie case of discrimination, the burden shifts to the employer to prove that there is a business necessity for the policy. Necessity can be a need for clarity in communication in the workplace for purposes of safety and warning of dangers, for supervisory evaluation of employees, for cooperation to maintain required business efficiencies, and for interacting with customers who can only speak the language addressed by the policy. But, while the language specific policy can be considered necessary for interacting with customers, the policy cannot be a result of customer preference alone.

If the English-only policy is adjudged to meet the business necessity requirement, the burden shifts back to the plaintiff to show that there is a less discriminatory alternative which will satisfy the material objectives of the policy. The only question left to be answered by the alternative is when and where the employer can require the employee to speak English, thus, addressing the requirements of the business necessity. If a supervisor needs to evaluate an employee, that supervisor could be bilingual or trained to communicate in the non-English language. English classes could be offered to all workers to improve a common communication language.

V. CONCLUSION

The court decisions, so far, are limited to several circuits; not all federal courts have ruled on language specific policies and constitutional and federal law. And, state courts are not required to accept EEOC guidelines. As the number of cases under English-only policies or English-only related actions increase, so will the costs to employers and the implications to third parties. These increasing costs of English-only

and related actions are enough to concern even small and medium sized businesses, but the advice, as to how to handle them, which now differs greatly from state to state, is beginning to differ less from one federal jurisdiction to another. Given the cases supra, the following is offered as a general guideline for implementing an English-only policy in the workplace.

First, there must be a business necessity. This necessity can be shown by problems arising in the workplace involving language which makes it necessary to address the language involved. For example, if the issue is safety, that is, if language must be understood by the many for the protection of all and English is the language required, then there may be a necessity. If the language is necessary for customer relations, that is, without the speaking of English a business is diminished, there may be a necessity. And, of course, in the name of employee harmony, that is, if there is tension in the workplace which exists because of the speaking of a language other than English, or workplace tension is exacerbated by it, there may be a necessity.

Next, the crafting of the policy must reflect that business necessity. The wording of the policy should be such that the application of the rule is simple, such as, English-only during the hours of work. It should be limited in scope, that is, not applicable during breaks, lunch, before or after work while on employer's premises, or when it interferes with the understanding in communication between employees and supervisory personnel. The policy must be applied to all employees, not just the employees who may be negatively affected.

Lastly, the policy should be narrowly construed and consistently applied so as to minimize any other negative effects. English-only rules tend to have a much greater impact on those who originate from non-English speaking countries than it does on others. The harm it may cause must not outweigh the benefits, otherwise, the policy should fail. The English-only rule should not tend to isolate the employees in a protected class, nor should it intimidate them or have a punitive effect on them as a result of the rule. And, as with all business policies, employees must be given full notice of the policy, and times and places of the applicable restrictions.

AUTOMATIC REASSIGNMENT OF DISABLED PERSONS UNDER THE ADA: *HUBER v. WAL-MART STORES* WIDENS THE CIRCUIT SPLIT

by ROBERT C. BIRD[*] AND JEANNINE LAWLOR DEPHILLIPS[**]

I. INTRODUCTION

In 2004 Pam Huber, a disabled employee, filed suit against her employer, Wal-Mart Stores, Inc.,[1] alleging that Wal-Mart discriminated against her in violation of the Americans with Disabilities Act[2] when it refused to reassign her automatically to an equivalent, vacant position for which she was a qualified, but not the most qualified, candidate. Wal-Mart contended that reassignment was not required under the ADA since it had an established policy of hiring the most qualified candidate. It argued that allowing Huber to apply and compete for the position was sufficient.[3] The district court granted Huber's cross-motion for summary judgment[4] and Wal-Mart filed an appeal with the United States Court of Appeals for the Eighth Circuit.

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[1] Huber v. Wal-Mart Stores, Inc., No. 04-2145, 2005 U.S. Dist. LEXIS 40251 (W.D. Ark. Dec. 7, 2005). Pam Huber and Wal-Mart Stores, Inc. hereinafter will be referred to as Huber and Wal-Mart, respectively.

[2] Americans with Disabilities Act of 1990, 42 U.S.C. §§ 12101-12213 (2000) (hereinafter ADA).

[3] Huber v. Wal-Mart Stores, Inc., 486 F.3d 480, 481-82 (8th Cir. 2007).

[4] *Id*. at 482.

The Eighth Circuit framed the *Huber* issue, which was one of first impression for the court, as whether, under the ADA, an employer must reassign a disabled employee to a vacant position where the employer has a policy of hiring the most qualified candidate and the employee, while qualified, is not the most qualified candidate.[5] The court reversed the district court's ruling. It held that automatic reassignment is not required, noting that the ADA is not an affirmative action statute.[6]

With this holding, the court widens the circuit split that exists regarding what reassignment under the ADA requires where a non-discriminatory policy to hire the most qualified applicant exists. As in the Eighth Circuit, the United States Court of Appeals for the Seventh Circuit has held that automatic reassignment is not required, equating it with unwarranted preferential treatment.[7] In contrast, the United States Court of Appeals for the Tenth Circuit has held that automatic reassignment is required, finding that merely providing a disabled employee with the opportunity to compete for a vacant position insufficient.[8] While the Supreme Court has addressed the reassignment language of the ADA in *US Airways v. Barnett*,[9] it only did so within the narrow context of a seniority system and so did not resolve the issue for the ADA overall.

For a brief period of time, the question raised by *Huber* was going to be resolved by United States Supreme Court. In October, 2007, Huber filed a petition for a writ of certiorari with the Supreme Court, requesting the Court to address whether the ADA requires that an employer: (a) reassign a qualified disabled employee to a vacant, equivalent position; or (b) merely permit the employee to apply and compete with other applicants for the vacant position.[10] Huber did not frame the issue in the context of where an employer has an established policy of hiring the best applicant; that task was left to Wal-Mart in its opposition brief.[11] In December, 2007, the Supreme Court granted Huber's petition

[5] *Id*. at 48l.

[6] *Id*. at 483.

[7] *See, e.g.,* EEOC v. Humiston-Keeling, Inc., 227 F.3d 1024, 1028-29 (7th Cir. 2000) (ADA is not a mandatory preference act.); Williams v. United Insurance Company of America, 253 F.3d 280, 282 (7th Cir. 2001) ("[The ADA] is not an affirmative action statute in the sense of requiring an employer to give preferential treatment to a disabled employee merely on account of the employee's disability. . . .").

[8] *See, e.g.,* Smith v. Midland Brake, Inc., 180 F.3d 1154, 1166-67 (10th Cir. 1999).

[9] 535 U.S. 391 (2002).

[10] Petition for a Writ of Certiorari at i, Huber v. Wal-Mart Stores, Inc., No. 07-480 (filed October 4, 2007) (hereinafter Writ of Certiorari).

[11] Brief in Opposition to Petition for a Writ of Certiorari at i, Huber v. Wal-Mart Stores, Inc., No. 07-480 (filed November 9, 2007). Wal-Mart presented the first issue as: "Whether this Court should review a decision of the Eighth Circuit holding that the Americans with Disabilities Act ("ADA") does not forbid an employer from using a

as to this particular issue.[12] However, soon thereafter, the parties settled the lawsuit and in January, 2008 the Supreme Court dismissed the case.[13] As a result, the circuit split still exists. What reassignment opportunities a disabled employee is entitled to under the ADA when an employer has a "most qualified" hiring policy remains an unresolved question.

II. THE ADA AND THE REASSIGNMENT ACCOMMODATION

The ADA prohibits discrimination "against a qualified individual with a disability because of the disability of such individual in regard to job application procedures, the hiring, advancement, or discharge of employees, employee compensation, job training, and other terms, conditions, and privileges of employment."[14] An individual with a disability is "qualified" under the ADA if he can perform the "essential functions" of the position he holds or desires "with or without reasonable accommodation."[15] Failure to provide a reasonable accommodation is unlawful discrimination. Under the ADA, discrimination includes: "not making reasonable accommodations to the known physical or mental limitations of an otherwise qualified individual with a disability who is an applicant or employee, unless such covered entity can demonstrate that the accommodation would impose an undue hardship on the operation of the business of such covered entity[.]"[16] A reasonable accommodation may include "reassignment to a vacant position,"[17] which is considered the accommodation of last resort.[18]

legitimate, nondiscriminatory job transfer program to fill vacant positions where the decision under review is fully consistent with the only other circuit court decision to address this subject after *U.S. Airways, Inc.. v. Barnett,* 535 U.S. 391 (2002)." *Id.*

[12] 128 S. Ct. 742 (2007). The Court denied review of Huber's second issue of whether the Equal Employment Opportunity Commission's interpretation of its regulation is entitled to deference by the courts. Writ of Certiorari at ii.

[13] Huber v. Wal-Mart Stores, Inc., 128 S. Ct. 1116 (2008).

[14] 42 U.S.C. § 12112(a) (2000).

[15] 42 U.S.C. § 12111(8) (2000).

[16] 42 U.S.C. § 12112(b)(5)(A) (2000).

[17] 42 U.S.C. § 12111(9)(B) (2000); 29 C.F.R. § 1630.2(o)(2)(ii) (2007). Other examples of reasonable accommodations listed in the statute include job restructuring, part-time or modified work schedules, and the acquisition or modification of equipment or devices. 42 U.S.C. § 12111(9)(B).

[18] EEOC Enforcement Guidance, Reasonable Accommodation and Undue Hardship Under the Americans with Disabilities Act, 8 Fair Empl. Prac. M. (BNA) 405:7601, at 7622 (Oct. 17, 2002) (hereinafter Enforcement Guidance) ("Before considering reassignment as a reasonable accommodation, employers should first consider those accommodations that would enable an employee to remain in his/her current position. Reassignment is the reasonable accommodation of last resort and is required only after it has been determined that: (1) there are no effective accommodations that will enable the employee to perform the essential functions of his/her current position, or (2) all other reasonable

The Equal Employment Opportunity Commission ("EEOC"), which is responsible for promulgating the regulations for the ADA, clearly states in its enforcement guidance that, where other accommodations have failed and reassignment to a vacant, equivalent position is not an undue burden, then an employer is obligated to reassign a qualified, disabled employee to the position.[19] The employee does not have to compete with other employees or applicants for the vacant position.[20] In its enforcement guidance the EEOC also states: "The employee does not need to be the best qualified individual for the position in order to obtain it as reassignment."[21]

While the EEOC's position on reassignment is clear, the federal appellate courts' position is not. The courts disagree about the meaning of the reassignment language in cases where employers have non-discriminatory, most qualified candidate hiring and transfer policies. The circuit split exists, in large part, because of distinct views of the purposes and goals of the ADA. For the Tenth Circuit, a disabled employee is entitled to automatic reassignment regardless of whether he is the most qualified applicant. It views the interests of the protected class, including the goal of economic independence, as outweighing the interests of employers and non-disabled workers. For the Seventh Circuit and now the Eighth Circuit, the opportunity for a disabled employee to compete for a vacant position is sufficient. These courts view the ADA's purpose as creating a level playing field for disabled employees in the workplace, not as providing affirmative action for disabled employees.[22]

III. KEY CASES CREATING THE PRE-HUBER CIRCUIT SPLIT

A. The Tenth Circuit Requires Automatic Reassignment.

In the Tenth Circuit, a qualified disabled employee, who seeks reassignment as a reasonable accommodation, does not have to compete against other applicants for the vacant position. If reassignment does

accommodations would impose an undue hardship."). *See also* 29 C.F.R. pt. 1630 app. (2007) ("In general, reassignment should be considered only when accommodation within the individual's current position would pose an undue hardship.").

[19] Enforcement Guidance at 405:7621. In light of US Airways v. Barnett, 535 U.S. 391 (2002), the EEOC acknowledges one exception to this rule; *i.e.*, where an employer has a seniority system in place. "Generally, it will be 'unreasonable' to reassign an employee with a disability if doing so would violate the rules of a seniority system." *Id*. at 405:7625.

[20] *Id*. (Question 29: "Does reassignment mean that the employee is permitted to compete for a vacant position? [Answer] No. Reassignment means that the employee gets the vacant position if s/he is qualified for it. Otherwise, reassignment would be of little value and would not be implemented as Congress intended.").

[21] *Id*. at 405:7621.

[22] See *infra* Section III.A –B.

not create an undue hardship for the employer, then the employee automatically gets the new position. It is irrelevant that the disabled employee may not be the most qualified applicant.

In *Smith v. Midland Brake, Inc.*,[23] the appellant Smith formerly worked in the light assembly department of Midland Brake. While working at the company he was exposed to chemicals and developed severe contact dermatitis. His physicians found that he was "permanently disabled" and could not work in the department.[24] After some time, Midland Bank terminated Smith on the ground that it was unable to make accommodations that would have allowed Smith to continue working in the light assembly department.[25] Smith then filed a lawsuit in district court against Midland Brake alleging, in part, violation of the ADA. The court granted Midland Brake's motion for summary judgment: since Smith was not a "qualified individual with a disability," Midland Brake was not obligated to consider his reassignment request. The Tenth Circuit reaffirmed the district court's granting of summary judgment.[26]

The en banc panel of the Tenth Circuit agreed to rehear the ADA claim.[27] It reversed and remanded the district court's granting of the summary judgment motion.[28] The court examined various aspects of the ADA including the meaning of a "qualified individual with a disability"[29] and the meaning of the reassignment language. It defined the scope of an employer's obligation to offer reassignment, holding that:

> If no reasonable accommodation can keep the employee in his or her existing job, then the reasonable accommodation may require reassignment to a vacant position so long as the employee is qualified for the job and it does not impose an undue burden on the employer. *Anything more, such as requiring the reassigned employee to be the best qualified*

[23] 180 F.3d 1154 (10th Cir. 1999).

[24] *Id.* at 1160.

[25] *Id.*

[26] Regarding the ADA claim, the Tenth Circuit reaffirmed the district court's ruling on different reasoning. The district court found that Smith was not a "qualified individual" because he did not provide Midland Brake with a medical release to return to work. The appellate court, however, found that Smith was not a "qualified individual" because "no amount of accommodation could allow Smith to perform his existing job." *Id.*

[27] *Id.* at 1159.

[28] *Id.* at 1179-80. The court found that two genuine issues of material fact existed: first, whether Smith had engaged in the interactive process that the ADA requires when a disabled employee seeks reassignment; and, second, if Smith had done so, whether Midland Brake had "adequately responded" to Smith's reassignment request. Smith v. Midland Brake, Inc., 180 F.3d 1154, 1180 (10th Cir. 1999).

[29] The court held that an employee could be a "qualified individual with a disability" where he could not perform the essential functions of his position, with or without reasonable accommodation, but could perform the essential functions of vacant positions within the company, with or without reasonable accommodation. *Id.* at 1159.

> *employee for the vacant job, is judicial gloss unwarranted by the statutory language or its legislative history*.[30]

The court's rationale was based largely on interpretation of the statutory language. If the reassignment language only means that a disabled employee is given the opportunity to compete for a vacant position, then he would be treated like any other job applicant. The ADA already prohibits discrimination against disabled job applicants. Therefore, the court contended that the reassignment language would "add nothing to the [company's] obligation not to discriminate."[31] The listing in the statute of reassignment to a vacant position as a reasonable accommodation would be "redundant" and meaningless. [32] Preferring not to disregard explicit statutory language, the court found that the reassignment language must mean more than just granting an opportunity to compete.[33]

The "legislative history" relied on by the court to reach its ruling was principally from the EEOC enforcement guidance, which states that reassignment does not mean that the employee has to compete for the vacant position.[34] "Otherwise, reassignment would be of little value and would not be implemented as Congress intended."[35]

The Tenth Circuit also rejected the dissent's view that automatic reassignment is affirmative action. For the court, undue hardship is the only statutory exception to an employer's obligation to make reasonable accommodations to a qualified, disabled employee. Permitting an employer not to reassign a qualified, disabled employee because he was not the best candidate would create a second, unwarranted exception.[36] The court further noted that while the dissent focused on equal opportunity, which is only one of the ADA's goals, it ignored the ADA's goal of "facilitat[ing] economic independence" for disabled employees.[37]

[30] *Id*. at 1169 (emphasis added).

[31] *Id*. at 1164-65.

[32] *Id*. *See also* Enforcement Guidance at 405:7625 n.90 ("Such an interpretation [that reassignment means simply an opportunity to compete for a vacant position] nullifies the clear statutory language stating that reassignment is a form of reasonable accommodation. Even without the ADA, an employee with a disability may have the right to compete for a vacant position.").

[33] *Midland Brake*, 180 F.3d at 1165.

[34] Smith v. Midland Brake, Inc., 180 F.3d 1154, 1166-67 (10th Cir. 1999) (citing EEOC Guidance: Reasonable Accommodation and Undue Hardship Under the Americans with Disabilities Act at 44 (1999)).

[35] *Id*.

[36] *Midland Brake* at 1167-68.

[37] *Id*. at 1168. *See also* 42 U.S. C. § 12101(a)(8) (2000) ("[Congress finds that] the Nation's proper goals regarding individuals with disabilities are to assure equality of opportunity, full participation, independent living, and economic self[-]sufficiency for such individuals[.]").

B. The Seventh Circuit Requires that the Disabled Employee Must Apply and Compete with other Job Applicants.

In the Seventh Circuit, a disabled employee seeking reassignment does have to compete with other job applicants for the vacant position, if the employer has a most qualified hiring policy. The employee is not given a "preference" over other job applicants.

In *EEOC v. Humiston-Keeling, Inc.*,[38] the EEOC represented Nancy Cook Houser ("Houser"), who worked as a picker in the warehouse at Humiston-Keeling. As a result of a work-related accident, Houser developed tennis elbow, could not lift various products, and was no longer able to perform the essential functions of her job. The company's attempt to provide a reasonable accommodation to Houser so that she could remain in her warehouse position failed.[39] Humiston-Keeling had a "bona fide policy, consistently implemented of giving a vacant job to the best applicant rather than the first qualified one."[40] Over a period of time, Houser applied, unsuccessfully, for several clerical positions at Humiston-Keeling. Humiston-Keeling hired other, more qualified, candidates for these positions.[41] The company eventually terminated Houser[42] and she then filed an EEOC charge. The EEOC appealed the district court's granting of the employer's motion for summary judgment. It requested the court to rule, in part, on whether Humiston-Keeler violated the ADA by failing to make a reasonable accommodation.[43]

The issue before the Seventh Circuit was the scope of an employer's obligation to reassign. The court characterized the EEOC's interpretation of the reassignment language as requiring an employer to automatically reassign a disabled employee to a vacant position, as long as the employee is minimally qualified for the job and there is no undue hardship to the employer.[44] To the EEOC, it was irrelevant that the employer had a best applicant hiring policy and that Houser's disability "put her at no disadvantage in competing for the vacant clerical jobs."[45]

The Seventh Circuit rejected the EEOC's interpretation, which it viewed as establishing a bonus point system for the disabled.[46] The court held that the ADA does not require an employer to reassign a

[38] 227 F.3d 1024 (7th Cir. 2000).
[39] *Id*. at 1026.
[40] *Id*. at 1027.
[41] *Id*. at 1026-27.
[42] *Id*. at 1027.
[43] *Id*. at 1025-26.
[44] EEOC v. Humiston-Keeling, Inc., 227 F.3d 1024, 1027 (7th Cir. 2000).
[45] *Id*.
[46] *Id*.

disabled employee to a job for which there is a superior applicant, as long as the employer has a "consistent and honest policy to hire the best applicant. . .rather than the first qualified applicant" for a position.[47] An employer is not obligated to "turn away a superior applicant" when a disabled employee requests reassignment.[48]

The court's ruling was based on its view that the ADA is not a "mandatory preference act."[49] Two facts were significant to the court. First, Humiston-Keeling's best applicant hiring policy was a legitimate, non-discriminatory policy. Second, the employee's disability bore no relationship to the clerical positions she sought. The court reasoned that if the law required mandatory reassignment, the employer would hire the disabled employee merely because she belonged to a statutorily protected class.[50] This would be "affirmative action with a vengeance" and would go beyond the ADA's goal of allowing disabled employees to compete equally against non-disabled workers. [51] Mandatory reassignment also would fail to accomplish the ADA's goal of requiring employers to remove barriers they created that discriminate against disabled employees.[52]

IV. HUBER WIDENS THE CIRCUIT SPLIT

A. Factual Background

While working for Wal-Mart as an order filler, earning $13.00 per hour, Pam Huber injured her right hand and arm, resulting in her inability to perform the essential functions of her job.[53] As a reasonable accommodation under the ADA, Huber requested reassignment to a router position. Wal-Mart had an established policy of hiring the most qualified applicant for all of its open positions,[54] known as the Associate Job Transfer Program.[55] Pursuant to this program, Wal-Mart required

[47] *Id*. at 1029. The court acknowledged that reassignment is mandatory where the disabled employee is qualified for the vacant position, the reassignment is not an undue burden for the employer, and the employer does not have to turn away superior applicants. *Id.* at 1027.

[48] *Id*.

[49] EEOC v. Humiston-Keeling, Inc., 227 F.3d 1024, 1028 (7th Cir. 2000).

[50] *Id*. at 1028-29.

[51] *Id*. *See also* Daugherty v. The City of El Paso, 56 F.3d 695, 700 (5th Cir. 1995) (City treated disabled, part-time employee the same as any other part-time employee whose position was eliminated. The ADA does not require "affirmative action in favor of individuals with disabilities.").

[52] *Humiston-Keeling*, 227 F.3d at 1028-29.

[53] Huber v. Wal-Mart Stores, Inc., 486 F.3d 480, 481 (2007).

[54] *Id*. at 481-82.

[55] Huber v. Wal-Mart Stores, Inc., No. 04-2145, 2005 U.S. Dist. LEXIS 40251 at *3 (W.D. Ark. Dec. 7, 2005).

Huber to apply and compete for the router position. While Huber was qualified to perform the essential functions of the router position, she was not the most qualified applicant.[56] Therefore, she did not get the job. Wal-Mart reassigned Huber to a vacant janitorial position, where she initially earned $6.20 per hour.[57]

Huber filed suit against Wal-Mart in district court alleging that Wal-Mart discriminated against her when it did not reassign her to the router position and, instead, required her to compete for the position. Wal-Mart filed a motion for summary judgment asserting that it was not required to reassign Huber to the router position, because it had a non-discriminatory policy of hiring the best applicant for a vacant position. The court granted Huber's cross-motion for summary judgment[58] and Wal-Mart filed an appeal.

B. Issue, Ruling and Rationale

The Eighth Circuit framed the issue as whether the ADA requires an employer, with a best applicant hiring policy, to give a disabled employee preference in filling a vacant position when she is not the most qualified applicant.[59] The court answered this question in the negative.[60] Wal-Mart was not required to violate its transfer policy and automatically reassign Huber to the router position. It did not have to give Huber "preference" and turn away superior applicants. Allowing Huber to apply and compete with other applicants was enough.

The court acknowledged that the meaning of the reassignment language in this context was an issue of first impression for it and the subject of a circuit split.[61] In reaching its holding, the court first noted and then quickly disregarded the Tenth Circuit's approach in *Smith v. Midland Brake*.[62] As discussed, in *Midland Brake* the court held that a disabled employee is entitled to automatic reassignment to a vacant position. The Eighth Circuit summarized the Tenth Circuit's rationale as requiring mandatory reassignment because the reassignment language of the ADA would be "redundant" and add nothing to an employer's obligation not to discriminate if it only required that a disabled employee "compete equally with the rest of the world for a

[56] *Huber*, 486 F.3d at 481. The parties stipulated that the person Wal-Mart hired for the vacant position was the most qualified applicant. *Id.*

[57] At the time of the hearing of the matter before the Eighth Circuit, Huber still worked for Wal-Mart in the maintenance department, earning $7.97/hour. *Id*.

[58] Huber v. Wal-Mart Stores, Inc., 486 F.3d 480, 481-82 (2007).

[59] *Id*. at 482.

[60] *Id*. at 483.

[61] *Id*. at 482.

[62] 180 F.3d 1154 (10th Cir. 1999).

vacant position."[63] The Eighth Circuit found the rationale unpersuasive, without further explanation.[64]

The Eighth Circuit then noted and agreed with the Seventh Circuit's approach in *EEOC v. Humiston-Keeling, Inc.*[65] As noted, *Humiston-Keeling* held that that the ADA does not require an employer to reassign a disabled employee to a position where there are more qualified applicants, if the employer has a policy of hiring the most qualified applicant. The Eighth Circuit found this approach in agreement with its view that the ADA is not an affirmative action statute.[66] If it were to rule that an employer was obligated to reassign a less qualified applicant to a position -- in violation of its own non-discriminatory policy—the court would change the ADA from a non-discrimination statute to a mandatory preference act.[67]

V. IMPLICATIONS OF THE HUBER-WIDENED CIRCUIT SPLIT: COSTS AND CONTEXTS

The *Huber* decision, in examining whether an employer must automatically reassign a disabled employee and answering in the negative, has widened an already existing circuit split. With the parties in the *Huber* case reaching a settlement[68] after the Supreme Court granted certiorari in the case,[69] there is little likelihood of a resolution in the immediate future.

In the meantime, an understanding of the broader context of employment reassignment generally under the ADA can help illuminate the relevant cases. The scope of the reassignment burden is a complex one and courts have not yet fully fleshed out the extent of an employer's affirmative duty to reassign. There are some situations, however, where courts agree across circuits that a duty to reassign does not exist. For example, employers do not have to reassign a disabled employee to a

[63] Huber v. Wal-Mart Stores, Inc., 486 F.3d 480, 482-83 (2007) (citing Smith v. Midland Brake, Inc., 180 F.3d 1154, 1164-65 (10th Cir. 1999)).

[64] The Eighth Circuit also distinguished the case of Aka v. Washington Hospital Center, 156 F.3d 1284 (D.C. Cir. 1998), relied on by appellant Huber, on the ground that the case did not address the situation where reassigning a qualified, disabled employee would require the employer not to hire a superior applicant. *Huber*, 486 F.3d at 483.

[65] 227 F.3d 1024 (7th Cir. 2000).

[66] *Huber* at 483.

[67] *Id.* (citing EEOC v. Humiston-Keeling, Inc., 227 F.3d 1024, 1028 (7th Cir. 2000)).

[68] *Disabilities: Settlement Follows Supreme Court's Grant of Review in ADA Lawsuit Against Walmart*, 09 BNA DAILY LAB. REPT. A-1 (2008). Huber's attorney said, "The litigation between Pam Huber and Wal-Mart has been resolved to our satisfaction and we have withdrawn our appeal[.] The settlement agreement is confidential and we will not be providing further comment." *Id.*

[69] Huber v. Wal-Mart Stores, Inc., 128 S. Ct. 742 (2007) (granting certiorari on single issue).

position for which he or she is not qualified at all.[70] Employers do not have to remove a non-disabled employee from a position that the employee currently holds to make way for a disabled one.[71] An entirely new position does not have to be created for a disabled employee.[72] Disabled employees do not have to be promoted to be accommodated.[73] Employers also do not have to contravene established seniority systems.[74]

Traditionally, the EEOC and federal courts have relied upon interpretations of the Rehabilitation Act for guidance in interpreting the ADA.[75] For example, the interpretive guidance of the EEOC suggests

[70] *E.g.,* Aka v. Washington Hospital Center, 156 F.3d 1284, 1305 (D.C. Cir. 1998) (en banc) ("the ADA does not require that a disabled employee be reassigned to a position for which he is not otherwise qualified."); Baert v. Euclid Beverage, Ltd., 149 F.3d 626, 633 (7th Cir. 1998) (similar).

[71] *E.g.,* Eckles v. Consolidated Rail Corp., 94 F.3d 1041, 1047 (7th Cir. 1996) ("While Congress certainly contemplated job structuring changes as part of reasonable accommodation, the suggestion that reassignment be to a vacant position suggests that Congress did not intend that other employees lose their positions in order to accommodate a disabled coworker."); Emrick v. Libbey-Owens-Ford Co., 875 F. Supp. 393, 397 (E.D. Tex. 1995) ("The ADA does not require that an employer create a vacancy by 'bumping' another employee."). Interestingly, *Emrick* notes that a non-disabled employee's offer to voluntarily relinquish her position may be a valid means of accomplishing a reasonable accommodation. *Id*. *See also* 29 C.F.R. § 1605.2(d)(1)(i) (2008) (listing voluntary shift swapping and voluntary transfers as a means of reasonably accommodating conflicts between employment and religious practices).

[72] *E.g.,* Benson v. Northwest Airlines, Inc. 62 F.3d 1108, 1114 (8th Cir. 1995) (employer is not required to "create a new position" to accommodate a disabled employee).

[73] *E.g.,* Lucas v. W.W. Grainger, Inc., 257 F.3d 1249, 1256 (11th Cir.2001) (noting that the ADA does not require promotion of a disabled employee as a reasonable accommodation); Cravens v. Blue Cross and Blue Shield of Kansas City, 214 F.3d 1011, 1019 (8th Cir.2000) (promotion not necessary accommodation under the ADA); Malabarba v. Chicago Tribune Co., 149 F.3d 690, 699 (7th Cir. 1998) ("[A]n employer does not have to accommodate a disabled employee by promoting him or her to a higher level position.").

[74] U.S. Airways, Inc. v. Barnett, 535 U.S. 391, 406 (2002) (ADA does not ordinarily require "employer to assign a disabled employee to a particular position even though another employee is entitled to that position under the employer's 'established seniority system.'").

[75] Sarah J. Parrot, Note, *The ADA and Reasonable Accommodation of Employees Regarded as Disabled: Statutory Fact or Bizarre Fiction?*, 67 OHIO ST. L.J. 495, 1501 n. 24 (2006) ("The interpretive guidance of the Equal Employment Opportunity Commission ("EEOC") pertaining to the ADA acknowledges that Congress adopted the definition of 'disability' from the Rehabilitation Act's definition of 'handicapped individual' and, '[b]y so doing, Congress intended that the relevant case law developed under the Rehabilitation Act be generally applicable to the term "disability" as used in the ADA.'") (citing 29 C.F.R pt. 1630 app. (2005)); John E. Murray and Christopher J. Murray, *Enabling the Disabled: Reassignment and the ADA*, 83 MARQ. L. REV. 721, 723 (2000) ("Congress, the Equal Employment Opportunity Commission (EEOC), and the courts have all relied upon the Rehabilitation Act for guidance in interpreting the ADA[.]").

that the 'business necessity' standard[76] has the same meaning under the Rehabilitation Act as well as the ADA.[77] The Supreme Court has already examined reassignment within the context of the Rehabilitation Act. In *School Board of Nassau County v. Arline*,[78] the Court stated in a footnote that employers need only give employees the same opportunities as other employees receive under their existing policies.[79] Although *Arline* initially appears to foreclose decisions such as *Midland Brake* that disagree with *Huber* and require reassignment, the ADA and the Rehabilitation Act do not fall in lockstep with one another. The Rehabilitation Act has been saddled with a series of court cases holding that reassignment did not constitute a valid reasonable accommodation. For example, in *Shea v. Tisch*,[80] a postal service worker could not be reassigned to a new job location because of the worker's medical issues arising from Vietnam War related anxiety disorder disability.[81] The court stated that reassigning the worker to accommodate his disability would violate a collective bargaining agreement.[82] Other cases under the Rehabilitation Act have similarly ruled against accommodation through reassignment.[83]

Regulations interpreting the ADA, however, have specifically removed any possibility of a total barrier to reassignment as an accom-

[76] The business necessity standard has been generally explained as an employer defense that shows a discriminatory hiring policy accurately, but not perfectly, assesses an applicant's ability to perform a job in question. *See, e.g.,* El v. Southeastern Pennsylvania Transportation Authority, 479 F.3d 232, 242 (3d Cir. 2007) (discussing definition in context of disparate impact claim).

[77] Karl P. Evangelista, Ellen J. Messing, and James S. Weliky, *The Relationship Between the Americans with Disabilities Act, Massachusetts Handicap Discrimination Law, and The Massachusetts Workers' Compensation Act*, MA-CLE S-21-1 § 21.4.4(b) (2007).

[78] 480 U.S. 273 (1987).

[79] *Id.* at 289 n.19 ("Employers have an affirmative obligation to make a reasonable accommodation for a handicapped employee. Although they are not required to find another job for an employee who is not qualified for the job he or she was doing, they cannot deny an employee alternative employment opportunities reasonably available under the employer's existing policies.").

[80] 870 F.2d 786 (1st Cir. 1989).

[81] *Id.* at 786-87.

[82] *Id.* at 789.

[83] *E.g.,* Mackie v. Runyon, 804 F. Supp. 1508 (M.D. Fla. 1992) (holding that reassignment did not qualify as a reasonable accommodation); Fields v. Lyng, 705 F. Supp. 1134 (D. Md. 1988) (holding that accommodation to reassign employee because of anxiety disorder not necessary under Rehabilitation Act), *aff'd*, 888 F.2d 1385 (4th Cir. 1989); Carty v. Carlin, 623 F. Supp. 1181 (D. Md. 1985) (accommodation does not require reassignment). Reassignment under *Arline*, however, was specifically permitted though not required under the Rehabilitation Act. *See* Arline, 480 U.S. at 289 n.19. *See also* Jeffrey S. Berenholz, Note, *The Development of Reassignment to a Vacant Position in the Americans with Disabilities Act*, 15 HOFSTRA LAB. & EMP. L.J. 635, 639-40 (1998).

modation. The EEOC regulations state that "[r]easonable accommodation may include but is not limited to . . . (ii) [j]ob restructuring; part-time or modified work schedules; reassignment to a vacant position. . . ."[84] Furthermore, according to Parry, EEOC regulations, the EEOC interpretive appendix, and legislative history all take precedence in interpreting the ADA over the Rehabilitation Act.[85] Commentators have also contended that the ADA's language and legislative history establish a rejection of some judicial interpretations under the Rehabilitation Act.[86] Courts thus cannot blindly rely on Rehabilitation Act cases to interpret the scope of reassignment cases under the ADA.[87]

Even though courts faced with ADA reassignment cases are arguably permitted to require a reassignment accommodation, it does not necessarily mean that employers should be burdened with a duty to reassign. A reassignment can impose a significant burden. A reassignment without free competition for the position means that the employer will not necessarily be able to fill the opening with the most qualified person. The employer then loses any difference in productivity between the optimal candidate and the reassigned disabled employee. Such losses make firms less efficient and costs of production more costly. Such costs are ultimately passed along to the consumer.

A mandatory reassignment, then, is fundamentally another type of impairment on the job mobility of workers. Limitations placed upon job mobility can have a variety of theorized effects. The higher costs associated with the threat of litigation for failure to comply with the ADA increase the bargaining power of disabled employees to demand higher wages from their employer.[88] In addition, employers burdened with the increased cost of hiring disabled workers may simply make

[84] 29 C.F.R. § 1630.2 (o)(2)(ii) (2008).

[85] John Parry, *Title I - Employment*, *in* IMPLEMENTING THE AMERICANS WITH DISABILITIES ACT 58-59 (Lawrence O. Gostin & Henry A. Beyer eds., 1993) (listing order of importance for interpreting Title I of ADA as: (1) EEOC regulations, interpretive appendix and explanations, (2) legislative history, (3) Rehabilitation Act, interpretations and case law, and (4) ADA compliance manual published by EEOC and Department of Justice).

[86] Barbara A. Lee, *Reasonable Accommodation under the Americans with Disabilities Act: The Limitations of Rehabilitation Act Precedent*, 14 BERKELEY J. EMP. & LAB. L. 201, 206-08 (1993).

[87] Stephanie Proctor Miller, *Keeping the Promise: The ADA and Employment Discrimination on the Basis of Psychiatric Disability*, 85 CAL. L. REV. 701, 745 (1997) ("Judges should carefully examine their use of Rehabilitation Act precedent to be certain that those cases are not inappropriate for interpreting the ADA, either by virtue of changes in the statute and its implementing regulations or because of the legislative intent of the statute.").

[88] *See* Robert C. Bird and John D. Knopf, *Do Wrongful Discharge Laws Impair Firm Efficiency?* at 8, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=854684 (discussing impact of dismissal protections upon labor mobility).

capital investments over labor investments to avoid hiring altogether, a trend known as capital deepening.[89] Employers without the ability to shift from labor to capital may simply avoid hiring disabled workers altogether because of the litigation risk that accompanies them. One study found that the passage of the ADA was correlated with a significant and surprising *decrease* in the employment of disabled workers.[90] The adoption of a mandatory transfer requirement for disabled works as an accommodation would only make hiring disabled employees even more unattractive, and perhaps exacerbate the problem of the decline in the hiring of disabled applicants in certain sectors.[91] Thus, the reassignment requirement may hinder employment of the very class of workers it is intended to protect.

In addition, mandatory reassignment may impose non-labor related costs on businesses. Employers may be forced to implement a second round of accommodations for the reassigned employee. The reassigned employee will need time to reach the productivity level of experienced workers in that position. Extra training and guidance may be necessary.

Furthermore, the mandatory reassignment might generate resentment amongst other employees. Co-workers may perceive the reassignment as 'unfair' to more qualified employees. Non-disabled employees are in effect deprived of the ability to compete for that position.[92] Accusations might be raised that the ADA is becoming a backdoor affirmative action statute, a conclusion that *Huber* and other cases have already reached.[93]

[89] *Cf. id.* at 10. *See also* David H. Autor, William R. Kerr and Adriana D. Kugler, *Do Employment Protections Reduce Productivity?*, 117 THE ECON. JOURNAL, F189, F190 (2007) (noting capital deepening effect in wrongful discharge context).

[90] Daron Acemoglu and Joshua D. Angrist, *Consequences of Employment Protection? The Case of the Americans with Disabilities Act*, 109 J. POL. ECON. 915, 948-49 (2001).

[91] *See* Thomas DeLeire, *The Unintended Consequences of the Americans with Disabilities Act*, 23 REGULATION 21 (2000). DeLeire explains:

The added cost of employing disabled workers to comply with the accommodation mandate of the ADA has made those workers relatively unattractive to firms. Moreover, the threats of prosecution by the Equal Employment Opportunity Commission (EEOC) and litigation by disabled workers, both of which were to have deterred firms from shedding their disabled workforce, have in fact led firms to avoid hiring some disabled workers in the first place.

Id. at 21.

[92] Stephen F. Befort, *Reasonable Accommodation and Reassignment under the Americans with Disabilities Act: Answers, Questions, and Suggested Solutions after U.S. Airways, Inc. v. Barnett*, 45 ARIZ. L. REV. 931, 946 (2003).

[93] *E.g., Huber*, 486 F.3d at 483 ("the ADA is not an affirmative action statute and does not require an employer to reassign a qualified disabled employee to a vacant position when such a reassignment would violate a legitimate nondiscriminatory policy of the employer to hire the most qualified candidate. . . . To conclude otherwise is 'affirmative

VI. CONCLUSION

Huber v. Wal-Mart Stores, Inc. was an excellent opportunity for the Supreme Court to resolve a troubling issue surrounding implementation of the ADA. In granting certiorari, the Court was obviously amenable to providing much needed interpretation. Instead, the last-minute settlement of the parties has left the appellate *Huber* decision to widen the circuit split. Multiple circuits now disagree as to whether a disabled employee must be automatically reassigned to a vacant position under the ADA. No doubt further disagreement at the lower court level is soon to follow.

At its core, the reassignment split is more than just a question about an interesting nuance of implementing accommodations. The judicial fissure reveals fundamental differences of opinion in how to interpret the ADA. On the one hand, the ADA is remedial legislation and requires a broad application.[94] ADA provisions should be given a literal interpretation and exception to the ADA should be narrowed and limited to effectuate the intended remedy.[95] Given that the ADA specifically permits reassignment as an accommodation and that disabled employees may require such assignment to retain gainful employment, the mandatory transfer of disabled employees to available jobs reasonably falls within the ADA's broad purposes.

A competing interpretation of the ADA looks simply at the language of the statute. As one court stated, the ADA "prohibits employment discrimination against qualified individuals with disabilities, no more and no less."[96] This view conceives of the ADA as a tool to ensure that disabled citizens receive the same treatment as that given to non-disabled citizens.[97] The goal is equality and not preferential treatment.[98] Applying this emphasis, the required transfer provides special treatment to disabled workers that the ADA did not intend. This special treatment, plus the attendant costs associated with that treatment, can potentially result in resentment towards disabled employees.

The answer of whether or not *Huber* reached the 'correct' decision remains unclear. Parties have litigated the issue a number of times in the appellate courts, and judges have not hesitated to disagree with one

action with a vengeance.'") (citing EEOC v. Humiston-Keeling, 227 F.3d 1024, 1029 (7th Cir. 2000)). *See generally* Stephen F. Befort and Tracey Holmes Donesky, *Reassignment under the Americans with Disabilities Act: Reasonable Accommodation, Affirmative Action, or Both?*, 57 WASH. & LEE L. REV. 1045 (2000).

[94] International Brotherhood of Teamsters v. United States, 431 U.S. 324, 381 (1977).

[95] *Id.*

[96] Daugherty v. City of El Paso, 56 F.3d 695, 700 (5th Cir. 1995).

[97] Robinson v. City of Friendswood, 890 F. Supp. 616, 620 (S.D. Tex. 1995).

[98] Emrick v. Libbey-Owens-Ford Co., 875 F. Supp. 393, 398 (E.D. Tex. 1995).

another. More clear is that the *Huber* case and cases like it both implicate the functioning of businesses as well as expose an underlying fault line of conflicting interpretations of the goals and purposes the ADA.

THE JORDAN'S FURNITURE "MONSTER DEAL": ILLEGAL GAMBLING? TAXABLE INCOME?

by ELI C. BORTMAN*

I. INTRODUCTION

Jordan's Furniture was in the news last spring when it announced "Jordan's Monster Deal"—"EVERY Sofa, EVERY Sectional, EVERY Dining Table, EVERY Bed, EVERY Mattress … can be YOURS FREE if the Red Sox win the World Championship in 2007." As the self-proclaimed "Official Furniture Store" of the Boston Red Sox, the promotion's name, the "Monster Deal," was a reference to the "Green Monster," the left-field wall in Boston's Fenway Park.

Jordan's is well known in the Boston area, with large stores in three Boston suburbs and one in Southern New Hampshire, and a history of quirky television advertising and other promotions. Jordan's CEO Eliot Tatelman and his recently retired brother Barry starred in commercials that often were parodies of television ads for non-furniture companies. (A tag line in their commercials for many years was "Jordan's. Not to be confused with Jordan Marsh"—a reference to a much larger company.[1])

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[1] Barry Tatelman tells the story that when the Tatelman brothers went to a radio station to record one of their first radio commercials, a station advertising executive asked whether their advertising might lead listeners to think their then-small company was associated with Jordan Marsh. That executive suggested the tag line. Barry said he was surprised to learn that he was allowed to use the name of another company in his company's advertising. Greg Gatlin, *THE MESSENGER; Distinguished by radio ads, Jordan's Waltham gets subtracted*, BOSTON HERALD, Oct. 21, 2004, at 41.

Jordan's was a family owned business that grew to become the company with the highest dollar sales per square foot in the industry. The family sold the company to Berkshire Hathaway in 1999 for a reported $450 million in cash, but the company seems to have maintained a great deal of autonomy in its operation.[2]

So, an offer of a complete refund, provided the Red Sox won the World Series, certainly caught the public's attention. It also raised two interesting legal questions:

- Was the arrangement an illegal gambling transaction?
- If the Red Sox won the Series and a buyer got his money back, would he have taxable income? At first blush, one would think that the people who suggested that this was illegal gambling might be those 'consumer activists' who, like the Puritans of Old New England, were afraid that someone, somewhere, might be enjoying himself. The income tax question was merely of hypothetical interest when the promotion was announced in the spring. It became a real question in October, when the Red Sox defeated the Colorado Rockies to win the World Series. This paper will address both the gambling and the income tax questions.

The offer was detailed in its wording, specifying what was included and what was not. The only items that qualified were sofas, dining tables, beds and mattresses. The "Terms and Conditions" of the "Deal" defined those terms, explaining, for example, that a 'love seat' did not count as a 'sofa' but a 'sofa sleeper' did count.[3] The items had to be

[2] Jordan Marsh was a New England chain founded in 1841. Its parent company merged with Federated Department Stores, which also owns Macy's, in 1992. Over a period of years, Jordan Marsh stores were renamed Macy's. In 1996, when the last of the Jordan Marsh stores became a Macy's, Jordan's Furniture changed its advertising tag line to "No longer confused with Jordan Marsh." *A short history of Jordan Marsh*, *at* http://www.massmoments.org/moment.cfm? mid=95.

[3] The terms of the offered deal are as follows:

1. Deal Merchandise Description. Deal Merchandise includes the following items. No other items will be eligible for the Rebate.

—Sofas—includes sectionals, sofa sleepers - any price, no limit on quantity. Does not include other similar items such as loveseats, loveseat sleepers, settees, recliners, chairs, ottomans, and individual chaises.

—Dining Table - includes formal, casual, and islands—any size, any price, no limit on quantity. Does not include dining-table related items such as chairs, stools, benches, table pads, china cabinets, buffets, sideboards, bar servers, cocktail tables, sofa tables, end tables, game tables, and accent tables.

—Beds—twin, full, queen, king, day beds, and bunk beds (in wood, upholstery, or metal).A bed includes at least a headboard and may also include the following: footboard, rails, support system, canopy, platforms, pier walls and under-bed storage. Bunk beds include:

purchased between March 7 and April 16, and the purchaser had to take delivery before July 10—the date of the All Star Game. The rebate would be limited to the purchase price, and would not apply to sales taxes, nor would it cover set up or delivery charges.

Jordan's was not the first retailer, nor the only one, to tie a money back promotion to a sporting event.

- In September 2006 a Plano, Illinois (a Chicago suburb) furniture retailer offered purchasers their money back if the Chicago Bears shut out the Green Bay Packers in the football season's opening game. The offer applied to purchases made during the preceding Labor Day weekend. The Bears did shut out the Packers, and 206 purchasers received refunds totaling nearly $300,000.[4]
- In December 2006 a Los Angeles furniture retailer made a money back offer to anyone who bought more that $2000's worth of furniture if UCLA beat USC. The offer was open for only in the three days immediately preceding the UCLA-USC football game.[5] (The number of purchasers or the total dollar value was not published.)
- A Libertyville, Illinois (also a Chicago suburb) furniture retailer offered a full refund for anything purchased between March 30 and April 29 if the Chicago Cubs won the 2007 World Series instead of the Red Sox.[6]
- Alpha Omega, a Boston area jeweler, offered partial refunds on engagement rings tied to the Red Sox performance on the day the ring was purchased. This offer, good during the entire month of April, would entitle the purchaser to a $500 refund if a Sox player hits a home run, $1,000 if it's a grand slam, and, if the Red Sox pitcher pitches a no-hitter, the customer gets a full refund.[7]

headboards, footboards, bed ends, ladders, guardrails, bunkie boards and slats. Does not include bed-related items such as nightstands, dressers, mirrors, armoires, chests, trundle units, lingerie chests, bureaus, blanket chests, bed benches, optional storage and other non-structural units, cribs, and bed frames.

—Mattresses—any size, any price, no limit on quantity. Does not include mattress-related items such as foundations, adjustable bases, and bed frames.

http://www.jordans.com/jordansmonsterdeal.pdf (details of Jordan's Monster Deal at official Jordan's Furniture web site).

[4] Sara Olkon, *Furniture's free after Bears turn the tables on Packers*, CHICAGO TRIBUNE, Sept. 12, 2006, at S1.

[5] Daniel Yi, *Bruin Fans Get Home (Furnishing) Advantage*, L. A. TIMES, Dec. 4, 2006, at C1.

[6] Laura Petrecca, *Cubs, Bosox fans mull furniture stores' pitch* USA TODAY, Apr. 5, 2007, at S1.

[7] Bruce A. Mohl, *Diamonds (and free couches) are a Red Sox fan's best friends*, THE BOSTON GLOBE, Apr. 22, 2007, at C1.

II. IS THE PROPOSAL A GAMBLING CONTRACT?

There were really two consequences if the arrangement was determined to be a lottery or a gambling contract. First, of course, is that lotteries are illegal in Massachusetts unless run by the Commonwealth or certain charities. Second, skipping past the legality issue, if the Monster Deal is a lottery then the rebate might be a 'prize,' which is includible in gross income under section 74 of the Internal Revenue Code. One newspaper reported that several "experts," including a lawyer who specializes in retail promotions, believed that the promotion was a lottery. One such expert said:

> A lottery has three key elements: a prize, an element of chance, and consideration, usually the payment of money. … [T]he Jordan's Furniture deal appears to qualify as a lottery because customers who bought furniture (the consideration) between March 7 and [April 16] will receive a full rebate (the prize) if the Red Sox win the World Series (the element of chance).[8]

This analysis apparently did not persuade the Massachusetts Attorney General to take action. A spokeswoman for that office said that it was not clear that the statute applied to this promotion. While they were 'monitoring' the situation, they could not see that anyone was being harmed. The spokeswoman also said that they could not determine whether people were buying furniture because of the rebate offer or whether they simply needed or wanted furniture.[9] Some observers were not convinced. At least one person had a letter to the editor published in the Boston Globe, expressing her concern for people who might be induced by the promotion to buy furniture they did not need, and (should the Sox not win) could not afford.[10]

The Massachusetts statute is titled "Lotteries; disposal of property by chance." The statute uses the word "lottery" as a shorthand label for any arrangement in which someone disposes of property, if the disposal

[8] *Id.*

[9] *Id.*

[10] Letter from [name withheld] to Letters to the Editor, *For diehard fans, Sox are a sure thing*, THE BOSTON GLOBE, Sept. 2, 2007 at D3. The letter stated that,

> Apparently, Attorney General Martha Coakley is not up on gambling problems and the extent of Red Sox fans' faith ("Suit alleges Jordan's, Alpha Omega promotions were illegal lotteries," Aug. 5). Many people are such diehard Sox fans that they truly believe that there is no doubt the Sox will win the World Series.
>
> I have no doubt that a lot of people, not just chronic gamblers, went out and bought furniture that they did not really need and couldn't afford because they were so sure the Sox will win and they will get their money back. If they don't win, a lot of people will be hurt by this promotion.

Id.

of the property is "dependent upon … chance .. [and] … such chance … is made an additional inducement to the disposal or sale of said property."[11]

Jordan's told the press at the time the promotion was first announced that the store was not really betting against the Red Sox. The company's president, Eliot Tatelman, said that he was a lifelong Red Sox fan, and he wanted nothing more than to see his team win the Series. He said that the company had bought insurance – he would not identify the insurance company or even hint at the cost of the coverage – so he wanted it clearly understood that Jordan's was not betting against the Sox.

There are companies that issue insurance for promotions of this sort. Odds On Promotions, a Reno, Nevada company that writes such coverage, said they had been invited to quote on Jordan's business – they said they would have charged 30% of the exposure – and did not get the sale. Odds On did write the coverage for the Bears-Packers promotion mentioned above, but would not disclose the premium, except to say that it was in "the tens of thousands of dollars." They said they had determined the premium by examining the two teams' records and counting the number of NFL shutouts in recent years.[12] The retailer that made the Chicago Cubs promotion reported that they had bought coverage from Lloyd's of London for 2% of the exposure – but (the reader might recall) the last time Cubs won the World Series was 1908. That retailer also considered a promotion offering purchasers their money back if the Chicago White Sox won the Series – the insurer quoted a premium of 18% of the coverage, and the store dropped the idea of that promotion.[13]

Commentators who tried to estimate the cost of the Jordan's insurance coverage pointed to the Las Vegas sports books, who were quoting 10:1 odds on the Sox to win the Series. Those odds would be a

[11] MASS. GEN. LAWS ch. 271, § 7 (2008).

> Lotteries; disposal of property by chance
>
> Whoever sets up or promotes a lottery for money or other property of value, or by way of lottery disposes of any property of value, or under the pretext of a sale, gift or delivery of other property or of any right, privilege or thing whatever disposes of or offers or attempts to dispose of any property, with intent to make the disposal thereof dependent upon or connected with chance by lot, dice, numbers, game, hazard or other gambling device, whereby such chance or device is made an additional inducement to the disposal or sale of said property… shall be punished by a fine of not more than three thousand dollars or by imprisonment in the state prison for not more than three years, or in jail or the house of correction for not more than two and one half years.

[12] Olkon, *supra* note 4, at S1.

[13] Melissa Lafsky**,** *Here's Why Yankees Fans Aren't the Only Ones Rooting Against the Red Sox, at* http://freakonomics.blogs.nytimes.com/2007/10/18/.

reasonable proxy for an insurance premium, they said.[14] They then tried to use this figure to demonstrate the 'consideration' part of the 'lottery' analysis. If someone were buying a $1,000 sofa, for example, a fair allocation of the $1,000 would be $900 for the sofa and $100 for the bet. With $100 allocated to the bet, the logical conclusion is that if the Sox win the Series, the $100 bet pays off at 10:1, providing the $1000 'prize.'

If we try to apply this line of reasoning to the Jordan's promotion, it would seem clear that the purchaser is not paying any more for the chance to get a refund—if that is the definition of providing 'consideration' in the legal or economic sense. Jordan's always offered this hypothetical sofa for sale with a list price of $1,000. A purchaser during the promotion period could not elect to pay only $900 and forego the money back feature. The list price of the particular sofa was $1,000 before the promotion period, $1,000 during the promotion period, and also $1,000 after the promotion period. From the perspective of basic contract law there's no logical basis for the allocation of part of the $1000 to the rebate offer. Perhaps it was this analysis that led the Attorney General to decide no purchaser was being harmed.

Unfortunately, the Massachusetts Supreme Judicial Court has not applied this basic approach to contract law in cases that might seem relevant here. Cases in Massachusetts going back to the 1930s might support the contrary conclusion—at least three cases in which movie theaters advertised one night a week as "Lucky" night or "Bank" night. One or more ticket holders chosen at random would receive a cash prize. Although tickets that night were the same price as on all other nights, the theaters were held to have conducted illegal lotteries.[15] In each of the three movie cases, the theaters made it clear that people could enter the drawings without buying tickets to the movie. They did have to hear their names called out and claim their prizes with a few minutes of the drawing. The court said:

> One participating in such a game from outside the theatre would obviously be at a disadvantage compared with a person playing it inside the theatre. The inference is warranted that some of the persons attending the theatre … would feel that by paying for a ticket and entering the theatre their chance for winning a prize would be better

[14] In October, Tatelman said that the odds were 6:1 before the season began. Whether the correct odds were 10:1 or 6:1 does not matter for purposes of this analysis. Greg Turner, Fully furnished: Jordan's customers happy about free stuff, Sox win, METROWEST NEWS SERVICE, Oct. 30, 2007, *available at* http://www.metrowestdailynews.com/homepage/x1909900666.

[15] Commonwealth v. McLaughlin, 29 N.E.2d 821 (Mass. 1940), Commonwealth v. Heffner, 24 N.E.2d 508 (Mass. 1939), Commonwealth v. Wall, 3 N.E.2d 28 (Mass. 1936).

> than it would be if they attempted to play the game outside the theatre, and that they paid their money in part for that better chance.[16]

A 1972 SJC case, *Mobil Oil Corp. v. Attorney General,* suggests that Jordan's could have run the promotion without potentially running afoul of the Massachusetts anti-lottery statute by allowing people to sign up with no purchase required. A gasoline retailer gave prize tickets to anyone purchasing gasoline at its outlets, and also gave tickets with no purchase required to anyone asking for one. Winning numbers were periodically drawn and posted at the retailer's stations, and these tickets could be redeemed over a period of several weeks. In that decision, the SJC repeated its view of the definition of a "lottery":

> This court has consistently held that three elements must exist in order for any scheme to constitute a lottery. The three elements are payment of a price, a prize, and some element of chance. … [citations omitted]. We have also stated that price means 'something of value and not merely the formal or technical consideration, such as registering one's name or attending at a certain place, which might be sufficient consideration to support a contract,' … [citations omitted] and that "the price must come from participants in the game in part at least as payments for their chances."[17]

The court noted that the price of gasoline at stations offering the prize tickets was about the same as at stations that did not offer such tickets. While such an observation would seem to suggest the court would overturn the "bank night" cases, the statement was made almost as an aside. The court did not go that far. It said:

> The "bank night" cases are distinguishable from the present case. Those cases involved schemes whereby prizes were awarded at a theatre close to, or between, the times of performances. Attendance at the theatre at the time of the awarding of the prizes was required. In each of the 'bank night' cases, the arrangements were such that, although not required to do so, participants who purchased theatre tickets gained a distinct advantage over those who did not purchase them.[18]

Enforcement of the anti-gambling is not left solely to law officers. Another Massachusetts statute provides that anyone who loses money in a gambling situation can sue "in contract" to recover, "and if he does not within three months after such loss … prosecute such action with effect, any other person may sue for and recover in tort treble the value

[16] *McLaughlin,* 29 N.E.2d at 823.
[17] Mobil Oil Corp. v. Attorney General, 280 N.E.2d 406, 411 (Mass. 1972).
[18] *Mobil Oil Corp.*, 280 N.E.2d at 412.

thereof."[19] The provision allowing that "other person" to sue dates back to colonial times.[20]

The Boston Globe reported in August 2007 that a man filed a suit against both Jordan's and Alpha Omega (the jeweler with the engagement ring refund offer) under this provision.[21] A hearing on Jordan's motion to dismiss was held on January 8, 2008. The judge took the matter under advisement and a month later, granted the motion to dismiss. The conclusion has to be that the "Monster Deal" promotion was not an illegal gambling contract under current Massachusetts law.

The income tax questions:

- Is Jordan's required to give each customer receiving a rebate a Form 1099-MISC?
- Is the customer entitled to treat the rebate as a tax-free reduction of the purchase price or is he required to include it in his gross income?

The logical order for addressing these questions is as set forth above, since Jordan's would have to decide whether it had a reporting obligation before the 1099-MISC filing deadline of January 31, 2008.

III. IS THE REBATE INCLUDIBLE IN GROSS INCOME?

The Monster Deal announcement included a sample of the form that a purchaser would have to submit to get his rebate. One item of information required to be furnished on the rebate claim form was the purchaser's Social Security Number. An accompanying document (entitled "Monster Deal FAQs") said that Jordan's would need the Social Security Number to file Forms 1099—but it also said that Jordan's would not file Forms 1099 unless required to do so by the Internal Revenue Service.

Internal Revenue Code section 6041 requires payers of certain types on income to file Forms 1099, as prescribed in more detail in the Income Tax Regulations. The specific provision that Jordan's would have been referring to in the FAQ would be the paragraph that says: "Prizes and awards. Amounts paid as prizes and awards that are required to be included in gross income under section 74 and section 1.74-1 when paid

[19] MASS. GEN. LAWS. ch. 137, § 1 (2008).

[20] *See* Cole v. Applebury, 136 Mass. 525; 1884 Mass. LEXIS 156 (1884) (provides history of this statute).

[21] Alpha Omega filed for protection under Chapter 11 of the Bankruptcy Code in December 2007. There was no public information about whether Alpha Omega's Red Sox promotion contributed to the company's financial woes. Nicole C. Wong, *Alpha Omega files for bankruptcy protection,* THE BOSTON GLOBE, Jan. 3, 2008, at E1.

in the course of a trade or business are required to be reported in returns of information under this section."[22]

Code Section 74, titled "Prizes and awards," states "Except as otherwise provided in this section or in section 117 (relating to qualified scholarships), gross income includes amounts received as prizes and awards." The exceptions in section 74 relate to prizes for civic or literary achievement, such as the Nobel Prize or Pulitzer Prize, and certain types of employee achievement awards—none of which are relevant here.

There have been a few cases and Revenue Rulings in which taxpayers have won prizes in contests run by retailers, and the prize in each case has been held to be includible in the taxpayer's income. For example, a department store gave a numbered ticket to each customer who brought in a copy of the newspaper advertisement for the store's promotion. If the customer's number matched the number drawn at the end of the promotion, the winner was allowed to buy a television for "a small fraction" of the usual retail price. The Internal Revenue Service ruled that this was a 'prize' includible in income under section 74, in the amount of the difference between the retail price and the nominal amount paid.[23]

In another case, a restaurant gave each customer who purchased a meal a numbered ticket. Every six months the restaurant drew one number at random. The holder of the winning ticket received an automobile. The Service held that the fair market value of the car was a prize includible in gross income pursuant to section 74.[24]

In a final example, a subscriber to a newspaper received a coupon allowing him, as a subscriber, to enter a drawing for an automobile. Without his knowledge his maid completed and submitted the contest entry. When the man was notified that he had won, he gave the car to the maid, since she had been the actual entrant. The Service claimed, and the court ruled, that the man, not the maid, was in receipt of income.[25]

Jordan's would likely take the position that these cases and rulings are not controlling, since the formats in the contests in those cases were different from the Monster Deal. Those contests gave very large value prizes to one or a few people who did nothing more than enter a drawing or eat dinner—the value of the benefit to the winner was very large compared to the winner's effort or cost to enter the contest. Jordan's

[22] Treas. Reg. §1.6041-1(d)(3).

[23] Rev. Rul. 67-40, 1967-1 C.B. 19.

[24] Rev. Rul. 69-510, 1969-2 C.B. 23. In fact, this Rev. Rul. was a restatement of a 1923 ruling, under the IRS program to republish old rulings to cite section numbers changed by the enactment of the 1954 Code.

[25] Reynolds v. United States, 118 F. Supp. 911, 912 (N.D. Cal. 1954).

strongest argument is that the Monster Deal is more like a seller's rebate case, since every purchaser who bought merchandise covered by the program received a rebate of no more than the purchase price.

There are several cases and revenue rulings involving rebates—some addressing the tax treatment of the payer of the rebate and some addressing the tax treatment of the recipient. The leading case is the 1956 Tax Court decision *Pittsburgh Milk Co. v. Commissioner*,[26] which involved a dairy that sold milk to retail stores. Although state law required the seller to charge no less than a regulated price, the dairy gave rebates to its customers. The Internal Revenue Service sought to disallow the deduction of the rebates, because they were illegal under state law. The taxpayer dairy argued that it was entitled either to exclude the rebates from its sales income or to deduct them as business expenses. The court held that the proper treatment was to allow the seller to reduce its sales revenue by the amount of the rebates, ruling that a reduction of sales revenue was to only way to accurately reflect the reality of the transactions.[27] Because the court decided on the exclusion from gross income, it did not have to consider whether a deduction would have been allowable.

The Service had a hard time with the decision in *Pittsburgh Milk*, flip flopping between nonacquiescence and acquiescence several times, probably because the Service has a traditional reluctance to allow deductions for illegal payments. But in a 1976 Revenue Ruling the Service applied the theory of *Pittsburgh Milk* to both parties in a rebate situation without mentioning *Pittsburgh Milk*. Revenue Ruling 76-96 addressed the tax treatment of rebates paid by an automobile manufacturer to qualifying retail purchasers. A qualifying retail customer was one who independently negotiated, at arm's length, with a dealer to arrive at a purchase price for a new automobile. The automobile had to be a type specified by the manufacturer and the purchase had to be made within a prescribed period. The rebates were made subsequent to the delivery of the automobile. The Service held that in these circumstances, the manufacturer was entitled to a deduction for the rebates. More importantly, for the Monster Deal participants, the Service specifically ruled that the automobile purchasers did not have to include their rebates in their gross incomes.[28]

A 1993 U.S. District Court case involved a taxpayer who bought a life insurance policy and the sales agent gave the buyer a full refund of the

[26] 26 T.C. 707 (1956), nonacq. 1959-2 C.B. 8-9, nonacq. withdrawn and acq. 1962-2 C.B. 5-6, acq. withdrawn and nonacq. 1976-2 C.B. 3-4, and nonacq. withdrawn in part and acq. in part 1982-2 C.B. 2.

[27] *Id.* at 717.

[28] Rev. Rul. 76-96, 1976-1 C.B. 23.

first year's premium. The sales agent's commission from the insurer on this type of policy was 115% of the premium. The Internal Revenue Service insisted that the buyer had to include the refund in his gross income. The court said that the price adjustment theory of the *Pittsburgh Milk* case would allow the taxpayer to treat a rebate he received the rebate from the seller as a tax free purchase price reduction. However, in this case, since the taxpayer received the rebate from the salesman, not from the insurance company, the court said the rule of *Pittsburgh Milk* did not apply.[29]

In 2005 the Service reviewed the manufacturer's tax treatment of rebates of the sort described in Revenue Ruling 76-96. It decided that a pharmaceutical manufacturer should reduce its gross sales revenue by the amount of rebates paid to state Medicaid agencies. The Service announced that it was reconsidering the position taken in the 1976 Ruling, that the manufacturer was entitled to a business expense deduction for the rebates. The Service summarized Revenue Ruling 76-96 as follows:

> Rev. Rul. 76-96, 1976-1 C.B. 23, addresses the tax treatment of rebates paid by an automobile manufacturer to retail customers. The manufacturer offered rebates of a set amount to retail customers who independently negotiated at arm's length with one of the manufacturer's dealers to arrive at a purchase price for a new car. The ruling holds that the rebates reduce the purchase price of the cars and are not includible in the retail customer's gross income.[30]

So the Internal Revenue Service is agonizing over the proper way for the seller to treat the rebate (whether as a reduction of sales revenue or as a business expense deduction). However, the Service specifically said that it was not making any change in its position about the purchaser's tax treatment.

If Jordan's had decided not to issue Forms 1099-MISC, they would run the risk that the Internal Revenue Service might later decide that Jordan's had failed to file forms that were required. The penalty for failing to file these forms is $50 per form, up to a maximum of $250,000 (unless the failure to file is due to their "intentional disregard" of the filing requirement).[31] In October 2007, shortly after the Red Sox won the World Series, Eliot Tatelman said that Jordan's had originally planned to report the payments to the Internal Revenue Service but now

[29] Woodbury v. United States, 1993 U.S. Dist. LEXIS 12752, 93-2 U.S. Tax Cas. P50, 528, 72 A.F.T.R.2d 6140 (D.N.D 1993).

[30] Rev. Rul. 2005-28, 2005-1 C. B. 997. This ruling focused on the seller's tax treatment of the rebate. The summary quoted here makes it clear that the 1976 view of the buyer's tax treatment was unchanged.

[31] I. R. C. §. 6721.

his lawyers were rethinking that idea. Tatelman said that may not be necessary—"It's really a rebate. It's not a prize." [32]

Whatever Jordan's decided about Forms 1099 would have had an effect on the purchasers. If Jordan's decided not to file Forms 1099-MISC, it would be unlikely that any purchasers would report their refunds on their personal income tax returns. If the Internal Revenue Service had later determined that Jordan's should have filed, one can only speculate whether they would then follow through with a demand to see the list of purchasers and then pursue them for the unpaid taxes.

On the other hand, if Jordan's had decided to file Forms 1099-MISC, that decision would have caused problems for a large number of purchasers, and not have settled the taxability issue. If Jordan's had filed the forms, the Internal Revenue Service's document matching process would automatically produce "Notices of Proposed Changes"—their form letter CP2000—and send them to all the purchasers. Those notices simply state that the IRS has received "income information … from others" which "does not match" information on an individual's tax return. In such a case, the CP2000 would name Jordan's as the source of the income, the refund amount as the 'income' not on the taxpayer's return, and, since the IRS already has the purchaser's tax return in its computer, the Service would compute the additional income tax then due. The purchaser—as a taxpayer—would then have to take the position that he received a tax-free rebate instead of a taxable prize. But the burden has now shifted, in the sense that the form letter tells the recipient to pay the additional tax or else explain why he believes the amount on the Jordan's Form 1099-MISC is not income.

Jordan's did not make a public statement about whether it was going to report the refunds or not. In January 2008, however, they announced that they had received a Private Letter Ruling from the Internal Revenue Service, in which the Service agreed that the rebates were purchase price reductions, not income.[33] So, the issue was finally

[32] The Monster Deal FAQs released in March 2007, contained the following Q&A: "Will I get a Form 1099 concerning my rebate? Jordan's does not intend to file Forms 1099 with respect to rebate payments unless it is required to do so by the Internal Revenue Service." http://www.jordans.com/jordansmonsterdeal.pdf (details of Jordan's Monster Deal at official Jordan's web site).

[33] The letter from Jordan's says, in relevant part,

> In order to clarify our reporting obligations, Jordan's requested and has now obtained a private letter ruling from the Internal Revenue Service. We are very pleased to announce that the IRS has agreed with Jordan's position that the Monster Deal rebates represent a reduction in the purchase price for Monster Deal merchandise, and has ruled that Jordan's is *not* required to report Monster Deal rebates on Forms 1099. Since each Monster Deal rebate is treated as a purchase price reduction, the ruling also indicates that a rebate generally will not be includible in a customer's gross income for federal income tax purposes except to the

resolved and in the most favorable fashion for both Jordan's and the purchasers.

IV. WHAT DOES THIS MEAN FOR THE FUTURE?

In March 2008 Jordan's announced a repeat of the 2007 Monster Deal, although this year's version is called the "Monster Sweep." The new name reflects the higher hurdle—for the purchasers to receive the refund, the Red Sox would have to win the 2008 Series in a 4-game sweep. Again Barry Tatelman assured the public that the company was buying insurance, so he was not betting against the Red Sox. In his television commercials announcing this year's program he points out that the last two times the Red Sox won the World Series they did it in 4 games. But Jordan's still has not disclosed the total amount of money refunded after the Red Sox won the 2007 World Series, nor has the company identified the insurer. Unless the Attorney General changes her mind on the gambling issue, the legal and tax issues are "old news."

> extent that the customer has been entitled to a tax deduction or other tax benefit in connection with the purchase of Monster Deal merchandise.

Jordan's Furniture form letter to Eli Bortman (Jan. 18, 2008) (on file with author).

STONERIDGE v. SCIENTIFIC-ATLANTA: PULLING ANOTHER TOOTH FROM PRIVATE PARTY LITIGATION UNDER SECTION 10(B) OF THE SECURITIES EXCHANGE ACT OF 1934

by BRIAN ELZWEIG[*] AND BO OUYANG[**]

I. INTRODUCTION

On January 15, 2008 the United States Supreme Court issued its decision in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*,[1] (hereinafter referred to as *Stoneridge*) which many in the popular press considered to be one of the most important securities fraud cases in the last ten years.[2] The Court considered the extent to which a private right of action, which has been implied by section 10(b) of the Securities Exchange Act of 1934 (hereinafter referred to as the 1934 Act)[3] and SEC Rule 10b-5,[4] extends to third party actors under the theory of scheme

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[1] Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. ____, 128 S. Ct. 761 (2008). (Since at the time of writing of this article, only a slip opinion was available for this case, the authors have included specific citation to the Supreme Court Reporter as well as the general citation to United States Reports.) The case was a 5-3 decision with Justice Kennedy writing the majority opinion. Justice Stevens wrote a dissenting opinion that was joined by Justices Souter and Ginsburg. Justice Breyer took no part in the case.

[2] *See ie.* Linda Greenhouse, Supreme Court Limits Lawsuits by Shareholders, *New York Times*, January 16, 2008 (Late Edition) Section C Page1.

[3] 15 U.S.C. § 78j(b).

[4] 17 CFR §240.10b-5.

liability. Scheme liability arises from the language in section 10(b) of the Securities Exchange Act of 1934, which states in relevant part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange...[t]o use or employ, in connection with the purchase or sale of any security...any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.[5]

Congress, in this section of the 1934 Act, gave the Securities and Exchange Commission (hereinafter referred to as SEC) the power to promulgate rules to prevent fraudulent acts in regard to sales of securities. The SEC, in response to this power, promulgated Rule 10b-5, giving wide breadth to the definition of securities fraud. Rule 10 b-5 makes it:

> unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
> (a) To employ any device, scheme, or artifice to defraud,
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[6]

From the language of Rule 10b-5(a) we get the term scheme liability. The Court in Stoneridge grappled with the question of whether this so-called scheme liability could bring a private cause of action under section 10(b) by investors who felt that they were defrauded. Congress, in the 1934 Act, did not give any right for a private cause of action under section 10(b), but this right has been "implied in the words of the statute and its implementing regulation."[7] Since the 1940's the federal district courts have recognized an implied private remedy for violations of section 10(b) and rule 10b-5, based on the rationale that it was implied in the statute.[8] The Supreme Court held in 1964, "while there is "no

[5] 15 U.S.C. § 78(j)(2006).
[6] 17 C.F.R. §240.10b-5 (2007).
[7] Stoneridge, 128 S. Ct. at 768.
[8] Scott M. Murray, *Central Bank of Denver v. First Interstate Bank of Denver: The Supreme Court Chops a Bough From the Judicial Oak: There is no Implied Private Remedy to Sue for Aiding and Abetting Under Section 10(b) and SEC Rule 10b-5,* 30 NEW ENG. L. REV. 475, at 476.

specific reference to a private right of action, among the chief purposes of [laws against securities fraud] is the protection of investors, which certainly implies the availability of judicial relief where none is available."[9] The Court reasoned that "in the absence of clear legislative expression to the contrary, the statute must be flexibly applied so as to implement its policies and purposes."[10] This implied that SEC enforcement alone is not enough, and that private actors should be able to sue for violations of fraud provisions in the 1934 Act to enforce the purposes of the act.[11] In 1966, a federal district court in Indiana held that this implied right to sue privately should be extended to cases that involve aiding and abetting a violation of section 10(b).[12] This gave a wide interpretation of who could sue privately for violations of securities laws. After this case, "numerous courts [had] taken the same position."[13] However, in two subsequent cases, the Supreme Court started narrowing the scope of what could be implied into the language of section 10(b).[14] This led many commentators to promote the idea that a private right of action for aiding and abetting a violation of the section 10(b) and Rule 10b-5 would no longer be viable since it was not clearly written into the statute.[15] According to Justice Stephens, this is an attempt by the Supreme Court to render private party litigation under section 10(b) "toothless."[16]

II. THE *CENTRAL BANK* DECISION AND AIDING AND ABETTING

The Supreme Court held, in the seminal case of *Central Bank of Denver, N.A v. First Interstate Bank of Denver, N.A.*, (hereinafter referred to as *Central Bank*) that a private right of action may be brought against a primary actor committing securities fraud.[17] In 1986 and 1988 a public building authority issued $26 million worth of bonds to finance a planned residential and commercial community in Colorado Springs. Central Bank of Denver was an indenture trustee for public bonds. These bonds were secured by liens on real estate and the developer required that the liens be worth 160% of the outstanding

[9] J.I. Case Co. v. Borak 377 U. S. 426, at 432 (1964).

[10] Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. 673 (N.D. Ind. 1966), *aff'd*, 417 F.2d. 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970).

[11] Murray, note 8 supra, at 498.

[12] *Id.* (citing Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. 673 (N.D. Ind. 1966), *aff'd*, 417 F.2d. 147 (7th Cir. 1969), *cert. denied*, 397 U.S. 989 (1970)).

[13] Central Bank of Denver, N.A., v. First Interstate Bank of Denver, N.A., 511 U.S. 164, at 169 (1994).

[14] See Santa Fe Industries, inc. V. Green 430 U.S. 462 (1977), and Ernst & Ernst v. Hochfelder 425 U.S. 185 (1976).

[15] Central Bank, 511 U.S., at 169.

[16] Stoneridge, 128 S. Ct. at 779.

[17] Central Bank, at 171.

bonds. There was concern that this 160% test was not being met, so Central Bank of Denver asked its in-house appraiser to review the 1988 property appraisals. Central Bank of Denver delayed the appraisal until the end of the year, six months after the closing of the bond dates. Prior to the completion of the appraisal, there was a default by the public building authority. The original plaintiffs in that case were purchasers of $2.1 million dollars worth of the bonds. They sued the underwriters of the bonds for violations of §10(b), and included Central Bank of Denver under the theory that the bank, by delaying the review of a suspicious appraisal, was an aider and abettor of the underwriters violation and therefore liable under §10(b) as well.

Even though the Court held that a private right of action may be brought against a primary actor committing securities fraud, this case held that there was no private cause of action for aiding and abetting of violation of section 10(b). The Court reasoned that section 10(b) "prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act."[18] This did not extend to "giving aid to a person who commits a manipulative or deceptive act."[19] The Court concluded that they "could not amend the statute to create liability for acts that are not themselves deceptive within the meaning of the statute."[20] The Court warned however, that secondary actors were not always free from liability under Section 10(b), since they may still be liable as a primary violator.[21] While *Central Bank* closed the door on the liability for a private party to sue an aider and abettor under section 10(b) of the 1934 Act, it failed to define when a secondary actor may have primary liability, leaving the door open for further litigation in this area to determine when primary liability exists.

A six part test was later adopted by the Court to determine under what conditions a private party may have a claim for liability under section 10(b):

> (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.[22]

[18] *Id.* at 177.
[19] *Id.*
[20] *Id.*
[21] *Id.* at 191.
[22] Dura Pharmaceuticals, Inc. v. Boudo, 544 U.S. 336, at 341-342 (2005), original citations omitted.

All of these elements must be proven in order to state a valid private action claim under section 10(b). The interpretation of these elements led to a split in the circuit courts as to when to treat secondary actors in a scheme to defraud as a primary violator. The element that is in contention is what constitutes reliance upon the misrepresentation or omission.

III. THE SPLIT IN THE CIRCUITS

The Ninth Circuit took up the issue in *Simpson v. AOL Time Warner, Inc.*[23] (hereinafter referred to as *Simpson*). This case involved multiple actors who engaged in a scheme to commit securities fraud by overstating the reported earnings of Homestore.com.[24] Allegedly, Homestore.com entered into sham "triangular transactions" with outside vendors who would then return the money to Homestore.com through contracts with AOL or L90.[25] It is also alleged that Cendant Corporation (hereinafter referred to as Cendant) allowed Homestore.com to overpay for some assets in return for Cendant funneling some of the money back to Homestore.com. This would allow Homestore.com to overstate its earnings in violation of SEC accounting rules. Homestore.com eventually restated its revenues showing a decrease of more than $170 million.[26] This led to a decline in Homestore.com's stock value, and a group of investors sued AOL Time Warner, L90 and Cendant, stating that they were primary actors in the fraud.[27] The defendants were dismissed from the action based on the rationale espoused in Central Bank by the district court.[28] While the court upheld the dismissal,[29] they crafted a test that circumvented the requirement of reliance. The court held that "when determining whether a defendant is a "primary violator," the conduct of each defendant…must be viewed alone for whether it had the purpose and effect of creating a false appearance of fact in the furtherance of an overall scheme to defraud."[30] The court, when speaking to reliance, applied a fraud-on-the-market theory, stating that a plaintiff may be presumed to have relied on a misrepresentation if the false or misleading information was injected into an efficient market."[31]

[23] Simpson v. AOL Time Warner, 452 F. 3d 1040 (9th Cir. 2006).
[24] *Id.* at 1042.
[25] *Id.*
[26] *Id.*
[27] *Id.*
[28] *Id.*
[29] *Id.* at 1055.
[30] *Id.* at 1050.
[31] *Id.* at 1051.

The Eighth Circuit tackled the issue in *In re Charter Communications Inc. Securities Litigation*.[32] (This case was renamed *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.* upon *certiorari* to the Supreme Court and the facts of the case are discussed, *infra* in section IV. of this article). The Eighth Circuit adopted a strict rule when deciding that the defendants were not primary actors in the scheme, and therefore could not face a private suit under Section 10(b), holding that:

> any defendant who does not make or affirmatively cause to be made a fraudulent misstatement or omission, or who does not directly engage in manipulative securities trading practices, is at most guilty of aiding and abetting and cannot be held liable under § 10(b) or any subpart of Rule 10b-5.[33]

The Fifth Circuit looked the issue in *Regents of the University of California .v Credit Suisse First Boston (USA)*[34](hereinafter *Regents of the University of California*). Plaintiffs in this case alleged that the defendant banks entered into partnerships and transactions that allowed Enron Corporation to take liabilities off of its books.[35] There "was no allegation that the banks were fiduciaries of the plaintiffs, that they improperly filed financial reports on Enron's behalf, or that they engaged in wash sales or other manipulative activities directly in the market for Enron securities."[36] The Fifth Circuit expressly rejected the rationale of Simpson and held that the defendant banks were only aiders and abettors and therefore did not primary liability in the scheme.[37] The Fifth Circuit agreed with the Eighth Circuit and reasoned that in order to be primarily liable the deceptive conduct must involve "either a misstatement or a failure to disclose by one who has a duty to disclose."[38]

IV. THE *STONERIDGE* DECISION

Stoneridge was a class action lawsuit filed by investors of Charter Communications, Inc. (hereinafter Charter).[39] Charter, headquartered in St. Louis, Missouri and a Fortune 500 company traded on the NASDAQ stock exchange, is the third-largest publicly traded cable operator in the U.S. that provides analog video, digital video, cable

[32] In re Charter Communications, Inc. Securities Litigation, 443 F. 3d. 987 (2006).
[33] *Id.* at 992.
[34] Regents of the University of California v. Credit Suisse First Boston (USA), Inc. 482 F. 3d 372 (5th Cir. 2007), cert denied___.
[35] *Id.* at 376.
[36] *Id.*
[37] *Id.* at 386.
[38] *Id.* at 388.
[39] Stoneridge, 128 S. Ct. at 766.

modem, and telephony services to approximately 5.7 million customers in 29 states.[40] Managers of public companies have strong incentive to meet or beat Wall Street analysts' forecasts to boost management's credibility for being able to meet market expectations and to mitigate litigation costs of unfavorable earnings surprises to investors.[41]

A. The Facts of Stoneridge

The facts of *Stoneridge* are to be viewed as they are alleged as the Court was examining whether to uphold the district court and Eighth Circuit's decision to grant a motion to dismiss for failure to state a claim upon which relief could be granted.[42] Stoneridge Investment Partners (herinafter Stoneridge Partners or petitioner), a group of investors in Charter, was the lead plaintiff in this class action.[43] Charter issued the financial statements and securities in question.[44] However, the Court in *Stoneridge* was not concerned with Charter, but two of its suppliers, Scientific-Atlanta and Motorola (hereinafter respondents).[45] Charter, in its cable television operations, was engaged in deceptive practices to ensure that its quarterly reports would meet the expectations of the market. Charter misclassified its customer base, delayed reporting of terminated customers, improperly capitalized costs that should have shown as expenses, and manipulated billing dates to inflate revenues.[46] In 2000, Charter realized that their cash flow projections would still be short.[47] To help with this shortfall Charter entered into a plan with respondents. Respondents were the suppliers of cable converter boxes to Charter, which Charter would issue to its customers. Charter arranged to pay $20 over the price (or pay liquidated damages of $20 per box that was not purchased) of the converter boxes that it bought from respondents until the end of 2000.[48] In exchange for this overpayment on the cable boxes, respondents agreed to use the money to purchase advertising from Charter. Financially for respondents it was a wash

[40] Information from Charter Communications website, available at http://www.charter.com/Visitors/AboutCharter.aspx?NonProductItem=20

[41] For managers' pressure and incentive to meet or beat analysts' forecasts, *see generally* Lawrence D. Brown, *A Temporal Analysis of Earnings Surprises: Profits Versus Losses*, 39 JOURNAL OF ACCOUNTING RESEARCH 221, 221-241(2001), Dawn A. Matsumoto, *Management's Incentives to Avoid Negative Earnings Surprises*, 77 ACCOUNTING REVIEW, 483, 483-514 (2002), and Fran Degeorge, Jayendu Patel, & Richard Zeckhauser, *Earnings Management to Exceed Thresholds*, 72 JOURNAL OF BUSINESS 1, 1-33 (1999).

[42] Stoneridge, 128 S. Ct. at 767.

[43] *Id.* at 766.

[44] *Id.*

[45] *Id.*

[46] *Id.*

[47] *Id.*

[48] *Id.*

transaction, but Charter would record the advertising as revenue and capitalize its purchase of the set top boxes. This was a violation of generally accepted accounting principles, and would allow Charter to deceive its auditor, Arthur Anderson LLP,[49] into approving its financial statements that met Wall Street expectations.[50]

In order to keep up the facade, respondents and Charter drafted documents to make it appear that there was no link between the advertising revenue and the payment for the cable boxes.[51] Respondents signed contracts for advertising at higher than normal rates, and backdated the sales of the convertor boxes to make it appear that they were negotiated a month prior to the sale of the advertising.[52] These agreements made it possible for Charter to inflate their revenue and cash flow by approximately $17 million.[53] The Supreme Court granted certiorari to review the case based on a split in the circuits as to how to treat secondary actors in a scheme to defraud that had emerged after the *Central Bank* case.[54]

B. The Stoneridge Interpretation of Reliance

In a 5-3 decision the Court upheld the decision of the Eighth Circuit.[55] The Supreme Court however, decided the case only partly under the same rationale as the Eighth Circuit. The Court addressed the Eighth Circuit's interpretation that for a deceptive act to have had occurred under section 10(b) that would lead to a private right of action, there must have been a misstatement, omissions by one with a duty to disclose and manipulative trading practices.[56] The Supreme Court stated that conduct itself can be deceptive.[57] Further, the Court stated that in this case the respondents' course conduct included both oral and written statements, such as backdated contracts agreed to by Charter and respondents.[58] The Court interpreted the holding in the Eighth Circuit to mean that petitioners cause was "not actionable because it did not have the requisite proximate relation to the investors' harm."[59] The Court addressed reliance without actual knowledge on the part of the

[49] *Id.* It is contended by petitioners that Arthur Anderson was complicit in this arrangement, but the Court did not address their culpability in this case.
[50] *Id.* 128 S. Ct. at 767.
[51] *Id.*
[52] *Id.*
[53] *Id.*
[54] *Id.* at 768.
[55] *Id.* at 774.
[56] *Id.* at 769.
[57] *Id.*
[58] *Id.*
[59] *Id.*

plaintiff, the Court cited two of its previous opinions to show when this proximate relationship could occur.

> We have found a rebuttable presumption of reliance in two different circumstances. First, if there is an omission of a material fact by one with a duty to disclose, the investor to whom the duty was owed need not provide specific proof of reliance[60]...Second, under the fraud-on-the market doctrine, reliance is presumed when the statements at issue become public. The public information is reflected in the market price of the security. Then it can be assumed that an investor who buys or sells stock at the market price relies upon the statement.[61]

When looking at these presumptions in light of the facts of the Stoneridge case, the Court held that neither applied. The respondents had no duty to disclose the transaction which took place and their deceptive acts were not communicated to the public.[62] The Court reasoned that since the investing public did not have knowledge of the deceptive acts by respondents, petitioners cannot claim reliance on them.[63]

The Court further discussed the issue of whether scheme liability would make respondents, although secondary actors, primarily liable using a fraud-on-the-market theory. Petitioners argued that since respondents participated in the scheme knowing that Charter's auditors may be tricked and the natural consequence of that was a financial report which would be released to the public, the fraud-on-the market should bind them to liability.[64] This, petitioner argues, would allow recovery in a private section 10(b) lawsuit absent any kind of a public statement by respondents.[65] The Court disposed of this argument by looking to the language of the statute which states, *inter alia*, that the "deceptive act must be in 'connection with the purchase or sale of any security.'"[66] The Court then separates the "in connection with" language of section 10(b), from the notion of causation. Even if there was causation *per se*, the Court interpreted the "in connection with" language to be viewed as the area of coverage of the statute. In other words, even if respondents were part of the cause of the fraud, the statute only covers frauds that are in connection with the purchase or sale of a security.[67]

[60] Id. (citing Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, at 154 (1972)).
[61] *Id.* (citing Basic v. Levinson, 485 U.S. 224, at 243 (1988)).
[62] *Id.*
[63] *Id.*
[64] *Id.* at 770.
[65] *Id.*
[66] *Id.* (citing 15 U.S.C. 78j(b)).
[67] *Id.*

Since it was Charter, not respondents, who misled the auditor and filed fraudulent statements, the requirement of reliance could not be met. "Respondents' deceptive acts, which were not disclosed to the investing public, are too remote to satisfy the requirement of reliance.…[N]othing respondents did made it necessary or inevitable for Charter to record the transactions as it did."[68] The crux of the argument is that there may be causation in fact, but proximate cause is lacking, since respondents had no control over the way Charter recorded its transaction.

Justice Stevens, writing for the dissent, takes umbrage with the Court's analysis. Justice Stevens states that this case is "critically different than *Central Bank* because the bank in that case did not engage in any deceptive act and, therefore did not *itself* violate §10(b)."[69] The dissent distinguishes the actions by respondents in *Stoneridge* with the bank in Central Bank, and argues that the *Stoneridge* respondents are primarily liable for the fraud. Central Bank of Denver did not engage in deceptive conduct, and at worst would have been an aider and abettor by delaying its audit.[70] This, the dissent argues, is what makes the *Central Bank* respondents different from the *Stoneridge* respondents, who are alleged to have knowingly facilitated Charter's ability to effect a sham transaction.[71]

The dissent argues that the Court's assertion that it would be necessary for respondents to have made it "necessary or inevitable for Charter to record the transactions as it did" to demonstrate reliance is a faulty premise.[72] Justice Stevens argues that reliance is presumed through a fraud-on-the-market theory.[73] It should not be necessary for a plaintiff in a private securities action to prove that they actually relied on the fraud that reached the market. The dissent states that what is important is the cause of the misleading information getting into the marketplace. The Court should focus on respondents' actions in which they purposefully entered into a sham transaction. This coupled with a presumption through a fraud-on-the-market theory should give the reliance needed to plead a private cause of action under section 10(b).[74] The causation that the dissent would adopt is transaction causation which they define as "requiring an allegation that but for the deceptive act, the plaintiff would not have entered into the securities transaction."[75] The dissenting opinion stated that even if this transaction

[68] *Id.*
[69] *Id.* at 775 (emphasis supplied).
[70] *Id.*
[71] *Id.* at 776.
[72] *Id.*
[73] *Id.*
[74] *Id.*
[75] *Id.*

causation (described as 'but for' causation) was not enough to establish reliance, petitioners had pled that respondents proximately caused Charter's misstatement of income. This is because "petitioner alleged that respondents knew their deceptive acts would be the basis for statements that would influence the market price of Charter stock on which shareholders would rely."[76] Since they knew the outcome of the sham transaction would be communicated to the market, they therefore should be liable.[77] This would give liability for a private section 10(b) lawsuit only to actors who have purposely (or recklessly) committed a fraud. The Court worried that these private causes of action "would reach the whole marketplace in which the issuing company does business."[78] Another concern of the Court was that this view of causation would expand section 10(b) to cover ordinary business operations (not just securities fraud cases). However, this concern would be alleviated in the view of the dissent since there would still be a requirement of the actor knowingly entering into a fraudulent transaction.[79]

C. Congress and the PSLRA

The Court reasoned if they were to allow the notion of reliance to expand to mean causation, that this would create a great expansion of federal power. This would apply section 10(b) beyond the securities markets and into the realm of ordinary business operations.[80] Ordinary business operations are generally covered by state law not federal law, and "Congress, in enacting securities laws, did not intend to provide a broad federal remedy for all fraud."[81] Respondents' actions may have been enough to meet the requirement standard for common law fraud, but the Court did not take up this issue. Instead the Court noted that "[s]ection 10(b) does not incorporate common-law fraud into federal law."[82]

The Court noted that Congress did take action in response to concerns over the *Central Bank* decision.[83] In 1995 the Private Securities Litigation Reform Act[84] (PSLRA) was enacted into law amending several sections of the 1934 Act. Of particular note to the Court was §104 of the PSLRA. This section states:

[76] *Id.* at 777.
[77] *Id.*
[78] *Id.*
[79] *Id.*
[80] *Id.* at 770.
[81] *Id.* at 771 (citing Marine Bank v. Weaver, 455 U.S. 551, at 556 (1982)).
[82] *Id.*
[83] *Id.*
[84] Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (Codified as amended in scattered sections 15 U.S.C.).

> Prosecution of persons who aid and abet violations. For purposes of any action brought by the Commission…any person that knowingly provides substantial assistance to another person in violation of a provision of this title, or of any rule or regulation issued under this title, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.[85]

An action for aiding and abetting liability is specifically authorized for actions brought forth by the SEC and not specifically authorized in actions by private parties.[86] To allow petitioners to go forward with a private cause of action, the Court opines, would undermine Congress' determination that some litigants should be held accountable by the SEC and some should be subject to suits by private litigants.[87] Congress in the PSLRA, purposely and recently restored aiding and abetting in some instances, and not in others. The amendment "supports the conclusion that there is no [primary] liability."[88]

The Court further states since the PSLRA imposed heightened pleading requirements and a loss causation requirement in regard to "any private action", that Congress wanted to reassert itself into the implied cause of action which allows a private litigant to sue under section 10(b).[89] Since congress is ratifying this private right of action in the PSLRA, congress should be able to set the limits on the action. "It is appropriate for [the Court] to assume that when [that part of the PSLRA] was enacted, Congress accepted the §10(b) private cause of action as then defined but chose to extend it no further."[90]

The dissent admits that the PSLRA did not include a private right of action based on aiding and abetting. Further the dissent even notes that it was discussed in the Senate Subcommittee on Securities.[91] Justice Stevens however, argues this does not matter. The argument is that Congress was reacting to the Central Bank decision, noting that hearings on *Central Bank*, which led to passage of the PSLRA, started within a month of the *Central Bank* decision being rendered. Instead of undoing the *Central Bank* decision entirely, Congress adopted "a compromise which restored the authority of the SEC to enforce aiding and abetting liability."[92]

[85] This section is codified as 15 U.S.C. §78t(e).
[86] Stoneridge, 128 S. Ct. at 771.
[87] *Id.*
[88] *Id.* at 772.
[89] *Id.* at 773 (citing 15 U.S.C. §78u-4(b)).
[90] *Id.*
[91] *Id.* at 778.
[92] *Id.*

D. Policy Issues

The Court also made some policy arguments for not allowing petitioners to hold respondents personally liable. A lawsuit of this type requires extensive discovery, leads to uncertainty in the outcome, and may become a disruption to ones business. This could lead to "plaintiffs with weak claims extort[ing] settlements from innocent companies."[93] The Court states that this may lead to a rise in the cost of doing business by contracting companies charging more to protect against these threats.[94]

Further, foreign companies with no other exposure to our securities laws could be deterred from doing business in the United States. This could "raise the cost of being a publicly traded company under our law and shift securities offerings away from domestic capital markets."[95] The dissenting opinion takes issue with this. Relying on an *Amicus Curae* Brief of former SEC commissioners,[96] Justice Stevens takes the opposite approach. The dissent argues that the reason overseas firms do business in the United States in the first place is that the safety and integrity of our markets make them the safest in the world.[97] Being the safest markets in the world makes them the strongest markets in the world.[98]

The dissenting opinion, states that the Court (in opinions since *Central Bank* and in this decision) is on a "continuing campaign to render the private cause of action under §10(b) toothless."[99] The Court counters this argument by stating that secondary actors are subject to criminal penalties and civil enforcement by the SEC.[100] Both parties in this case agree that criminal penalties are a strong deterrent, and SEC enforcement actions have collected over $10 billion in disgorgement and penalties since 2002.[101]

[93] *Id.* at 772.
[94] *Id.*
[95] *Id.*
[96] Brief of Former SEC Commissioners as Amicus Curiae Supporting Petitioners at 6, Stoneridge Investment Partners v. Scientific Atlanta and Motorola, 127 S. Ct. 1873 (2007).
[97] Stoneridge, 128 S. Ct. at 779.
[98] *Id.*
[99] *Id.*
[100] *Id.* at 773.
[101] *Id.*

V. THE *STONERIDGE* DECISION LEAVES THE SECURITIES MARKETS EXPOSED TO FRAUD

It seems that the Court was correct in its interpretation that respondents in Stoneridge could not be liable as an aider and abettor. It is clear that Congress examined, and rejected allowing private parties to have a cause of action under section 10(b). This right, Congress purposefully left to the SEC. This is even admitted in the dissenting opinion. "A private right of action was not…in the PSLRA despite support from Senator Dodd and members of the Subcommittee on Securities."[102] The dissent then goes further to argue that this is not necessary in light of the view that Scientific Atlanta and Motorola were not aiders and abettors but actual violators of § 10(b).[103] The dissent sees Stoneridge as an extension of *Central Bank* which "immunize[s] an undefined class of actual violators of §10(b) from liability in private litigation."[104]

This seems to be the better interpretation, and in light of the Stoneridge decision, Congress should clarify the PLSRA to include this type of violator. Here we have actors who purposefully entered into a scheme to inflate the cash flow and revenues of another company. It is at least alleged that respondents in the *Stoneridge* case knew that the scheme that they were involved with would be used to overstate earnings in Charter's financial statements, and that the stock in Charter would be traded on this false information. The dissent correctly justifies its position with the legal maxim that every "wrong shall have a remedy."[105] The majority opinion states that this principal is not violated since enforcement power was given to the SEC (and under its interpretation of reliance, respondents could not be aiders and abettors).[106] Although the SEC can bring action against companies like Scientific-Atlantic and Motorola, the amount of recovery may not come close to redressing the losses sustained by the plaintiffs who were defrauded.

The practical problem is that once a fraud is revealed, often times the company against whom the fraud was alleged goes into bankruptcy.[107] The defrauded investor is then without that company to sue. Fairness would dictate that a secondary actor who aided and abetted the

[102] *Id.* at 778.
[103] *Id.*
[104] *Id.*
[105] *Id.* at 779 (original citation omitted).
[106] *Id.* 769.
[107] Brief of Former SEC Commissioners as Amicus Curiae Supporting Petitioners at 8, Stoneridge Investment Partners v. Scientific Atlanta and Motorola, 127 S. Ct. 1873 (2007).

fraud should be more liable for the loss than the innocent investor. While both sides in the Stoneridge case admit that SEC enforcement is a deterrent, it may not lead to full recovery for plaintiffs in similar cases. Using the Enron case as an example, the SEC collected a judgment of $440 from former employees and secondary actors.[108] However, since *certiorari* was denied in the Regents of the University of California (a case similar to Stoneridge),[109] there will likely be no further private action for the investors. This leaves the investors with a loss of approximately $32 billion,[110] and no place to remedy these further losses. This loss is far greater than the 10 billion that the Court cites the SEC collecting in all cases since 2002.[111]

The Court has also made it nearly impossible for a company to have primary liability for participating in a scheme to defraud. The test for reliance is a very steep hill to climb (as discussed *supra* in section IV.B. of this article). This allows a company to knowingly enter into a scheme as long as it is not communicated to the public.[112] The dissent makes a valid argument that in a case like this, reliance should be presumed. The fraud-on-the-market theory, by itself, should not give an argument for reliance.[113] However, fraud-on-the-market coupled with causation should allow reliance to be pled.[114] When looking at causation, the dissent correctly states that it should be viewed, not from the point of view of the reliance on the specific fraud, but on what an "individual or corporation must do in order to have "caused" the misleading information that reached the market."[115]

In this case, the respondents are alleged to have knowingly committed a sham transaction that, although neutral on their books, allowed Charter to overstate their earnings by $17 million. It is further alleged that respondents knew that the overstatement of value would be used in Charter's financial statements.[116] Since respondents knew that they were enabling Charter to overstate their earnings in their financial statements that it was foreseeable that parties would trade securities in Charter on these statements. Since the trading was foreseeable, it is an easy argument to make that in a case where there was purposeful fraud

[108] http://www.sec.gov/divisions/enforce/claims/enron.htm
[109] See note 34 *supra*.
[110] Ellery Sedgwick, Limited Liability: Is Stoneridge a Threat to U.S. Markets, The Illinois Business Law Journal, February 27, 2008, http://iblsjournal.typepad.com/illinois_business_law_soc/2008/02/imagine-you-are.html#more.
[111] Stoneridge, 128 S. Ct., at 773.
[112] *Id*. at 769.
[113] *Id*. at 776.
[114] *Id*.
[115] *Id*.
[116] *Id*.

as alleged, the damages to petitioners were proximately caused by the fraud.[117] Foreseeability, coupled with a fraud-on-the-market theory (which is designed to allow reliance in cases to be shown by reliance on the market itself), should make a secondary actor primarily liable. All that should need to be proven is that a deceptive act had a material effect on the price of the stock, not that a plaintiff was subjectively aware of the deception at the time of the sale.[118] The Court, in *Stoneridge*, gives companies a license to engage in fraud and leaves little recourse against them, even though it may be alleged that they knew that securities would be traded on that fraud.

A private cause of action under §10(b) in a case similar to this would help to prevent fraud from entering into the securities markets. Instead, as it stands in Stoneridge, since respondents were at worst considered to be aiders and abettors, not primary violators of section 10(b), they were able to enter into a scheme to defraud, and did so knowingly. In the Court's view, since petitioners did not subjectively know of the fraud, there could be no reliance on the fraud. This precludes respondents from being a primary actor and prohibits a private §10(b) claim as a private actor. A private §10(b) claim is already prohibited for an aider and abettor under the decision in the Central Bank case, therefore a private litigant is precluded from bringing any claims. They are therefore left at the mercy of an SEC enforcement action in which they have no say, and may not collect the losses incurred by the fraud.

Probably the most important reason for Congress to clarify the PSLRA to include private suits against companies such as Scientific-Atlanta and Motorola is the underlying public policy issue. There are two competing policy issues that are argued in the majority opinion and the dissenting opinion. The majority argues that allowing private actions for participation in a scheme would lead to an increase in litigation, and cause plaintiffs with weak claims to file claims hoping to get a settlement.[119] This in turn would lead to further litigation and make it more costly to do business, and may even discourage foreign businesses from doing business in the United States. This argument is disingenuous. If the Court wants to adopt a policy that decreases litigation against companies to lower the cost of doing business in the United States, then the majority should have gone much further in this decision. There are many areas in the law in which there are heavy amounts of litigation and as the majority seems to view it, extortion of companies by forcing settlements due to the cost of litigation. In order

[117] *Id.*
[118] Basic, Inc. v. Levinson, 485 U.S. 224, at 248 (1988).
[119] See notes 93 and 94 *supra.*

to curb this, there would have to be comprehensive tort reform, a step which neither the Court nor Congress has not taken.

Surely the better policy argument is the one made in the dissenting opinion. The dissent takes the approach that while there may be more cost to doing business by allowing more private litigation under §10(b), what sustains our markets is the safety of our markets.[120] This is what drives investments into the United States securities markets from both foreign and domestic investors. The majority opinion allows companies to purposely engage in fraudulent scheme, and not be held liable since the fraud is not communicated directly to the investor. This certainly will do more harm to the securities markets than the occasional frivolous lawsuit.

VI. CONCLUSION

It is clear that the Supreme Court was correct in its interpretation that Congress examined aiding and abetting liability when amending the PSLRA. What is less clear is if Congress has purposely interpreted the PSLRA to exclude all secondary actors from private actions under section 10(b). However, since the Court in Stoneridge has taken this interpretation, it is now incumbent on Congress to act. Congress should clarify the PSLRA to state that secondary actors who are considered to have primary liability may be subject to a private section 10(b) lawsuit. They should further define clearly that an actor who is knowingly instrumental in a fraudulent scheme which results in a fluctuation in the price of a security would be primarily liable without actual knowledge of the defrauded investor. The test should be foreseeability that the fraud would cause the fluctuation on the part of the schemer, not actual reliance or knowledge of the scheme on the part of the investor. Congress may see some merit in avoiding frivolous lawsuits or extortionary lawsuits from increasing the cost of being a publicly traded company in the United States. However, a policy of preventing fraud in the markets is more important to ensure the overall safety and health of the markets. Justice Stephens is correct in his assertion that the Stoneridge decision does continue to make "toothless" the private cause of action under section 10(b). If Congress does not respond, then fraud is invited into the United States securities markets, with less recourse on the part of the person who is defrauded.

[120] See notes 96 and 97 *supra*.

UP IN SMOKE: THE EROSION OF EMPLOYEE PRIVACY

by DAVID A. GOODOF[*] AND ANDREW G. CHRISTENSEN[**]

INTRODUCTION

There is a fundamental right of privacy to which most Americans believe they are entitled. It is about human dignity and allowing people to make individual choices about how they wish to live their lives. It is the freedom from procedures that probe body and mind and areas of one's life that should be of no concern to others.[1] Concern regarding employer intrusion into an employee's right to privacy is not a new concept. Efforts by employers to regulate the off duty behavior of employees has led to complaints of interference with privacy rights of workers.[2] However, the recent case of *Rodrigues v. Scotts Co.*[3] has rekindled the debate over the extent to which an employer may pry into the private lives of its employees.

Employee and potential employee privacy issues have been debated for years and have led to a number of state statutes regulating hiring, firing and promotion practices of employers. Additionally, there have been a number of cases testing the right of an employer to make employment decisions based on the performance of legal activities of

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[1] 1 L. CAMILLE HEBERT, EMPL. PRIVACY LAW § 1:4 (2007).

[2] 2 L. CAMILLE HEBERT, EMPL. PRIVACY LAW § 13.4 (2007).

[3] Rodrigues v. Scotts Co., No. C.A. 07-10104-GAO, slip op. 2008 WL 251971 (D. Mass. Jan. 30, 2008).

employees or potential employees outside of the work environment. Courts have recognized the importance of autonomy. For example, the Supreme Court of West Virginia has stated, "[W]e are firmly committed to the unique and essential role of courts in protecting the individual's private life and 'space' from well-intentioned but ultimately oppressive, insulting, degrading, and demeaning, intrusions—whether these intrusions come from the omnipresent forces of the state, or from the equally omnipresent and inescapable forces of the market."[4] This was recognized even as the court was upholding pre-employment drug testing for non-safety sensitive personnel.[5]

Employers have a vested interest in having healthy employees. Health insurance costs have risen greatly in recent years, and there are various studies that indicate that those who lead unhealthy lifestyles lead to higher medical costs. Also, healthy employees use fewer sick days, are much more productive and have better interpersonal relationships.[6] Over the course of the past two to three decades, employers have come up with a number of cost reducing programs, some of which will be discussed herein. The lack of success in of these programs or their failure to lower health insurance costs significantly has led to the major question in the *Rodrigues* case, which is one of discrimination in employment decisions.

Should employers have the right to dictate what legal activities an employee can partake in outside of the workplace as well as within? And, if they can order employees to cease the use of tobacco products, what other areas of one's life can an employer exert control over? Is it appropriate for an employer to discriminate based on weight or height? Should there be control over the food one eats, the games one plays or the legal consumption of alcoholic beverages? These questions raise issues relating to rights of privacy and how much intrusion by an employer is allowable.

This article will examine the major facts of *Rodrigues*. It will identify and briefly describe other cases involving attempts by employers, both public and private, to restrict the use of tobacco products both at work and off hours by current and potential employees. It will discuss the attempts by employers to regulate other legal activities and to make them part of employment decisions. This article then will examine employer justification for intrusions into the private activities of employees, focusing on the ever-increasing cost of medical insurance and the proliferation of wellness programs. A majority of states have enacted statutes prohibiting termination of employees for their

[4] Baughman v. Wal-Mart Stores, Inc., 215 W. Va. 45, 49, 592 S.E.2d 824, 828 (2003).
[5] *Id*.
[6] 1 L. CAMILLE HEBERT, EMPL. PRIVACY LAW § 1:1 (2007).

engagement in otherwise legal activities, and this article examines several of these. In addition, there is a brief discussion of the statute in Massachusetts that allows public employment decisions based on tobacco use. Finally, there is an update of *Rodrigues* and a possible legislative resolution in Massachusetts to the issues that have arisen in this area.

THE *RODRIGUES* CASE

Scott Rodrigues is a 31-year old lawn-care technician who was fired by the Scotts Company when the results of a urine test revealed that Rodrigues had tested positive for nicotine.[7] He was fired on the grounds that he had violated Scott's anti-smoking policy which prohibits employees from smoking both on and off the job.[8] Rodrigues contends that, although he was informed of the policy, he was told that after his sixty day probationary period, Scott's would assist him in his efforts to quit smoking.[9] Although Rodrigues voluntarily participated in the urine test that resulted in his termination,[10] voluntariness of submission to these types of tests when your employer conditions employment or continued employment on taking the tests might be questioned.

A few months later, Rodrigues filed a lawsuit in Massachusetts state court, which was subsequently removed to federal court, alleging that his termination violated his right to privacy, violated the federal ERISA statute, and constituted wrongful termination given that he was fired for smoking cigarettes in private, while he was off duty and away from the workplace.[11] In response, Scotts argued that Rodrigues was let go from the company as a result of his violation of its anti-tobacco policy, which is part of its overall wellness program, also known as the Live Total Health Initiative.[12] Scotts readily admits that its wellness program is intended to reduce its corporate costs spent on medical care for its more than 6,000 employees nationwide.[13] Rodrigues fired back by arguing that Scott's anti-smoking policy is an inappropriate, and

[7] *See* Michele Conlin, *Get Healthy—Or Else*, BUS. WK., Feb. 26, 2007, at 60; *See also, Fired Smoker Sues Ex-Employer*, CBS NEWS, Nov. 30, 2006, *available at* http://www.cbsnews.com/stories/2006/11/30/national/ printable2218378.shtml.

[8] *See* Michele Conlin, *Get Healthy—Or Else*, BUS. WK., Feb. 26, 2007, at 60.

[9] *See id.*

[10] Amended Complaint and Jury Trial Demand at 2-3, Rodrigues v.Scotts Co., No. C.A. 07-10104-GAO, slip op. 2008 WL 251971 (D. Mass. Jan. 30, 2008).

[11] *Id*. at 1.

[12] Memorandum of Law in Support of Motion to Dismiss at 1-2, Rodrigues v. Scotts Co., No. C.A. 07-10104-GAO, slip op. 2008 WL 251971 (D. Mass. Jan. 30, 2008).

[13] *Id*. at 2.

perhaps illegal, vehicle which enables Scotts to control their employees' personal lives by prohibiting private conduct.[14]

Although Rodrigues has asserted a number of claims against the Scotts Company for their conduct, noticeably absent from his Complaint are references to Massachusetts case or statutory law regarding the legality of employee termination for smoking outside of the work place. This absence is a result of the fact that the Massachusetts legislature has not enacted a statute outlawing such conduct. By extension, the Massachusetts courts have not taken a stance on this issue either. In approximately twenty-one states, it is not illegal to hire and fire people based upon their smoking habits.[15] However, a number of states outside of Massachusetts have enacted statutes prohibiting this behavior.[16]

Employer Regulations

Several other cases have arisen in the past dealing with employer regulations. These cases include regulations put into place by both private employers and public employers. In a 1976 case involving a hair grooming regulation for male police officers, the United States Supreme Court ruled that the constitutional issue is one of whether or not the regulation is so irrational that it should be ruled arbitrary.[17] If so, the Court would find that it would be a deprivation of his liberty interest.[18] The Court recognized that there is, under that Fourteenth Amendment to the United States Constitution, a protected substantive aspect of liberty against unconstitutional restrictions put into place by the State.[19] There is a distinction made, however, with those cases that involve a substantial infringement on an individual's freedom of choice such as procreation, marriage and family.[20] In another hair grooming case, a public junior college teacher was discharged for growing and keeping a beard.[21] His claim was that the grooming policy was arbitrary and unenforceable.[22] Hander claimed that his due process and equal protection rights under the Fourteenth Amendment were violated.[23] The United

[14] *See* Amended Complaint and Jury Trial Demand, *supra* note 9 at 1.

[15] *See* Conlin, *supra* note 7 at 60-64.

[16] *See, e.g.*, KY. REV. STAT. ANN. § 344.040 (LexisNexis 2005); ME. REV. STAT. ANN. tit. 26, § 597 (2005); N.J. STAT. ANN. § 34:6B-1 (West 2000); N.Y. LABOR LAW § 201-D (McKinney 2001); N.D. CENT. CODE § 14-02.4-01 (2002); OKLA. STAT. tit. 40, § 500 (2004); S.D. CODIFIED LAWS § 60-4-11 (2004); VA. CODE ANN. § 2.2-2902 (2002); WIS. STAT. ANN. § 111.31 (West 2004); WYO. STAT. ANN. § 27-9-105 (2005).

[17] Kelley v. Johnson, 425 U.S. 238, 248, 96 S.Ct. 1440, 1446 (1976).

[18] *Id.*

[19] *Id.* at 245, 96 S.Ct. at 1444.

[20] *Id.*

[21] Hander v. San Jacinto Junior Coll., 519 F.2d 273, 275 (5th Cir. 1975).

[22] *Id.*

[23] *Id.*

States Court of Appeals, Fifth Circuit held that the regulation was arbitrary and held no reasonable relation to the quality of teaching or other aspects of the position.[24] Additionally, the court ruled that an adult's right to wear his hair long supersedes the state's right to intrude.[25]

In another case involving use of tobacco products, the Tenth Circuit Court of Appeals held that it assumed a liberty interest exists within the Fourteenth Amendment that protects the right of a firefighter to smoke when off duty.[26] In this case, the City of Oklahoma City had a regulation in place prohibiting smoking for firefighter trainees on or off duty for a period of one year. Grusendorf was fired for having a cigarette during his lunch break. The court in this case ruled that good health and physical conditioning are essential requirements for the job and that gave a rational basis for the regulation.[27] The only irrational aspect of the regulation was that it was limited in scope to first year firefighter trainees only.[28]

The Supreme Court of Florida, in a 1995 case, ruled that a City of North Miami regulation requiring city job applicants to sign an affidavit that they had not used tobacco products for one year to be valid.[29] The court ruled that Florida's constitutional right to privacy, when raised, requires an evaluation of the action to determine whether there is a compelling state interest.[30] The court said that there, the right to smoke is not one included in the privacy rights within its constitution and, even if it were, there is a legitimate state interest in reducing health costs and increasing productivity.[31]

Private employers also have a long history of attempting to curtail employee rights, and have not been immune from legal action when enforcing regulations involving employee regulations. A New Jersey case held that an employee has a right to a safe work place and that, given her allergy to cigarette smoke, a smoke filled environment was not safe.[32] The company had no smoking regulations and the plaintiff was forced to work in an area with other employees who smoked. She

[24] *Id.* at 277.
[25] *Id.* at 275.
[26] Grusendorf v. City of Oklahoma City, 816 F.2d 539, 543 (10th Cir. 1987).
[27] *Id.*
[28] *Id.*
[29] City of North Miami v. Kurtz, 653 So.2d 1025, 1027 (1995).
[30] *Id.*
[31] *Id.* at 1028.
[32] Shimp v. New Jersey Bell Tel. Co., 145 N.J. Super. 516, 521, 368 A.2d 408, 410 (1976).

alleged that the defendant, New Jersey Bell Telephone Co. caused her to work in an unsafe working environment.[33]

A South Dakota statute prohibits discharge of employees for tobacco use during off-work hours.[34] In a case involving a cement factory, the South Dakota Supreme Court upheld the right of the employer to institute and enforce a smoking ban at work or off work due to the nature of the business and the dangers of smoke inhalation along with the dust and particles being inhaled in the ordinary course of employment.[35] Supporting this decision was a doctor's testimony strongly recommending cessation of smoking, as well as testimony pertaining to the health requirements for the position.[36]

In addition to the current focus on smoking of tobacco products, employers have attempted to regulate various other legal activities of employees. Some of these involve alcohol use, dating, sexual behavior, hazardous sports, and personal relationships, as well as political activities and family responsibilities. For example, the United States District Court for the Northern District of California ruled that the discharge of a postal worker for "immoral conduct" (living with a woman who was not his wife) was a violation of a constitutional right to privacy in his private sex life and that he could not and should not be held to another's special moral code, especially if his actions had no effect on his job performance.[37] The United States Court of Appeals for the Ninth Circuit also held that the private, consensual sexual activity of a public employee is subject to the protection of the constitutional right to privacy.[38]

EMPLOYER JUSTIFICATION

The cost of health insurance coverage is soaring, and employers are trying numerous strategies to combat these costs. The *Boston Globe* has reported that health care premiums in Massachusetts are approaching $10,000.00 per employee per year.[39] The costs are increasing faster than inflation despite a number of strategies being implemented.[40] These costs have led employers to the implementation of various programs designed to reduce the burden of health insurance costs. Many of these programs involve the regulation of off duty conduct including the

[33] *Id.*
[34] S.D. CODIFIED LAWS § 60-4-11 (2004).
[35] Wood v. South Dakota Cement Plant, 588 N.W.2d 227 (1999).
[36] *Id.*
[37] Mindel v. U.S. Civil Serv. Comm'n, 312 F. Supp. 485, 487-488 (D.C. Cal. 1970).
[38] Thorne v. City of El Segundo, 726 F.2d 459 (9th Cir. 1986).
[39] Jeffrey Krasner, *Employers' Health Insurance Costs Soar in Boston*, BOSTON GLOBE, Nov. 20, 2007, at C2.
[40] *Id.*

cessation of smoking. Some involve lifestyle changes for employees, such as losing weight or reducing their cholesterol levels to keep a job.[41] Employers have also attempted to control areas of employees' private lives in order to preserve the employer's reputation in the community. Again this is the attempt to instill behavior on employees based upon someone else's moral values and beliefs. Americans enjoy a right to employment, a right to acquire and maintain a job. Presumably, this right should depend upon one's ability to perform that job and not upon some outside standard of right and wrong.[42]

Nevertheless, an employer is also entitled to hire the right employees. This has traditionally meant that those who are mentally and physically capable of performing the duties requisite to the job qualify for an employer's consideration. Employers have required physical exams for those who are expected to lift heavy weights. Similar testing, including aptitude tests, have been required for other positions. With the technology available today, employers are able to gather a great deal of information that in the past was beyond the scope of inquiry.[43] As a result, employees are being forced to undergo more intrusive testing required by an employer as a condition of employment.[44] Given the cost of health insurance as well as the need for hiring the right employee, employers feel justified in obtaining as much information as possible to assist them in making hiring and other employment decisions.

Employers should certainly hire productive employees who will perform their duties in a professional and capable manner.[45] Drug and alcohol abuse cost businesses billions every year. Employee theft, another justification of increased testing of employees, also results in tremendous costs. Thus, alcohol and drug testing are used by employers, while psychiatric exams are used to predict theft and other employee actions that might cause the employer harm. Questions as to their effectiveness will always be debated.[46]

Wellness Programs

Numerous wellness programs have been implemented by employers to assist employees in attaining and maintaining good health.[47] One article estimates that over two thirds of all companies with fifty or more

[41] 2 L. CAMILLE HEBERT, EMPL. PRIVACY LAW § 13:2 (2007).
[42] *Id*.
[43] HEBERT, *supra* note 5.
[44] *Id*.
[45] 1 L. CAMILLE HEBERT, EMPL. PRIVACY LAW § 1:2 (2007).
[46] *Id*.
[47] Marc Leepson, *Does Wellness Really Work? Company Health Programs*, NATION'S BUSINESS, August 1988, *available at* http://findarticles.com/p/articles/mi_m1154/is_n8_v76/ai_6572054.

employees offered some type of wellness activity.[48] Most of the plans work on an incentive basis. Other companies are simply charging employees more for health insurance if they fail to take advantage of the programs provided. In the 1980s, Adolph Coors Company provided incentives to employees for being healthy or attempting to improve their physical condition.[49] Coors paid ninety percent of the health cost of those employees who undergo medical evaluations and are judged healthy, but only eighty-five percent of the cost of those who fail to answer questionnaires or failed to attempt to improve.[50] This incentive program was reasonably successful at the time.[51]

The City of Bellevue, Washington provided extra money for those who agreed to such things as a fitness evaluation and for not smoking or calling in sick.[52] The personnel director stated that about eighty percent of employees had received some benefit.[53] Speedcall Corporation paid employees who didn't smoke a bonus of seven dollars per week.[54] Scherer Brothers, a lumber company in Minneapolis, awarded a bonus to employees who did not call in sick.[55]

Another company, Kimberly Clark, offered extensive medical screenings and a series of programs for attaining and maintaining good health.[56] This included nutritional training and weight control. McKee Baking Company in Tennessee provided a gym within five minutes of work as well as health screenings and education.[57]

The major question that has arisen over the years is the effectiveness of these programs. Proponents of the programs state that the programs make employees healthier and happier and more productive.[58] Medical claims have fallen among those who take advantage of the gyms, weight rooms, smoke cessation programs and other health related programs provided by employers. Opponents say that the only people who take advantage are those who are already in good physical health.[59]

Regardless of the debate, it appears that employers need to find ways to increase health consciousness among employees and to institute

[48] *Id.*

[49] Glenn Kramon, *What's New in Employee Health Plans; When Good Health is Part of the Job*, N.Y. TIMES, Jul. 19, 1987, *available at* http://query.nytimes.com/gst/full page.html?res=9B0DE7DF123FF93AA25754C0A 961948260.

[50] *Id.*

[51] *Id.*

[52] *Id.*

[53] *Id.*

[54] *Id.*

[55] *Id.*

[56] Leepson, *supra* note 46.

[57] *Id.*

[58] *Id.*

[59] *Id.*

programs to take advantage of insurance cost reduction. Whatever motives can be attributed to employers, it is obvious that health care costs must be reduced, and new programs should be put in place to effect this goal. Among the programs, Scotts has instituted its policy of non-smoking on or off premises for all job applicants.

LAWS EXPRESSLY PROHIBITING TERMINATION OF AN EMPLOYEE FOR SMOKING

The legislative bodies of at least thirty states have taken the affirmative step of enacting statutes that specifically prohibit termination of an employee for smoking outside of the workplace.[60] Most of these also prohibit basing other employment decisions of an employer on partaking in legal activities during off-work hours and off the employer's premises. These were a reaction to the early 1990s when employers began the process of interfering with the privacy rights of employees or of prospective employees. Discrimination is the common theme in these laws. Most states recognized that businesses were making employment decisions based on legal activities of the employees. These prohibitions are either located in anti-discrimination statutes or are enacted as free-standing statutes. For example, Kentucky's legislature added a prohibition against termination of an employee for smoking into its anti-discrimination laws.[61] Pursuant to Kentucky's Revised Statutes Annotated §344.040:

> It is an unlawful practice for an employer: (1) to fail or refuse to hire, or to discharge any individual, or other wise to discriminate against an individual with respect to compensation, terms, conditions or privileges of employment, because of the individual's race, color, religion, national origin, sex, age forty (40) and over, because the person is a qualified individual with a disability, or because the individual is a smoker or nonsmoker, as long as the person complies with any workplace policy concerning smoking.[62]

Alternatively, New Jersey's legislature enacted a statute specifically prohibiting employer discrimination against persons who smoke or use tobacco products.[63] New Jersey Statutes Annotated §34:6B-1 states:

> No employer shall refuse to hire or employ any person or shall discharge from employment or take any adverse action against any employee with respect to compensation, terms, conditions or other privileges of employment because that person does or does not smoke

[60] *See supra* note 15.
[61] KY. REV. STAT. ANN. § 344.040 (LexisNexis 2005).
[62] *Id.*
[63] N.J. STAT. ANN. § 34:6B-1 (West 2000).

> or use other tobacco products, unless the employer has a rational basis for doing so which is reasonably related to the employment, including the responsibilities of the employee or the prospective employee.[64]

The New York statute is a general statute that protects political activities, union activities, the legal use of consumable products and legal recreational activities outside of work hours and off the employer's premises.[65] The statute lists out a large number of exceptions and also provides for different health care plans for those who participate in outside activities that may give rise to higher premiums.[66] The statute does, however, require that the employer provide employees notice of the different rates for the types of policies that are offered.[67]

Louisiana has entitled its statute "Prohibition of Smoking Discrimination."[68] The statute prohibits discrimination in employment based on smoking as long as the smoker complies with regulations, policy and applicable law relative to smoking.[69] It specifically limits it applicability to those who smoke tobacco.[70]

Massachusetts Law

As previously stated, Massachusetts has no statute dealing with discrimination in employment decisions based on employees or prospective employees engaging in legal activities. Nor is there any significant basis of case law to fall back on. The federal court in the *Rodrigues* case will have to rely on decisions made in other jurisdictions.

In 1987, Massachusetts enacted a statute that denied eligibility for appointment as a police officer or firefighter to those who smoke any tobacco product.[71] It also called for termination of any officer appointed after that date who smokes any tobacco products.[72] There is a public interest in having police and firefighters be healthy and able to perform the duties of their jobs. The courts have ruled that there is no discretion relative to discharge in this scenario. The statute is specific and requires termination for indulging in the regulated behavior.[73]

[64] *Id.*
[65] N.Y. LABOR LAW § 201-D. (McKinney 2001).
[66] *Id.*
[67] *Id.*
[68] LA. REV. STAT. ANN. § 23:966 (2003).
[69] *Id.*
[70] *Id.*
[71] MASS. GEN. LAWS ch. 41, § 101A (2006).
[72] *Id.*
[73] *See* Town of Plymouth v. Civil Serv. Comm'n, 426 Mass 1, 686 N.E.2d 188 (1997).

Massachusetts also has a statute restricting the use and abuse of intoxicating liquors.[74] This statute does not require dismissal. That final employment decision is left to the discretion of the employer.[75]

CONCLUSION

Scott Rodrigues may be the most important voice for Massachusetts employees in this century. This importance is due to the unresolved law as to whether employers can regulate employees' non-work lawful activities. During the completion of this paper the United States District Court for the District of Massachusetts has issued an opinion as to the defendant's Motion to Dismiss, holding that Rodrigues' ERISA and privacy claims should move forward to trial, while his wrongful termination and civil rights act claims were dismissed.

Should Massachusetts employers be allowed to regulate the non-work lawful activities of their employees which pose health risks? Where does the control end? Will employers seek to regulate employee participation in skydiving, bicycling, rock climbing, or the consumption of red meat or drinking alcohol during non-work hours? In addition, what about the effect false positive tests will have on employees? False positive tests may yield a very chilling effect on employees' sense of autonomy and willingness to participate in lawful activities. Typically, there are no appeal procedures where an employee or potential employee may seek internal company remedies if they test positive. There are also issues relating to the extent of information discovered during testing. Should employers be able to receive information relative to genetic disposition to certain medical issues such as heart attack?

In all, the Scotts Company sends a distressing message to employees of its company and to employees across this country. While most would agree there is a major health care crisis in the United States, the answer is not to restrict lawful activities during off-work hours. This has the effect of further infringing on the rights of the individual.

Whether the Massachusetts legislature will react at the conclusion of *Rodrigues* case is unknown. Other states have taken action as to clarifying employers' rights and responsibilities in the testing and firing of employees for using tobacco products during non-work time. It is time for the Massachusetts Legislature to take some action. It would be very simple to amend its discrimination in employment statute by adding language banning employment decisions based on tobacco use to the already existing employment discrimination statute.[76] In the alternative, the Massachusetts Legislature could enact a new statute to

[74] MASS. GEN. LAWS ch. 31, § 50 (2006).
[75] *Id.*
[76] MASS. GEN. LAWS ch. 151B, § 4 (2006).

specifically ban discrimination based on otherwise legal activities. It would be preferable, and very proactive, to have a comprehensive statute covering a myriad of legal activities. The other alternative is for the United States Congress to enact similar legislation to protect the employment rights of the individual. Employers and employees can expect a landmark decision effecting employees' right to privacy and rights afforded to employees under ERISA.

COMPUTATION OF STATUTORY DAMAGES FOR WILLFUL COPYRIGHT INFRINGEMENT OF SOUND RECORDINGS AND MOTION PICTURES: "SUE ME. I AM NEVER GOING TO JOIN."

by WILLIAM E. GREENSPAN*

I. INTRODUCTION

Consider a hypothetical scenario whereby John Doe owns a restaurant that provides live musical performances three nights each week. Neither John nor the musicians are licensed to perform copyrighted musical compositions. The American Society of Composers, Authors, and Publishers (ASCAP), which represents the composers of musical compositions, warns John that unauthorized public performances of copyrighted musical compositions constitute copyright infringement. Over a three-year period ASCAP contacts John numerous times by letter, phone calls, and personal visits. ASCAP offers John an ASCAP license to perform ASCAP-protected musical compositions. John consistently replies: "Sue me. I am never going to join." So the copyright owners sue John for willful copyright infringement claiming statutory damages.

In an unrelated incident, four university students are running file-sharing services on the Internet, uploading and downloading copyrighted musical compositions without permission from the copyright owners. (Downloading is taking musical compositions from someone else's computer, while uploading is making files available to others for

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downloading.) Recording companies investigate, identify, and warn the offending students this conduct violates federal copyright law. The response of each student is: "Sue me." So the recording companies sue the students for willful copyright infringement, claiming statutory damages.

How does the court compute damages when a defendant has committed willful copyright infringement? The answer to this question is of interest not only to copyright owners (composers and publishing companies), but also to those who publicly perform or distribute unauthorized copyrighted works (concert halls, bars, restaurants, nightclubs, hotels, business establishments, and uploaders and downloaders of music on the Internet).

This paper will: (1) review relevant statutory law relating to copyright and statutory damages for willful infringement; (2) discuss recent case applications of computation of damages for willful copyright infringement of sound recordings and motion pictures; and (3) recommend strategies for copyright owners on how to best maximize statutory damages, followed by a counter-strategy for willful violators on how to minimize such damages.

II. RELEVANT STATUTORY LAW

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 made in 1831, 1870, and 1976.[2] Several minor revisions have been made since the 1976 revision. The philosophy behind U.S. copyright law is well expressed in a couple of leading U.S. Supreme Court cases. In *Twentieth Century Music*, the Court observed: "The immediate effect of our copyright law is to secure a fair return for the author's creative labor. But the ultimate aim is, by this initiative, to stimulate artistic creativity for the general public good."[3] As stated in the *Sony* case, 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]

[1] U.S. Const, Art. I, §8, cl. 8.
[2] 17 U.S.C. §§ 101 *et. seq*. (2008).
[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).

A. Requirements, Exclusive Rights, Subject Matter, Remedies

The Copyright Act gives a person who creates an original[5] work of authorship in fixed form[6] six exclusive rights, including the exclusive rights to reproduce the work in copies,[7] to distribute copies of the copyrighted work,[8] and to perform the copyrighted work publicly.[9] The subject matter of a copyright falls into eight categories, three of which are literary works,[10] motion pictures and other audiovisual works,[11] and sound recordings.[12] Any person who violates any of the exclusive rights of the copyright owner is liable for copyright infringement.[13]

The Copyright Act provides the owner of a copyright with a potent arsenal of remedies against an infringer of the copyright owner's work. These remedies include: (1) an injunction to restrain the infringer from continuing violations,[14] (2) the impoundment and destruction of all reproductions of his work made in violation of his rights,[15] (3) a recovery of the copyright owner's actual damages and any additional profits of the infringer, or statutory damages,[16] and (4) an allowance for costs and a reasonable attorney's fee in the discretion of the court to the prevailing party.[17] Moreover, the Copyright Act also provides for criminal sanctions against any person who infringes a copyright under certain

[5] "Original" as the term is used in copyright law "means only that the work was independently created by the author (as opposed to being copied from other works), and that it possesses at least some minimal degree of creativity." Feist Publications, Inc. v. Rural Tel. Serv. Co., 499 U.S. 340, 345 (1991).

[6] 17 U.S.C. § 102 (a) (2008).

[7] 17 U.S.C. § 106 (1) (2008).

[8] 17 U.S.C. § 106 (3) (2008).

[9] 17 U.S.C. § 106 (4) (2008).

[10] 17 U.S.C § 102 (a) (1) (2008). "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 (2008).

[11] 17 U.S.C § 102 (a) (6). "Motion pictures" are audiovisual works consisting of a series of related images which, when shown in succession, impart an impression of motion, together with accompanying sounds, if any. 17 U.S.C. § 101 (2008).

[12] 17 U.S.C. §¡ì 102 (a) (7). "Sound Recordings" are works that result from the fixation of a series of musical, spoken, or other sounds, but not including the sounds accompanying a motion picture or other audiovisual work, regardless of the nature of the material objects, such as disks, tapes, or other phonorecords, in which they are embodied. 17 U.S.C. § 101 (2008).

[13] 17 U.S.C. § 501 (2008).

[14] 17 U.S.C. § 502 (2008).

[15] 17 U.S.C. § 503 (2008).

[16] 17 U.S.C. § 504 (2008).

[17] 17 U.S.C. § 505 (2008).

circumstances.[18] This paper will focus on the statutory damages component of civil copyright remedies.

B. Statutory Damages

Section 504(a) of the Copyright Act allows a copyright owner to sue an infringing party for either (1) actual damages and any additional profits of the infringer, or (2) statutory damages. Frequently, actual damages are difficult to prove, or, in some cases, far inadequate to warrant bringing a lawsuit. For example, if a university student illegally downloads one copy of a musical composition from a file-sharing website, a plaintiff may have difficulty identifying that student. Even if the plaintiff can locate the student, the damages the copyright owner suffered are far too small to warrant a lawsuit to recover actual damages. Thus, plaintiffs usually elect to recover statutory damages.

Plaintiffs may not elect statutory damages until they have first met certain copyright registration requirements. If the copyrighted work is published, plaintiffs need to show only that they registered their works with the U.S. Copyright Office either before that infringement or within three months of first publication.[19] If plaintiffs have an unpublished work, they must register it with the U.S. Copyright Office before the infringement takes place.[20]

Assuming a copyright owner has properly registered a work, Section 504(c) (1) allows a copyright owner to elect an award of statutory damages instead of actual damages any time before final judgment is rendered. The plaintiff does not have to prove any actual damages; the plaintiff need only show the defendant committed copyright infringement. Under current law, a court must award a minimum statutory damage award of $750 and a maximum of $30,000 as the court considers just.[21] However, a court in its discretion may increase the statutory damages award to a maximum of $150,000 if the court finds the infringement was committed willfully. On the other hand, the court may reduce the award to a sum of not less than $200 if the court finds the infringer "was not aware and had no reason to believe his or her acts constituted an infringement of copyright."[22] Simply stated, statutory

[18] 17 U.S.C. § 506 (a) (2008).

[19] 17 U.S.C § 412 (2) (2008). *See* FM Industries, Inc. v. Citicorp Credit Services, Inc., No. 07 C 1794, 2008 U.S. Dist. LEXIS 20670 (N.D. Ill. Mar. 17, 2008) (denying statutory damages because the infringement took place two years before the plaintiff registered its copyright).

[20] 17 U.S.C. § 412 (1) (2008). *See* Homkow v. Musika Records, No. 04 Civ. 3587 (KMW) (THK), 2008 U.S. Dist. LEXIS 14079 (S.D.N.Y. Feb. 26, 2008) (holding plaintiff did not timely register copyright to be entitled to statutory damages).

[21] 17 U.S.C. § 504 (c) (1) (2008).

[22] 17 U.S.C. § 504 (c) (2) (2008).

damage awards range from $200 to $150,000. If a plaintiff can prove the defendant willfully violated the Copyright Act, then the plaintiff has the potential to recover significant damages.

C. Willfulness

What constitutes "willful infringement"? What must a court find to decide an infringement was committed "willfully"? The Copyright Act does not define "willfully." Thus federal courts have developed their own definitions. One court definition of "willful" within the Copyright Act means "with knowledge the defendant's conduct constitutes copyright infringement."[23] Another definition is stated in the alternative: "A finding of willfulness is justified if the infringer has knowledge that his conduct is infringing another's copyright or if the infringer has acted in reckless disregard of the copyright owner's rights."[24] One commentator suggests a two-part willfulness test which requires knowledge and an affirmative duty to investigate.[25]

A court may consider many factors in determining whether an infringement was committed willfully: Did the infringer receive notice of infringement? Did the infringer continue to infringe after the copyright owner sent the infringer a cease and desist letter? How familiar is the infringer with the copyright laws? Has the infringer been sued for copyright infringement in the past? Have the police ever raided the infringer's establishment looking for infringing articles? Is the infringer involved with copyrighted works as part of its normal business activities? If the defendant is not a natural person, did the appropriate person in the organization have knowledge of the infringement? Did the infringer appear at trade shows where it would have been exposed to the copyright owner's work?[26]

[23] Zomba Enterprises, Inc. v. Panorama, 491 F.3d 574, 584 (6th Cir. 2007); Mitchell International, Inc. v. Fraticelli, No. 03-1031 (GAG/BJM), 2007 U.S. Dist. LEXIS 86787, at *21 (D.P.R. Nov. 26, 2007).

[24] Yash Raj Films (USA) Inc. v. Sur Sangeet Video Electronics Inc. , No. 06-3968 (SRC), 2008 U.S. Dist. LEXIS 14951, at *12 (D.N.J. Feb. 28, 2008) (holding video store committed willful infringement by, among other things, copying plaintiff's Indian films and audio albums on a DVD "burner").

[25] Jeffrey M. Thomas, *Comment: Willful Copyright Infringement: In Search of a Standard,* 65 WASH. L. REW. 903 (1990).

[26] *See,* Frederick F. Mumm, *Department: Practice Tips: Proving Willfulness in Copyright Infringement Actions,* 27 L.A. LAWYER 18 (2004).

III. RECENT CASE APPLICATIONS OF COMPUTATION OF DAMAGES FOR WILLFUL COPYRIGHT INFRINGEMENT OF SOUND RECORDINGS AND MOTION PICTURES

Statutory damages are formulated not only to be compensatory or restitutionary, but also they are designed to discourage wrongful conduct.[27] The more culpable or willful the infringement, the more likely a court will enhance statutory damages within the permissible range. The amount of statutory damages a court awards should "further the Copyright Act's dual objectives of compensating copyright owners for past infringement and deterring future infringement."[28] Courts have dealt with willful copyright infringement in various ways, as partly evidenced by the following cases.

A. Public Performance of Sound Recordings

In a case similar to the first scenario in the introduction to this paper, *International Korwin v. Kowalczyk,*[29] Tadeusz Kowalczyk, the sole owner of the Orbit restaurant in Chicago, provided live musical performances three nights each week. Neither Kowalczyk nor the musicians were licensed to publicly perform copyrighted musical compositions. Representatives from ASCAP warned Kowalczyk that unauthorized public performances of copyrighted musical compositions constitute copyright infringement. Over a three-year period ASCAP contacted Kowalczyk numerous times by letters, phone calls, and personal visits. ASCAP offered Kowalczyk an ASCAP license to perform ASCAP-protected musical compositions. Kowalczyk consistently replied: "Sue me. I am never going to join." So the copyright owners sued Kowalczyk for willful copyright infringement claiming statutory damages.[30]

The court focused on "the willfulness of the defendant's conduct and the deterrent value of the sanction imposed." The court noted "defendants must not be able to sneer in the face of copyright owners and copyright laws." Instead, "defendants must be put on notice that it costs less to obey the copyright laws than to violate them." It would have cost Kowalczyk $3,500 to purchase an ASCAP license. Taking into account the deterrent value of a sanction, the court tripled that amount and awarded the plaintiffs $10,500 in statutory damages.[31]

[27] F.W. Woolworth Co. v. Contemporary Arts, Inc., 344 U.S. 228, 234 (1952); Paramount Pictures Corporation v. Hopkins, No. 5:07-CV-593 (FJS/GJD), 2008 U.S. Dist. LEXIS 8107, at *6 (N.D.N.Y. Feb. 4, 2008).

[28] *Id.* at *7.

[29] 655 F. Supp. 652 (N.D. Ill. 1987), *aff'd,* 855 F. 2d 375 (7th Cir. 1988).

[30] 665 F. Supp. at 654-56.

[31] *Id.* at 658-660. Additional remedies included injunctive relief, costs, and a reasonable attorney's fee.

In a 2007 case, *Broadcast Music, Inc. v. H.S.I., Inc.,*[32] Broadcast Music, Inc. (BMI), which grants licenses on behalf of copyright owners to perform copyrighted music, sued H.S.I., doing business as Buckaroo's, a bar that regularly featured unlicensed karaoke performances of copyrighted music. Over a period of four years, BMI contacted H.S.I. and its owner, Capuano, eighty times by way of letters and phone calls, offering a license and warning against infringement. The defendants never responded. BMI moved for summary judgment asking the court to award, among other things, $39,000 ($3,000 for each of 13 violations) in statutory damages for willful infringement.[33]

Rather than assessing damages on the basis of the number of unlicensed songs performed on a particular evening, the court preferred "a superior yardstick," awarding damages on the basis of a multiple of unpaid licensed fees. Defendants were on notice for four years that they were committing copyright infringement. The BMI licensing fee would have been $8,928 for those four years. In the interest of deterring future violations, the court tripled that amount for a total award of $26,784 in statutory damages.[34]

While some courts prefer to award damages on the basis of a multiple of unpaid licensing fees,[35] others prefer to measure damages by the number of infringements.[36] In *Entral Group Intern., LLC v. YHLC Vision Corp.,*[37] YHLC committed willful copyright infringement when it failed to properly license Chinese-language songs played at its karaoke club. Since there were mitigating circumstances indicating the defendant was acting in good faith, trying to get a fairly-priced license to perform the songs, the court awarded damages of $750 each for 12 infringements totaling $9,000.[38]

[32] No. C2-06-482, 2007 U.S. Dist. LEXIS 86642 (S.D. Ohio Nov. 26, 2007).

[33] *Id.* at *11.

[34] Id. at *18. See also, Chi-Boy Music v. Charlie Club, Inc. 930 F.2d 1224 (7th Cir. 1991) (awarding $40.000, three times the ASCAP licensing fees for unauthorized radio and taped music); Rilting Music v. Speakeasy Enters, Inc., 706 F. Supp. 550 (S.D. Ohio 1988) (awarding $3,000 in statutory damages, twice the licensing fee); Rodgers v. Eighty-Four Lumber Co., 623 F. Supp. 889 (W.D. Pa. 1985) (awarding $122,500, three times the licensing fees over a four-year period).

[35] Broadcast Music, Inc. v. H.S.I., Inc., No. C2-06-482, 2007 U.S. Dist. LEXIS 86642 (S.D. Ohio Nov. 26, 2007).

[36] Bertram Music Co. v. Yeager Holdings of Cal., Inc., No. S-07-1766 LEW GGH, 2008 U.S. Dist. LEXIS 36990 (N.D. Cal. May 6, 2008) (awarding statutory damages of $10,.000 for the unauthorized public performance of five copyrighted songs at the defendants' Sports Page Bar & Grill, $2,000 for each copyrighted song).

[37] No. 05-CV-1912 (FB) (RLM), 2007 U.S. Dist. LEXIS 90684 (E.D.N.Y. Dec. 10, 2007).

[38] *Id.* at *11. *See also,* Sailor Music v. IML Corporation, 867 F. Supp. 565 (E.D. Mich. 1994) (awarding $2,000 for each of five infringing works for a total of $10,000); Prater Music v. Williams, 5 U.S.P.Q.2d (BNA) 1813 (W.D. Mo. 1987) (awarding $3,000 for each

In summary, courts use two different methods to calculate damages for willful copyright infringement in cases involving unlicensed public performances of sound recordings in business establishments. Both methods take into account a deterrent component. Hopefully business establishments that publicly perform copyrighted sound recordings will realize it is less expensive to join ASCAP and BMI, rather than take the chance they will face a court award for multiple damages.

B. Copying and Distributing Motion Pictures

Unlicensed public performances of sound recordings in business establishments have been an ongoing problem for years. A more recent phenomenon is the unauthorized copying and distribution of motion pictures.[39]

In *Twentieth Century Fox Film Corp. v. Jordan,*[40] Plaintiff, Twentieth Century Fox, was the copyright owner of the motion picture *Supercross*. The plaintiff hired MediaSentry, a company that investigates motion picture piracy on peer-to-peer networks. With the help of an Internet Service Provider, MediaSentry identified Cindy Jordan as the account holder that downloaded *Supercross* without authorization from the copyright owner. Plaintiff sued Jordan for willful copyright infringement, asking for statutory damages of $6,000. Jordan did not answer. The court found a $6,000 default judgment to be reasonable based on the facts that the infringement occurred while *Supercross* was still playing in theaters; that Jordan made *Supercross* available on a peer-to-peer network for others to download, subjecting the movie to repeated and ongoing infringement; and that the plaintiff incurred significant expense in hiring MediaSentry to investigate and identify Jordan as the infringer.[41]

The statutory range of damages for willful copyright infringement applies to each infringing title or work. If there is more than one infringing work, the award for damages could be significant. For example, in *Yash Raj Films (USA) Inc. v. Sur Sangeet Video Electronics*

of seven infringing works for a total of $21,000); Music City Music v. Alfa Food, Ltd., 616 F. Supp. 1001 (E.D. Va. 1985) (awarding $1,5000 for each of three infringing works for a total of $4,500); Boz Scaggs Music v. KND Corporation, 491 F.Supp. 908 (D. Conn. 1980) (awarding $1,000 for each of 23 infringing works for a total of $23,000).

[39] *See,* Trent Seltzer, *RIAA [Recording Industry Association of America], MPAA [Motion Picture Association of America], and the Digital Piracy Issue: Comparing Public Relations Strategies and Effectiveness,* paper presented at the annual meeting of the International Communication Association, Sheraton New York, New York City, N.Y., April 22, 2008, online at http://www.allacademic.com/meta/pl4465_index.html.

[40] No. 4:07-CV-01249 (CEJ), 2007 U.S. Dist. LEXIS 90629 (E.D. Mo. Dec. 10, 2007).

[41] *Id.* at*3.

Inc. et. al.,[42] Plaintiff, Yash Raj Films owned copyrights in Indian films it manufactured and marketed. Plaintiff sued several parties connected with a video retail store in New Jersey that were making counterfeit copies of films, some of which films were still playing in movie theaters. An investigation revealed Defendants continued to make unauthorized copies of Plaintiff's films after Plaintiff had warned Defendants one year earlier not to make and sell unauthorized copies of Plaintiff's films. Plaintiff with deputies of the U.S. Marshal's Service seized hundreds of unauthorized CDs and DVDs of Plaintiff's copyrighted works. Defendants copied Plaintiff's works on a DVD "burner" and on VHS recorders, packaged the products with infringing artwork, including Plaintiff's tradename and logo, and sold the infringing articles to unsuspecting consumers.[43]

The court recognized Defendants committed willful copyright infringement. Taking into account the hundreds of separate and individual infringements of several different works along with a "clear need for deterrence," the court awarded Plaintiffs $50,000 per infringing work for a total $3,000,000 in statutory damages![44]

C. Uploading and Downloading Sound Recordings

Though illegal public performances of sound recordings as well as unlawful copying and distribution of motion pictures are continuing problems, an issue of interest to many college and university students is unauthorized uploading and downloading of sound recordings. The attitude of many students is: "Why should I pay to download and swap songs when I can get them for free. There are millions of people using file-sharing systems. The chances are miniscule that anyone will sue me. I will never join a site in which I have to pay a fee to legally download songs." As stated by one court: Swappers "are ignorant or more commonly disdainful of copyright and in any event discount the likelihood of being sued or prosecuted for copyright infringement."[45]

When several recording companies sued Jeffrey Howell for willful copyright infringement after an investigative agency, MediaSentry,[46] reported an individual had 4,007 song files available in a shared folder

[42] No. 06-3968 (SRC), 2008 U.S. Dist. LEXIS 14951 (D.N.J. Feb. 28, 2008).

[43] *Id.* at *6.

[44] *Id.* at *13.

[45] Interscope Records v. Sharp, No. 1:05-CV-920 (FJS/DRH), 2007 U.S. Dist. LEXIS 93065, at *4 (N.D.N.Y. Dec. 19, 2007) (awarding minimum statutory damages of $750 for each of ten infringing works, totaling $7,500, in order to sanction and vindicate the statutory policy of discouraging infringement).

[46] MediaSentry is a global provider of online content protection and promotion services for companies in the entertainment and software industries. Details on MediaSentry investigations may be found at http://www.mediasentry.com.

on the Kazaa online file-sharing system, and after the relevant Internet service provider (ISP), Cox Communications, identified the Internet Protocol (IP) address as registered to Howell, Howell gave several reasons why he should not be liable for copyright infringement. Howell argued he was at work when the MediaSentry investigation took place, taking screenshots of the contents of Howell's shared folder. Further, Howell claimed he owned the CDs at issue and put them on his computer for personal use. Finally, a computer malfunction or a third party was responsible for putting his files into his shared folder.[47]

The court found these arguments unpersuasive, if not ridiculous. The court noted that "distribution of copyrighted material need not involve a physical transfer. The owner of a collection of works who makes them available to the public may be deemed to have distributed copies of the works."[48] Further the court declared, "It is no defense that a Kazaa user did not directly oversee the unauthorized distribution of the copyrighted material."[49] The recording companies elected to seek minimum statutory damages. Consequently the court assessed the minimum amount of statutory damages award, $750 for each of 54 sound recordings owned by the plaintiff recording companies, totaling $40,504 in statutory damages.[50] The damage award was in line with the purpose of statutory damages to reduce online infringement of sound recordings by penalizing offending parties and sending a warning to others.

Frequently persons know they have committed willful copyright infringement and fail to respond to the copyright owners' complaints. When Michael Knox was caught using LimeWire, an online file-sharing program, to distribute 452 audio files over the Internet, and failed to answer the plaintiffs' complaint, the copyright owners asked the court to issue a default judgment against Knox for the minimum amount of statutory damages for willful infringement of ten of the recordings owned or licensed by the copyright owners. The court entered a default judgment against Knox for $750 for each of ten recordings, adding up to $ 7,500.[51]

[47] Atlantic Recording Corp. v. Howell, No. CV06-02076-PHX-NVW, 2007 U.S. Dist. LEXIS 61268 (D.Ariz. Aug. 20, 2007).

[48] *Id.* at*8.

[49] *Id.* at *9.

[50] *Id.* at *14.

[51] Priority Records LLC v. Knox. No. 07-13515, 2008 U.S. Dist. LEXIS 1141 (E.D. Mich. Jan. 8, 2008). *See also,* Atl. Recording Corp. v. Visione, No. 07-CV-2268, 2008 U.S. Dist. LEXIS 34843 (N.D. Ill. Apr. 29, 2008) (awarding statutory damages of $6, 000 - $750 per sound recording of eight infringing works - for unauthorized reproduction and distribution of sound recordings from the Kazaa peer-to-peer file exchange software). Arista Records LLC v. Ibanez, No. 07 CV 1037 JM (POR), 2008 U.S. Dist. LEXIS 691 (S.D. Cal. Jan. 8, 2008) (entering default judgment of minimum statutory damages for willful

The odds are increasing that copyright owners will be going after illegal uploaders and downloaders. Recently a district court found a plausible claim for relief against 27 University of Maine students, each sharing a range between 81 and 2903 audio files on Gnutella, a peer-to-peer (P2P), file-sharing network. The court was not impressed with the students' argument that Gnutella can be used for lawful purposes such as to download songs the students already owned. How did the students get caught? In this case, MediaSentry investigated the files, recorded the copyrighted songs downloaded, and identified the IP addresses of persons using the file-sharing network, noting the date and time the copyrighted songs were downloaded and/or distributed to the public and from which IP addresses. Then the University of Maine identified the owner of each IP address.[52]

IV. RECOMMENDED STRATEGIES FOR COPYRIGHT OWNERS AND USERS

Willful copyright infringement threatens all copyright owners. Copyrights are valuable property. Just as one protects an automobile through insurance, there are strategies copyright owners may use to protect their copyrights, and, if necessary, maximize statutory damages. On the other hand, there are steps copyright infringers can take to minimize damages.

A. Recommended Strategies for Copyright Owners

Register your copyrights with the United States Copyright office. Remember, there are registration requirements as a prerequisite to a suit for statutory damages.[53] Clearly mark your goods with a clear notice of copyright so that infringers cannot claim they were innocent infringers, thereby minimizing infringers' liability for damages. Monitor and protect your copyrights. Investigative agencies such as MediaSentry can check online file-sharing networks, searching for unauthorized distributions of copyrighted works. In addition, investigators can monitor retail establishments, flea markets, auction sites, and any other places or

copyright infringement of $750 for each of seven violations, for a total of $5250); Motown Record Company v. Armendariz, No. SA-05-CA-0357-XR, 2005 U.S. Dist. LEXIS 32045 (W.D. Tex. Sept. 22, 2005) (awarding default judgment of minimum statutory damages for willful copyright infringement of $750 for each of 11 copyrighted sound recordings, totaling $8,250).

[52] Arista Records, LLC v. Does 1-27, No. 07-162-B-W, 2008 U.S. Dist. LEXIS 6241 (D. Me. Jan. 25, 2008).

[53] 17 U.S.C.§412 (2008).

persons suspected of copying or distributing unauthorized copyrighted works.[54]

Once you have indentified a possible infringer, get as much information as you can about the infringer. Then decide whether to take action considering factors such as the scope of the infringement, the geographical location of the infringer, the financial status of the infringer, and the possible deterrent effect a suit will have on the infringer as well as a warning to others. If you decide to pursue the infringer, first send a cease and desist letter. That may end the matter.

If the violator continues to infringe, make significant contacts with the infringer before filing a copyright infringement suit. Send cease and desist letters by certified mail. Make phone calls to the infringer warning of the consequences of copyright infringement. Make personal visits to the infringer. Document these contacts. In court, a defendant can hardly deny willful copyright infringement after you prove you gave the infringer numerous warnings. As evidenced by cases cited in this paper, copyright owners usually make significant contacts and try to settle over a period of two to three years before bringing an infringement suit. Use other evidence in court to show willful copyright infringement such as whether the defendant had past experience with copyright law, whether on any previous occasion the defendant had been sued for or warned about copyright infringement, and whether the defendant had been involved with copyrighted works as part of its regular business activities.

One commentator suggests an interesting approach to sanction and deter unauthorized, willful copying and distribution of copyrighted works, especially sound recordings. Noting that teenagers make up half of the 60 million people who use online file-swapping services to illegally trade music, and that most minors would be unable to pay damage awards for willful copyright infringement, how about suing the parents. "A parent who provides a child with a computer and Internet access should be responsible for determining whether the child can be trusted to act responsibly with those devices. If the child uses the device to engage in illegal conduct, the parent should be held liable for negligently entrusting the equipment to his or her child."[55]

[54] For a list of companies offering monitoring services of the marketplace or the Internet for counterfeit goods, *see,* Bradley J. Olson, Esq.; Michael R. Graham, Esq.; John Maltbie, Esq.; and Ron Epperson, *The 10 Things Every Practitioner should Know about Anti-Counterfeiting and Anti-Piracy Protection,* 7 J. HIGH TECH. L. 106, 113 (2007).

[55] Chad Silver, *Note: Censure the Tree for its Rotten Apple: Attributing Liability to Parents for the Copyright Infringement of their Minor Children,* 3 CARDOZO PUB. L. POL'Y & ETHICS J. 977, 1004 (2006).

B. Recommended Counter-Strategy for Copyright Violators

The first rule for those considering engaging in willful copyright infringement is: Do not do it. The attitude of many teenagers and college and university students, as well as owners of retail stores and business establishments, is that they will never get caught. Each year, with increasing sophisticated technology, copyright owners are pursuing more violators.

If you do engage in copyright infringement, and a copyright owner sends you a certified letter asking you to cease and desist, open your mail. Certified letters are not junk mail. Read the letter and follow the advice: cease and desist. That frequently ends the matter.

If a representative from ASCAP or BMI visits your establishment and warns you that you are violating copyright laws by permitting unauthorized public performances of copyrighted music, and you must cease and desist, do not reply: "Sue me. I will never join." Joining ASCAP and BMI is much less expensive than paying $ 750 to $150,000 for each violation in a willful infringement suit.

V. CONCLUSION

With the advent of the Internet and continuing technological improvements, it has become easier than ever to commit willful copyright infringement. Copyright owners must understand copyrights are valuable property rights the owners must monitor and protect. Potential violators must realize the odds are increasing they will get caught if they engage in willful copyright infringement. Consumers have the right to benefit from the creative efforts of copyright owners, but copyright owners are entitled to a monetary reward for their creative efforts.

The emerging case law in the three areas of unlicensed public performances of sound recordings, unauthorized copying and distribution of motion pictures, and illegal uploading and downloading of music, are representative of the difficult task courts have in squaring the Constitutional philosophy that copyright protection balance the rights of the creator (to seek a fair return for one's creative efforts) against the interests of society (to stimulate artistic creativity for the general public good).[56] Has copyright protection tilted too far in one direction between the competing interests of mega-businesses and the general public? This balance will be maintained as long as the competing parties obey current copyright law.

Congress has given the public a strong incentive to obey copyright law. The provision for statutory damages in the Copyright Act makes

[56] Sony Corp. v. Universal City Studios, 464 U.S. 417, 429-30 (1984); Twentieth Century Music Corporation v. Aiken, 422 U.S. 151, 156 (1975).

"the cost of infringement significantly more burdensome than the cost of compliance."[57] As stated by one commentator: "Copyright laws encourage creativity, and without protection, there will be no incentive to invest time and money developing music, books, software, or other arts."[58]

[57] Thomas C. Welshonce, *Record Companies Score Two Victories in One Case Against Online Music Sharing,* 10 LAWYERS J. 5 (2008).
[58] *Id.*

MULTI-STATE TAXATION AND CAPTIVE REITS: WAL-MART'S "ROLLBACK" OF TAXES

by JOHN F. ROBERTSON* AND PATRICIA Q. ROBERTSON**

I. THE MULTIJURSDICTIONAL PROBLEM IN STATE CORPORATE TAXATION

Cities, counties, and states impose a variety of taxes on business enterprises. The focus of this paper is on the state corporate income tax. At the present time, 46 states and the District of Columbia impose some form of a broad based corporate income tax.[1] If a corporation is formed and does business in only one state, the state corporate tax calculation

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[1] For the purpose of this paper, we have included in the definition of an "income" tax any tax based on corporate profits. States use various terms such as franchise, excise, and privilege taxes to refer to their taxes on corporate profits. Franchise taxes are taxes imposed on the corporate entity in exchange for the privilege of doing business or holding property in the state. These taxes may or may not be based on corporate profits. Some states impose both a franchise tax based on net worth or capital stock and a tax based on corporate income. Michigan imposes a Single Business Tax that is based partially on federal corporate taxable income. Texas imposes a margin tax based on gross receipts less specified deductions. The three states do not impose a corporate income tax of any kind are: Nevada, Washington, and Wyoming. South Dakota imposes a franchise tax measured on net income on financial institutions. For comparison, 43 states and the District of Columbia impose a broad based individual income tax. Tennessee and New Hampshire impose an individual tax on interest and dividend income only. This information is based on the CCH Multistate Tax Guide, a part of the CCH Internet Tax Research NetWork. Accessed March 21, 2008.

is relatively simple. If, however, the corporation does business in multiple states, the corporate income must be apportioned among the various states. This apportionment can lead to inequities for both the taxpayer and the taxing authority.

Many states begin their corporate income tax calculation with federal taxable income, while others require a separate calculation. State taxable income (STI) typically differs from federal taxable income (TI) because some items are included in the calculation of STI that are not included in the calculation of TI, some items are excluded from STI that are included in TI, and some items are calculated differently for state purposes than for federal purposes. Two of these differences cause STI to be higher than TI—income included for STI that was excluded for TI and deductions that are not allowed for STI that were allowed for TI.[2] These are typically called Add-Back provisions. Two of the differences cause STI to be lower than TI—income that was included for TI but is excluded from STI and expenses that are deductible in calculating STI but not TI.[3] The items that are calculated differently for federal and state purposes could cause STI to increase or decrease from TI.[4] Every state has a slightly different list of adjustments between STI and TI, and it is unlikely that STI will be the same in every state that the corporate entity has a filing obligation.

The calculation of state tax liability is further complicated by two additional concepts. First, some income is specifically allocated to a given state. One type of income that is specifically allocated to the state it is earned in is the so-called "Non-Business Income." Second, once STI has been calculated, it must be apportioned between states.[5] Each state has its own apportionment factor. These factors typically include three components: sales, property, and payroll.

A certain amount of uniformity is provided in this area through the efforts of the Multistate Tax Commission (MTC). The MTC is an "intergovernmental state tax agency." The District of Columbia and

[2] *E.g.* States generally tax the interest earned on obligations of other states, and disallow a deduction for state income taxes paid.

[3] *E.g.* States generally do not tax interest income earned on federal obligations, and some states allow a deduction for federal income taxes paid.

[4] *E.g.* Not all states allow the full amount of federal accelerated and bonus depreciation. Similarly, states may have a different limitation on the deductible portion of charitable contributions.

[5] Some states require the taxpayer to apportion income before calculating tax. Other states require the taxpayer to calculate tax then apportion tax liability. If the state has a flat tax rate, the method does not matter. If the state uses graduated rates, apportioning after calculating tax can cause the corporate taxpayer to be in a higher marginal bracket than would apportioning income prior to calculating tax.

forty-seven states are members of MTC.[6] Nineteen of these member states and Washington, D.C. are "Compact Members" who have incorporated the Multistate Tax Compact into their state law. Most of the Compact Members are in the western portion of the United States, and most of the non-Compact MTC members are in the eastern portion of the United States. [7] The purposes of the Multistate Tax Compact include assistance with "proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes" and advancement of "uniformity or compatibility in significant components of tax systems."[8]

II. CORPORATE TAX PLANNING

Corporate entities, their boards of directors, and their shareholders have a legitimate right to plan to minimize state tax obligations. There are several planning areas that most businesses consider. One is the choice of business entity.

State income taxes can influence the choice of business entity as much as federal taxes.[9] Sometimes, certain business entities may be able to avoid state taxes altogether. For example, prior to 2007, businesses in Texas could avoid the Texas franchise tax by operating as a limited partnership or a limited liability partnership rather than as a limited

[6] MultiState Tax Commission, Members, *available at* http://www.mtc.gov/AboutStateMap.aspx and http://www.mtc.gov/About.aspx?id=1818 Delaware, Nevada and Virginia are not members of the MTC.

[7] MultiState Tax Commission, Members, *available at* http://www.mtc.gov/AboutStateMap.aspx and http://www.mtc.gov/About.aspx?id=1818

[8] MultiState Tax Commission, MultiState Tax Compact, Article I, Purpose, *available at* http://www.mtc.gov/About.aspx?id=78

[9] The federal tax law has a long history of allowing a taxpayer to structure his or her affairs to require the payment of the least amount of tax. One of the earliest cases to present this position was Bullen v. State of Wisconsin, 240 U.S. 625 36 S. Ct. 473; 60 L. Ed. 830 (1916). In Bullen, the Supreme Court stated "[w]e do not speak of evasion, because, when the law draws a line, a case is on one side of it or the other, and if on the safe side is none the worse legally that a party has availed himself to the full of what the law permits. When an act is condemned (sic) as an evasion what is meant is that it is on the wrong side of the line indicated by the policy if not by the mere letter of the law. *Id.* at 630-31. Bullen was cited by judge Learned Hand in his classic statement "[a]ny one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes." Helvering v. Gregory, 69 F.2d 809 at 810 (1934). Justice O'Conner expressed similar sentiments in her concurrence in U.S. v Carlton, 512 U.S. 26 at 35; 114 S. Ct. 2018; 129 L. Ed. 2d 22 (1994). Justice O'Conner stated "[a]nd like all taxpayers, Carlton was entitled to structure the estate's affairs to comply with the tax laws while minimizing tax liability. It is perhaps ironic that the taxing authority won all three of these cases.

liability company or a corporation.[10] Since Texas does not have an individual income tax, the earnings of such enterprises would not be subject to state taxation at any level. These enterprises essentially traded a reduced liability shield for a lower tax burden.[11]

A business taxed as a corporation for state purposes may incur a higher overall tax liability than one treated as a pass-through entity for state purposes. At the federal level, the concept of double taxation is fairly easily illustrated. A regular, or C-corporation, is subject to tax on its TI.[12] Dividends received by individual shareholders are part of gross income, and thus part of the individual's TI.[13] Dividends paid by a regular corporation are not deductible in calculating corporate TI.[14] Thus, the corporation pays tax on its earnings, distributes excess after-tax earnings to its shareholders, and those shareholders may pay a second level of tax. Further, a corporation must recognize the unrealized gain when appreciated assets are distributed to a shareholder.[15] Although state laws vary, in many states this same system applies.

Enterprises taxed as partnerships avoid the federal double tax system.[16] Profits are not taxed to the enterprise, but, instead are

[10] The Texas Franchise Tax had been amended in 1991 to include a component based on federal taxable income. Tex. Tax Code §171.110 (repealed by (H.B. 3), Laws 2006, effective January 1, 2008). The 2006 amendments to the Texas Tax Code added many formerly tax exempt entities to the list of taxable entities, Tex. Tax Code §171.0002, and changed the tax base to a modified gross receipts tax, Tex. Tax Code §171.101.

[11] Similar opportunities to avoid state taxation through the choice of entity existed in Tennessee prior to 2000.

[12] 26 U.S.C. §11.

[13] 26 U.S.C. §61(a)(7). To prevent further layering of taxation, corporate shareholders may be allowed a dividends received deduction under 26 U.S.C. §243. The double tax impact on individuals is temporarily alleviated by the provisions taxing qualified dividends at the special rates allowed for net long-term capital gains. For individuals in the 10% and 15% marginal brackets, the tax on qualified dividends for the years 2008-2010 is zero. 26 U.S.C. §1(h)(11). These special rules for individuals expire December 31, 2010. Tax Increase Prevention and Reconciliation Act of 2005, P.L. 109-222 §102.

[14] Nothing is deductible in calculating TI unless a specific code section provides for such a deduction. 26 U.S.C. 161. There is no provision in the Code authorizing a corporation to deduct dividends paid.

[15] 26 U.S.C. 311(b). However, unrealized losses are not deductible.

[16] Treasury regulations dealing with non-corporate business entities provide for a default classification and an optional classification. Entities with two or more owners have a default status of partnership and may elect to be taxed as corporations. As a practical matter, any enterprise with the term "partnership" in its description requires at least two owners under state law. Thus, general partnerships, limited partnerships, limited liability partnerships, and limited liability limited partnerships have a default tax status of partnership. Limited liability companies with two or more owners also have a default tax status of partnership. Entities with a single owner have a default status of disregarded entity, which means that they are ignored for tax purposes. These entities may also elect to be taxed as corporations. The typical non-corporate entity with a single

allocated among the owners. If the owner is an individual or a taxable entity, that owner pays tax on its share of partnership income. Many states follow this same system, allowing business entities to avoid double tax at the state level as well.

At the federal level, and in many states, the corporate entity may reduce the impact of the double tax system by filing an election to be taxed as an S Corporation.[17] S Corporation taxation is similar to the taxation of partnerships, although it is not identical.[18] Broadly stated, these types of business enterprises are "pass-through" entities. This means that the income of the enterprise is reported for on a federal information return, but is actually taxed to the owners. States that allow the use of the S Corporation have made a policy decision to provide tax relief to certain business enterprises. States can make other policy decisions to encourage business activity or to meet other social goals. This can result in reduced state taxes.

The above discussion illustrates tax opportunities available under state law. These are often available to business enterprises operating in a single state as well as to multi-state operations. More sophisticated tax planning attempts to take advantage of the differences in state law and the complexities of a given state's ability to impose a tax under the United States Constitution. Some of the more aggressive techniques are generally referred to as tax shelters. The MTC issued a report on July 15, 2003 that estimated 2001 state losses to corporate tax-sheltering techniques were between $8.32 billion and $12.38 billion.[19] The MTC's report specified two international and two domestic tax shelter techniques. The two domestic ones were the use of a corporate subsidiary to hold intangibles that are then licensed to the operating entities and the careful classification of income to specifically allocate as much income as possible to states without a corporate income tax.[20]

Consider a parent-subsidiary group of corporations. This enterprise may have operations in many states, and may earn many different types

owner is a limited liability company. 26 C.F.R. §301.7701-3.

[17] 26 U.S.C. 1361 *et. sec.*

[18] Major differences exist in the area of payroll and self-employment taxes, and property distributions. Under 26 C.F.R §1.707-1, a partner is not treated as an employee for payroll tax, retirement plan, or similar purposes. A shareholder of an S Corporation may also be an employee of the corporation. The 26 U.S.C. 311(b) rules requiring a corporation to recognize income upon the distribution of appreciated property apply to S Corporations as well as C Corporations. No similar rule applies to partnerships.

[19] Corporate Tax Sheltering and the Impact on State Corporate Income Tax Revenue Collections, Multistate Tax Commission, available on line at: http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Resources/Studies_and_Reports/Corporate_Tax_Sheltering/Tax%20Shelter%20Report.pdf. The report also indicated that 2001 total state corporate state tax collections were $35.4 billion.

[20] *Id* at 2. This creates what the authors of the study call "nowhere income."

of revenues. If the enterprise has passive revenues, it may benefit by incorporating the parent company in a state like Nevada that does not have a corporate income tax. The parent company can then directly own the investments that produce interest and dividend income, and such revenue will not be taxed in any state.[21] The operating activities will still be taxed in the states in which the various subsidiary corporations do business.

The use of a separate subsidiary to hold intangibles as a tax shelter gained widespread attention after the South Carolina Supreme Court decided the Geoffrey case in 1993.[22] Geoffrey, Inc. is a member of the Toys "R" Us corporate group. The original Toys "R" Us, Inc. reorganized along functional lines in 1984. One feature of this reorganization was the creation of Geoffrey, Inc. Geoffrey, Inc. is a Delaware corporation formed to hold the group's trademarks and trade names.[23] Geoffrey licensed the intangible assets to the parent corporation and other operating corporations in the group.[24] The parent company operated in South Carolina and deducted royalty payments to Geoffrey, Inc.[25] The state of South Carolina eventually allowed the deductions, but then maintained that Geoffrey, Inc. was subject to its corporate income tax. Geoffrey, Inc. countered that Due Process Clause and the Commerce Clause of the U.S. Constitution prohibited South Carolina from imposing its tax on Geoffrey's royalty income.[26] Geoffrey, Inc.'s arguments were that it did not have a substantial nexus with South Carolina, and that South Carolina provided it no services.[27]

A Due Process analysis of the imposition of a tax requires a showing that there is a minimum contact between the taxpayer and the state, and a showing that the income attributed to the state has a rational relationship to the values of the state.[28] The South Carolina Supreme

[21] A simple internet search will reveal that an industry has grown up around the formation and operation of Nevada corporations. The Nevada Secretary of State's web site lists several tax related reasons for forming a Nevada corporation. http://sos.state.nv.us/business/comm_rec/whyinc.asp

[22] Geoffrey, Inc. v. South Carolina Tax Comm'n, 437 S.E.2d 13 (1993). Cert. denied, Geoffrey, Inc. v. South Carolina Dep't of Revenue & Taxation, 510 U.S. 992 (1993).

[23] *Id.* at 15.

[24] Id.

[25] *Id.* The court states: "[i]n 1990, Geoffrey, without any full-time employees, had an income of approximately $ 55 million and paid no income taxes to any state. *Id.* footnote 1. This resulted from a combination of Delaware's exemption from corporate tax of royalty income and Geoffrey's position that it had no contact with any state other than Delaware.

[26] 437 S.E.2d at 16.

[27] *Id.* at 16 and 18.

[28] *Id.* at 16, citing Quill Corp. v. North Dakota, 504 U.S. 298 (1992). In Quill, the United States Supreme Court goes onto explain the minimum contacts requirement "…as whether a defendant had minimum contacts with the jurisdiction "such that the

Court concluded that no physical presence was required to meet the minimum contacts requirement of the Due Process clause.[29] The court held that licensing its intangibles in South Carolina and receiving payments for these contracts satisfied the minimum contact requirement, and that South Carolina provided Geoffrey, Inc. with benefits by creating an orderly society that allowed Geoffrey, Inc. to profit from the sales made by Toys "R" Us in South Carolina.[30]

With regard to the Commerce Clause, the South Carolina Supreme Court noted that "[a] tax will survive challenge under the Commerce Clause so long as it 1) is applied to an activity with a substantial nexus with the taxing state, 2) is fairly apportioned, 3) does not discriminate against interstate commerce, and 4) is fairly related to the services provided by the State."[31] The court held that Geoffrey, Inc.'s activity of licensing its assets to entities operating in the state and deriving income from those activities satisfied the nexus requirement.[32] The South Carolina Supreme Court applied the same reasoning it used in the Due Process Clause analysis to measure the services provided by the state, and found that Geoffrey, Inc. had not raised any arguments requiring analysis under the apportionment or discrimination against interstate commerce tests.[33]

Intangible holding companies like Geoffrey, Inc. are often referred to as passive investment companies (PICs). Some states have attacked royalty payments to PICs by maintain that the PICs have nexus with the state in the same way that South Carolina did.[34] Other states have dealt with the PIC issue in other ways. Many states required combined reporting by the members of a related group of corporations. This means that the PIC's income would be added together with the income of the operating companies before the total is apportioned among the states.[35]

maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'" Citing International Shoe v. Washington, 326 U.S. 310, 316 (1945), in turn quoting Milliken v. Meyer, 311 U.S. 457, 463, (1940).

[29] 437 S.E.2d at 16.

[30] *Id.* at 18.

[31] *Id.*, citing Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977).

[32] 437 S.E.2d at 18.

[33] *Id.*

[34] *See, e.g.,* Geoffrey, Inc. v. Oklahoma Tax Commission, 132 P.3d 632 (2005) finding substantial nexus between Geoffrey, Inc. and the state. Similarly, Geoffrey, Inc. v. Commissioner of Revenue, Massachusetts Appellate Tax Board, No. C271816, July 24, 2007.

[35] *See, e.g.* ALASKA STAT. § 43.20.031(i). According to the Institute on Taxation and Economic Policy, 17 states require combined reporting. Http://www.itepnet.org/pb24 comb.pdf. Last accessed March 23, 2008.

Other states require companies to add back payments to related parties for the use of intangibles in the calculation of STI.[36]

III. REITS

Real Estate Investment Trusts ("REITs") are "financial vehicles that allow investors to pool their capital for participation in real estate ownership or mortgage financing, while providing those investors with the benefits of many of the tax advantages available to larger and more sophisticated investors and businesses who can afford to invest directly in real estate."[37] A REIT is essentially a "mutual fund for real estate" that makes it easier for smaller investors to hold a professionally-managed, diverse real estate portfolio.[38]

Although a form of REIT existed as early as the mid-nineteenth century for the purpose of holding real estate, these pre-1960 REITs became subject to double-taxation and therefore lost popularity.[39] The pre-1960 REITs were essentially treated like C Corporations for tax purposes.[40] C Corporations normally encounter double taxation because these corporations typically pay taxes on corporate income, and then the corporations distribute some of the corporate income to shareholders as dividends that are also taxable at the shareholder level.[41]

Congress amended the Internal Revenue Code (IRC) in 1960 to afford favorable income tax treatment to REITs and increase the funds available for real estate development and investment.[42] The IRC provides a method for REITs to avoid taxation of income at the level of the REIT entity. The REIT may be treated as a pass-through entity. The justification for this "pass-through" status is that REITs are essentially the "structural alter ego of the shareholders."[43] A recent court

[36] *See, e.g.,* VIR. CODE §58.1-402(B)(8). These "add-back" statutes often have exceptions, so not all royalty payments are added back. *See,* VIR. CODE §58.1-402(B)(8) & (9). 18 states and the District of Columbia have add-back statutes. Surtees v. VFJ Ventures, inc., 2008 Ala. Civ. App. Lexis 50 (Feb. 8, 2008) at footnote 3.

[37] Jack H. McCall, *A Primer on Real Estate Trusts: The Legal Basics of Reits*, 2 TRANSACTIONS: TENN. J. BUS. LAW 1, 2 (Summer 2001).

[38] *Id.*; Nathan C. Brown, *Real Estate Investment Trusts and Subpart F: Characterizing Subpart F Inclusions for Purposes of the REIT Income Tests,* 20 EMORY INT'L L. REV. 833, 837 (2006); National Association of Real Estate Investment Trusts, NAREIT's "Talking Points" on Closely-Held REITs, http://www.nareit.com/policy/government/tpclose.cfm (last visited March 25, 2008).

[39] Jennifer Stonecipher, *From One Pocket to the Other: The Abuse of Real Estate Investment Trust Deductions*, 72 Mo. L. Rev. 1455, 1457 (2007).

[40] *Id.* (Describing Morrissey v. Comm'r, 296 U.S. 344 (1935) in which the Court held that a real estate trust was subject to double taxation).

[41] 26 U.S.C. §§ 11, 301 (2000).

[42] 26 U.S.C. § 856 (2000); Jennifer Stonecipher, *From One Pocket to the Other: The Abuse of Real Estate Investment Trust Deductions*, 72 Mo. L. Rev. 1455, 1456 (2007).

[43] BankBoston Corp. v. Comm'r of Revenue, 861 N.E.2d 450, 451 (Mass. App. Ct. 2007).

opinion explains the special tax treatment of REITs as follows: "These constructs of Federal law are intended to provide access for individuals of moderate means to investments that had previously been out of reach due to economies of scale and tax considerations."[44] REITs may escape double taxation if the REITs meet numerous requirements of the Internal Revenue Code[45] because REITs can deduct from the REIT income the dividends paid to beneficial owners.[46] Although corporations cannot deduct dividends received from REITs for federal tax purposes, many states still allow such deductions for STI.[47]

A corporation, trust or association may elect to elect to be a REIT if the corporation, trust or association satisfies Internal Revenue Code requirements for REIT status, including but not limited to the following general requirements: (1) One or more trustees or directors manages the REIT; (2) transferable shares evidence the beneficial ownership in the REIT; (3) except for the REIT provisions of the Internal Revenue Code the REIT would be taxed as a domestic corporation; (4) the REIT is not a financial institution or insurance company; (5) 100 or more persons have a beneficial ownership interest in the REIT; (6) the REIT is not closely held; and (7) the REIT complies with the dividend, income and asset requirements of the Internal Revenue Code.[48]

The Internal Revenue Code contains numerous requirements for REIT income, dividends and assets. A major general rule is that the REIT must distribute at least 90% of the REIT's taxable income as dividends.[49] In addition, the income requirements for a REIT include the following: (1) at least 95% of the REIT's gross income is from sources authorized by the Internal Revenue Code, including certain dividends, gains from certain sales of stock, rent from real property and gain from sale of real property;[50] and (2) at least 75% of the REIT's gross income is

[44] *Id.* (citing H.R. Conf. Rep. No. 94-658 at 353 (1976), reprinted in U.S.C.C.A.N. 2897, 3249-3250; 26 U.S.C. §857(b) (2)(B) (2000)).

[45] 26 U.S.C. §§ 11(c)(3), 856-860E (2000).

[46] 26 U.S.C. § 857(b)(2)(B) (2000).

[47] 26 U.S.C. § 857(c)(1) (2000); Jennifer Stonecipher, *From One Pocket to the Other: The Abuse of Real Estate Investment Trust Deductions*, 72 Mo. L. Rev. 1455, 1460 (2007).

[48] 26 U.S.C. §§ 856, 857 (2000).

[49] 26 U.S.C. § 857 (2000).

[50] 26 U.S.C. § 856(c)(2) (2000). A more extensive list of acceptable sources of REIT income for the 95% test includes the following: (a) dividends, (b) interest, (c) rents from real property, (d) gain from sale of stock, securities and real property other than inventory or property held for sale in the ordinary course of business; (e) real property tax refunds and abatements; (f) income and gain from foreclosure property; (g) consideration (not based upon income or profits of a person) for agreements to make mortgage loans or to purchase or lease real property; and (h) gain from sale of a real estate asset (except inventory or property held for sale in the ordinary course of business, unless that inventory or property is foreclosure property). *Id.*

derived from sources authorized by the Internal Revenue Code that are related to real estate, such as rent from real property, interest on obligations secured by mortgage on real property, gain from the sale of real property, and dividends or gain from other REITs.[51] The general asset requirements for a REIT include the rule that at the close of each quarter of the tax year, at least 75% of the REIT's total asset value is real estate assets, cash, cash items, receivables and Government securities.[52]

REIT investors include "individuals of moderate means," but also many "sophisticated investors" invest in REITs.[53] In recent years multi-state companies such as Wal-Mart and AutoZone have attempted to employ captive REITs in state tax planning strategies that would not be available to taxpayers located in only one state.[54]

One of the earliest cases involving a REIT and a state department of revenue was *Bridges v. AutoZone Properties, Inc.*[55] AutoZone, Inc. (AutoZone) reorganized in 1995. The new corporate structure involved:

[51] 26 U.S.C. § 856(c)(3) (2000). A more extensive list of acceptable sources of REIT income for the 75% test includes the following: (a) rents from real property; (b) interest on obligations secured by mortgages, (c) gain from sale of real property or mortgages not held for sale in the ordinary course of business; (d) dividends and gain from sale of shares in other REITS; (e) refunds or abatements of real property taxes; (f) income and gain from foreclosure property; (g) consideration (not based upon income or profits of a person) for agreements to make mortgage loans or to purchase or lease real property; and (h) gain from sale of certain real estate assets. *Id.*

[52] 26 U.S.C. § 856(c)(4) (2000). Additional asset rules for a REIT require that at the close of each quarter: (a) not more than 25% of the REIT's total asset value is securities (other than securities allowed in the 75% rule regarding real estate assets, cash, cash items, receivables and Government securities); (b) not more than 20% of the REIT's total asset value is securities of one or more taxable REIT subsidiaries; and (c) except for taxable REIT subsidiaries and securities to be included in the 75% rule regarding real estate assets, cash, cash items, receivables and Government securities: (i) not more than 5% of the REIT's total asset value includes securities of any one issuer; and (ii) the REIT does not own more than 10% of the outstanding securities of any one issue or securities with more than 10% of the voting power of any one issuer. *Id.*

[53] BankBoston Corp. v. Comm'r of Revenue, 861 N.E.2d 450, 451 (Mass. App. Ct. 2007). In 1971, market capitalization of publicly traded REITs in the United States was approximately $1.5 billion. In 2006 the market capitalization of publicly trade REITS in the United States had increased to approximately $438 billion, but this market capitalization decreased to $312 billion at the end of 2007. National Association of Real Estate Investment Trusts, Historical REIT Industry Market Capitalization: 1972-2007, *available at* http://www.nareit.com/library/industry/marketcap.cfm (last visited March 17, 2008).

[54] *See, e.g.,* Bridges v. AutoZone Props., Inc., 900 So.2d 784 (La. 2005); Commonwealth Fin. and Admin. Cabinet v. AutoZone Dev. Corp., 2007 Ky. App. LEXIS 401 (Ky. Ct. App. 2007); Wal-Mart Stores East, Inc. v. Hinton, No. 06-CVS-3928 (Wake Co. NC Super. Ct. 2007) *available at* http://taxprof.typepad.com/taxprof_blog/2008/01/wal-mart-loses.html (follow Wal-Mart Stores, Inc. v. Hinton hyperlinks).

[55] 873 So. 2d 25 (2004).

AutoZone as the parent holding company; AutoZone Stores, Inc. (Stores), the operating unit; AutoZone Development Corporation (Development), a REIT holding title to the AutoZone retail stores; and, AutoZone Properties, Inc. (Properties), a Nevada corporation that was the majority shareholder in Development.[56] The other shareholders were AutoZone employees who each held one share of preferred stock in Development, which entitled them to a $10 annual dividend.[57]

The retail stores were leased from Development to Stores. Stores deducted the rent paid to Development as a business expense. Development paid dividends to Properties and its other shareholders. The dividends Development paid its shareholders were deductible under federal and Louisiana law. Properties, as a Nevada corporation, paid no state income tax in its home state, and did not file a Louisiana state return. Development did file a Louisiana state return, but reported no income after the dividends paid deduction.[58]

The Louisiana Department of Revenue audited the members of the AutoZone group, and assessed a deficiency against Properties for the tax years 1996-1998. Properties failed to pay the assessed tax. The Department of Revenue brought suit in East Baton Rouge Parish to compel payment. Properties objected on jurisdictional grounds. The trial court agreed with Properties. The Department of Revenue Appealed.[59]

The Louisiana First Circuit Court of Appeal focused on the Due Process Clause requirements for personal jurisdiction, in particular minimum contacts.[60] The court discussed Louisiana's rules for determining the situs of intangible assets. They are normally taxed to the corporate owner's state of incorporation, unless the shares were used in another state as part of the business operations within that state ("business situs") or were held by a corporation with a headquarters outside its state of incorporation ("commercial domicile"). [61] The court concluded that the dividends paid to Properties had not acquired a business situs in Louisiana because the shares of Development had not been used in Louisiana business activities, no shares were transferred in Louisiana, no dividends were received in Louisiana, no accounting records were kept in Louisiana, and Properties did not make the decisions to pay dividends.[62] The court also concluded that the shares of Development had not acquired a commercial domicile in Louisiana because Properties was a Nevada corporation that had its principal place

[56] *Id.* at 26.
[57] *Id.* at 29, footnote 4.
[58] *Id.* at 26 & 27.
[59] *Id.* at 27.
[60] *Id.*
[61] *Id.*, citing United Gas Corp. v. Fontenot, 241 La. 488 (1961).
[62] 873 So. 2d at 30.

of business in the Bahamas. None of Properties' activities took place in Louisiana, it was not qualified to do business in Louisiana, and conducted no business activities in Louisiana.[63]

Upon appeal, the Louisiana Supreme Court held that the state had taxing jurisdiction to tax dividends received by a non-resident shareholder.[64] The court first concluded that a non-resident could be taxed on income generated from within a state based on its reading of the United States Supreme Court's interpretation of the Due Process Clause in several cases.[65] The court went on to decide that the ability to tax dividend income received by a non-resident shareholder was supported by the Supreme Court's holding in *International Harvester Co. v. Wisconsin Dept. of Taxation.*[66]

IV. WAL-MART AND CAPTIVE REITS

Recently a North Carolina state trial court examined state corporate income taxes in connection with rental payments to captive REITs. Wal-Mart Stores East, Inc. ("WMEast") and Sam's East, Inc. ("SEast"), both wholly-owned subsidiaries of Wal-Mart Stores, Inc. ("WMStores"), have deducted rent paid to captive REITs for several years on state corporate income tax returns. At least temporarily, WM Stores, WMEast and SEast reduced their state income tax liability in numerous states, including North Carolina, by making these rental payments to the captive REITs. However, in 2005, the North Carolina Department of Revenue assessed an additional approximately $30 million, including approximately $5 million penalties and interest, against WMEast and an additional approximately $3.5 million, including approximately $590,000 penalties and interest against SEast, for the fiscal years ending in January 1999, 2000, 2001 and 2002. WMEast and SEast paid the additional assessments, but WMEast and SEast filed suit against the Secretary of Revenue of the State of North Carolina for a refund of these amounts. [67]

The North Carolina tax dispute arose from WMStores' restructuring of its business in 1996 based upon a tax-planning "invitation" from Ernst and Young, LLP, an accounting firm. First, WMStores divided into "east" and "west" states. Most of the "east" states, including North

[63] *Id.* at 31.

[64] Bridges v. AutoZone Properties, Inc., 900 So. 2d 784 (2005).

[65] *Id.* at 800. These cases included Quill v. North Dakota, 504 US 298 (1992).

[66] 322 U.S. 435 (1944). 900 So. 2d at 803. In his concurrence to the denial of AutoZone's untimely request for rehearing, justice Calogero concluded that the original decision may have been decided incorrectly because the Louisiana Supreme Court may have failed to consider the state's personal jurisdiction over AutoZone Properties, Inc. 900 So. 2d at 809.

[67] Wal-Mart Stores East, Inc., No. 06-CVS-3928 (Wake Co. NC Super. Ct. 2007). *See also* Sam's East, Inc. v. Hinton, No. 06-CVS-3929 (Wake Co. NC Super. Ct. 2007).

Carolina, typically do not allow a corporation and its subsidiaries and affiliates to file a combined tax return, but the "west states" typically require that corporations file a combined tax return with its affiliates and subsidiaries. As part of the restructuring strategy, WMStores created several new subsidiaries, including the following: (1) WMEast, an Arkansas corporation, (2) Wal-Mart Property Company ("WMProperty"), a Delaware corporation, owned 100% by WMEast; and (3) Wal-Mart Real Estate Business Trust ("WMREIT"), a REIT owned 99% by WMProperty.[68] The remaining 1% of WMREIT was owned by approximately 100 executives of WMStores without voting rights to satisfy the requirement that the REIT have at least 100 shareholders.[69] SEast conducted analogous restructuring activities, but the discussion in this paper will focus primarily on WMEast for simplification purposes.[70] After WMStores engaged in the restructuring, all store accounts remained in the name of WMStores, WMStores continued to make all purchases for WMEast, and WMStores did not transfer any third party contracts with vendors. WMStores managed all cash for WMEast, WMProperty, and WMREIT, and neither WMProperty nor WMREIT had employees. The Realty Division of WMStores continued to manage the real estate of the retail stores. "In summary, the Restructuring had no appreciable impact on the daily management or operations of Wal-Mart Stores, Inc., nor did it affect [WMStores'] federal tax positions."[71]

After WMStores created the subsidiaries, many Wal-Mart store buildings and land were transferred to WMREIT by a "Master Deed" that was not recorded in the public real estate records. Immediately after the property transfer, WMREIT leased the store buildings and land to WMEast. Then essentially the following sequence of transactions occurred: WMEast paid rent to WMREIT, WMREIT paid the rental income to WMProperty as dividends, and WMProperty paid the dividends to WMEast. The result of this circular payment arrangement was that WMEast deducted the rents from its income for state income tax purposes, even though the rents eventually came back to WMEast in the form of dividends from WMProperty. WMEast did not pay tax on the dividends because normally a corporation does not pay taxes on

[68] *Id.*

[69] Jesse Drucker, *Wal-Mart Cuts Taxes by Paying Rent to Itself,* WALL ST. J., February 1, 2007, at A1 *available at* http://www.realestatejournal.com/reits/20070205-drucker.html.

[70] Sam's East, Inc. v. Hinton, No. 06-CVS-3929 (Wake Co. NC Super. Ct. 2007); Wal-Mart Stores East, Inc., No. 06-CVS-3928 (Wake Co. NC Super. Ct. 2007).

[71] Wal-Mart Stores East, Inc. v. Hinton, No. 06-CVS-3928 (Wake Co. NC Super. Ct. 2007) at 10 *available at* http://taxprof.typepad.com/taxprof_blog/2008/01/wal-mart-loses.html (follow Wal-Mart Stores, Inc. v. Hinton (findings) hyperlink).

dividends from a subsidiary. In addition, WMREIT did not pay tax on the rents because this REIT paid the rental income out to WMProperty in the form of dividends. WMProperty did not pay North Carolina state income tax on the dividends because WMProperty was a Delaware corporation that did not file a North Carolina tax return, and Delaware does not tax such dividends.[72]

Although North Carolina law did not allow a corporation and its subsidiaries and affiliates to file a combined tax return, the North Carolina Secretary of Revenue had statutory authority to require a corporation to file a tax return showing combined income of a parent and subsidiaries "if the Secretary finds as a fact that a report by a corporation does not disclose the true earnings of the corporation on its business carried on in this State."[73] The Secretary could then determine what portion of the combined income was attributable to North Carolina. Such combined reporting would eliminate some state income tax reporting distortions that could otherwise occur if a corporation has a parent, subsidiaries or other affiliates domiciled in another state. In addition, North Carolina law provided that if the Secretary of Revenue has "reason to believe" that a corporation operates to "distort" its income in North Carolina, "the Secretary may require any facts the Secretary considers necessary for the proper computation of the entire net income and the net income properly attributable to the State, and in determining these computations, the Secretary must have regard to the fair profit that would normally arise" from the corporation's business.[74] In 2005, North Carolina's Secretary of Revenue required that WMEast and SEast file consolidated returns for the fiscal years ending in January 1999, 2000, 2001 and 2002. North Carolina's examination of these consolidated returns resulted in the additional $30 million and $3.5 million assessments against WMEast and SEast, respectively.

WMEast and SEast filed suit against the Secretary of Revenue for refunds of these additional assessments. The court had to consider whether WMEast and SEast had taken lawful rent deductions.

The North Carolina Secretary of Revenue argued that the WMStores restructuring made it possible for WMEast to essentially pay rent to itself and use an artificial business structure to deduct that rent for purposes of North Carolina state income tax. Although WMEast took a state income tax deduction for rent payments, no entity paid a state

[72] Wal-Mart Stores East, Inc., No. 06-CVS-3928 (Wake Co. NC Super. Ct. 2007). *See also* Jennifer Stonecipher, *From One Pocket to the Other: The Abuse of Real Estate Investment Trust Deductions*, 72 Mo. L. Rev. 1455, 1459 (2007) (explaining that the shareholders of the REITs are incorporated in states that do not tax dividends, such as Delaware or Nevada).

[73] N.C. GEN. STAT. § 105-130.6 (2007).

[74] N.C. GEN. STAT. § 105-130.16(b) (2007).

income tax for the corresponding rental income. WMEast claimed that the restructuring has a legitimate business purpose because it placed the duties of property ownership in a separate entity. In addition, WMEast claimed that the restructuring and tax consequences was perfectly legal under North Carolina law. However, a criticism of this restructuring is that it results in WMEast's significant reduction of its state income taxes by artificially distorting true income of WMEast that should be shown on a North Carolina state income tax return.[75] WMEast argued that the true North Carolina income of WMEast is reflected in the North Carolina income tax returns because WMEast lawfully deducted rent paid to a separate entity.

However, the North Carolina trial court concluded that "there is no evidence that the rent transaction, taken as a whole, has any real economic substance apart from its beneficial effect on plaintiffs' North Carolina tax liability."[76]

WMEast further unsuccessfully argued that the North Carolina statute only permitted the Secretary of Revenue to require a consolidated tax return in cases where corporations did not eliminate payments "in excess of fair compensation." However, the court held that the North Carolina statutes require the Secretary to compel taxpayers to report income using a method that indicates the corporation's "true income." Combined or consolidated reporting may be necessary for these purposes when the corporation's income is otherwise distorted by separate reporting.[77]

WMEast also unsuccessfully advanced numerous arguments under the United States Constitution and the North Carolina Constitution, including arguments under the Due Process clause, Equal Protection clause and the Commerce clause. WMEast's constitutional arguments included the following: (1) The Secretary of Revenue's powers to determine a corporation's income by requiring combined reporting under the statutes are unconstitutional because the statutes give too much discretion to the Secretary and permit the Secretary to exercise legislative powers. The court disagreed with this argument of WMEast because the legislature has provided the Secretary sufficient "guiding standards," and WMEast has procedural safeguards in the process. (2) WEast further argued that the tax assessment violated Due Process under the U.S. Constitution and the N.C. Constitution. However, the court held that the ability to sue in court for a refund afforded WMEast

[75] Wal-Mart Stores East, Inc. v. Hinton, No. 06-CVS-3928 (Wake Co. NC Super. Ct. 2007) *available at* http://taxprof.typepad.com/taxprof_blog/2008/01/wal-mart-loses.html (follow Wal-Mart Stores, Inc. v. Hinton (findings) hyperlink).

[76] *Id.* at 23.

[77] *Id.* at 21-22.

procedural due process, and the Secretary "did not act arbitrarily" or otherwise in violation of substantive due process.[78] (3) WMEast claimed violation of the Equal Protection Clauses of the United State Constitution and the N.C. Constitution, because WMEast was placed in a class of taxpayers that must provide consolidated tax returns when other taxpayers are not required to provide consolidated tax returns. However, the court found no violation of the Equal Protection Clause because the classes satisfied the following requirement: "[t]he distinction between the classes must merely be 'reasonable' and must 'apply equally to all those within the class defined'." [79] (4) WMEast claimed a violation of the Commerce Clause of the United States Constitution because the Secretary requires combined returns when a corporation has out-of-state affiliates. However, the "United States Supreme Court has upheld the combined reporting method of arriving at net income, despite claims that combined reporting discriminates against interstate commerce."[80] WMEast argued that the denial of the rent deduction and the resulting tax violated the North Carolina Constitution because it did not tax WMEast's net income. However, the court did not agree, pointing out that the tax was appropriate because it was based upon "true net income." (5) WMEast also argued that the Secretary of Revenue had imposed an illegal tax on WMEast "retrospectively" in violation of the North Carolina Constitution. However, the court did not adopt WMEast's argument because WMEast's complaint was merely based on the allegation that the Secretary of Revenue was interpreting the tax laws differently than WMEast expected. Such a holding by the court would lead to the conclusion that the Secretary of Revenue must provide rules that anticipate every possible tax action.[81] The court ruled against WMEast in connection with all of those arguments.

WMEast further argued that the Secretary should not charge the 25% penalty because WMEast was not "negligent" in preparing or filing their tax returns and WMEast was cooperative at all times with the Secretary of Revenue. However, the court held that the North Carolina statute provided that the 25% penalty was available if a taxpayer "understated its tax liability by 25% or more" without regard to negligence or cooperation.[82]

On December 31, 2007, the trial court judge in the General Court of Justice, Superior Court Division, Wake County, North Carolina, granted

[78] *Id.* at 25-30.

[79] *Id.* at 31 (quoting Deadwood v. N.C. Dep't of Revenue, 572 S.E.2d 103, 106 (2002)).

[80] *Id.* at 32 (citing Barclays Bank PLC v. Franchise Tax Bd., 512 U.S. 298, 312, 314 (1994); Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 164-65 (1983)).

[81] Wal-Mart Stores East, Inc. at 23-25, No. 06-CVS-3928 (Wake Co. NC Super. Ct. 2007).

[82] *Id.* at 33-35.

the Secretary of Revenue of North Carolina a judgment as a matter of law. [83] The court stated as follows:

> Plaintiffs [WMEast and SEast] do not deny the facts demonstrating the circular journey taken by the "rents" paid by these plaintiffs, but contend that on each leg of the journey plaintiffs were only taking advantage of a lawful deduction afforded them by then-existing tax law. Such a piecemeal approach exalts form over substance, however. The court concludes that in analyzing a circular transaction such as that in the instant case, where all corporate participants were closely related as parents, subsidiaries and affiliates, the Secretary was authorized to examine the transaction *as a whole* and to consider the net effect of the entire transaction to determine whether there was any real economic substance to the "rental" payments. That is particularly warranted here, where their rent arrangement allowed plaintiffs to funnel a substantial amount of their gross income through their respective REITs and Property Companies only to have the "rent" return to them in a non-taxable form, prior to the eventual transfer of the funds to the parent Wal-Mart Stores, Inc. There is no evidence in this record of any economic impact (apart from the obvious state tax savings) of the transaction to plaintiffs, particularly as plaintiffs were rendered no poorer in a material sense by their "payment" of "rent."[84]

WMEast and SEast have appealed this judgment. [85]

V. CRITICISMS, SOLUTIONS AND SUGGESTIONS

Estimates of total state tax savings by WMStores through use of the captive REIT are as high as $350 million.[86] Numerous news articles have denounced the tax strategies of WMStores and other multi-state corporations using similar strategies.[87] These tax-planning techniques allow multi-state corporations and corporations with out-of-state

[83] Wal-Mart Stores East, Inc. v. Hinton, No. 06-CVS-3928 (Wake Co. NC Super. Ct. 2007) *available at* http://taxprof.typepad.com/taxprof_blog/2008/01/wal-mart-loses.html (follow Wal-Mart Stores, Inc. v. Hinton (order) hyperlink).

[84] Wal-Mart Stores East, Inc. v. Hinton at 23-25, No. 06-CVS-3928 (Wake Co. NC Super. Ct. 2007) at 18 *available at* http://taxprof.typepad.com/taxprof_blog/2008/01/wal-mart-loses.html (follow Wal-Mart Stores, Inc. v. Hinton (findings) hyperlink).

[85] Wal-Mart Stores East, Inc. v. Hinton, No. COA08-450 (N.C. App. 2008); Sam's East, Inc. v. Hinton, No. COA08-453 (N.C. App. 2008) docket sheets *available at* http://www.aoc.state.nc.us/www/public/coa/dsheet.htm (follow Wal-Mart Stores East, Inc. v Hinton, #08-450 hyperlink and Sam's East, Inc. v Hinton, #08-453 hyperlink).

[86] Jesse Drucker, *Wal-Mart Cuts Taxes by Paying Rent to Itself,* WALL ST. J., February 1, 2007, at A1 *available at* http://www.realestatejournal.com/reits/20070205-drucker.html.

[87] *See, e.g.,* Jesse Drucker, *Wal-Mart Cuts Taxes by Paying Rent to Itself,* WALL ST. J., February 1, 2007, at A1 *available at* http://www.realestatejournal.com/reits/20070205-drucker.html; Steve Bailey, *Extreme Tax Games,* BOSTON GLOBE, February 21, 2007, *available at* http://www.boston.com/business/articles/2007/02/21/extreme_tax_games/.

affiliates to avoid paying state taxes that other citizens must pay. Some corporations may thus escape paying their fair share of the state government's expense in providing services to the corporations. This makes it more difficult for state governments to provide necessary services and possibly indicates an element of unfairness in the tax system. One explanation of the significant decreases in state corporate income tax revenues in proportion to corporate profits is increased corporate tax planning.[88]

Although it is impossible for state legislatures to anticipate every tax-planning strategy, many state legislatures with the goals of increasing fairness and revenues should consider changing state corporate income tax laws to clarify that strategies such as that used by the WMStores are not permissible. Possible changes include combined reporting requirements, add-back of rents and expenses paid to captive REITs, and denial of the dividends paid deduction to non-resident REIT shareholders.[89]

The MTC provides several model statutes and regulations, including a Proposed Model Statute for Taxation of Captive Real Estate Investment Trusts. An appointed hearing officer conducted a hearing about this Proposed Model Statute in Washington, D.C. on October 26, 2007. The Proposed Model Statute provides that the "dividends paid deduction otherwise allowed by federal law in computing net income of a real estate investment trust that is subject to federal income tax shall be added back in computing the tax imposed by this [state income tax statute] if the real estate investment trust is a captive real estate investment trust."[90] Essentially, if a single corporation that is not tax-exempt owns more than 50% of the voting power or value of the REIT and the REIT is not publicly traded, the REIT is a "captive real estate investment trust" for purposes of the Model Statute.[91] The Report of the Hearing Officer notes that this Proposed Model Statute may not affect out-of-state REITs. Therefore, the Hearing Officer recommends that states that do not require combined filing "consider amending their

[88] Gary C. Cornia, Kelly D. Edmiston, David L. Sjoquist, and Sally Wallace, *The Disappearing State Corporate Income Tax,* ANDREW YOUNG SCHOOL OF POLICY STUDIES RESEARCH PAPER SERIES No. 06-27 (2004) *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=895140#PaperDownload.

[89] Justice Calogero suggested the denial of the REIT's dividends paid deductions as a solution to Louisiana's problem. 900 So. 2d at 813.

[90] Proposed Model Statute for Taxation of Captive Real Estate Investment Trusts, MultiState Tax Commission, *available at* http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/CaptiveREITs.pdf

[91] *Id.*

current add-back statutes to explicitly include the add-back of rents and interest expenses paid to a captive REIT."[92]

In addition the MTC approved a Proposed Model Statute for Combined Reporting on August 17, 2006. This Proposed Model Statute requires combined reporting for taxpayers in a unitary business with other corporations.[93] The Model Statute suggests that the term "unitary business" should include entities that are parts of the same business and entities under common control if the entities "are sufficiently interdependent, integrated and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange or value among them and a significant flow of value to the separate parts."[94] The MTC's Model Statute also provides for apportionment of the combined income of the taxpayers, based upon the percentage of the combined group's activity in the taxing state, based upon items such as property, payroll and sales in the state.[95]

Although the MTC's proposals appear helpful to further the goals of fairness and revenue collection in the states that enact these Model Statutes, the MTC approach is a piecemeal approach. Many states may choose not to enact these Model Statutes or similar provisions, or state legislatures may delay the enactment of such provisions due to political or other pressures. Sometimes states modify their tax laws only in reaction to their discovery of loopholes, and this occurs numerous years after aggressive well-financed taxpayers have discovered the loopholes. In 2003, North Carolina statutory law changed to provide that rents on real estate in North Carolina are taxable by North Carolina.[96] By October 2007, at least six states had reacted to their discovery of the captive REIT tax-planning strategy with proposed new laws to prevent tax savings by such methods.[97] However, WMStores started using this

[92] *Available at* http://www.mtc.gov/Uniformity.aspx?id=1822&ItemId=1822 (follow REIT Final Hearing Officer's Report hyperlink).

[93] Proposed Model Statute for Combined Reporting, § 2.A., MultiState Tax Commission, *available at* http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/Combined%20Reporting%20-%20FINAL%20version.pdf.

[94] Proposed Model Statute for Combined Reporting, § 1.F., MultiState Tax Commission, *available at* http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/Combined%20Reporting%20-%20FINAL%20version.pdf.

[95] Proposed Model Statute for Combined Reporting, § 2.B., MultiState Tax Commission, *available at* http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/Combined%20Reporting%20-%20FINAL%20version.pdf.

[96] Jennifer Stonecipher, *From One Pocket to the Other: The Abuse of Real Estate Investment Trust Deductions*, 72 Mo. L. Rev. 1455, 1464 (2007). *See* N.C. GEN. STAT. § 105-130.4(c), (d)(1) (2007).

[97] Jesse Drucker, *Inside Wal-Mart's Bid to Slash State Taxes,* WALL ST. J., October 23, 2007, at A1.

tax-planning strategy in 1996. Millions of dollars of state tax revenue may be lost if the statute of limitations expires for potential lawsuits.

One possible solution to improve the uniformity of the state tax situation in the case of captive REITs is to revise the Internal Revenue Code provisions in connection with REITs. Changing the definition of REIT in the Internal Revenue Code to exclude captive REITs would be helpful to prevent cases like the WMStore North Carolina case. For example, if a single corporation or individual owns more than 50% of the voting power or value of a non-publicly-traded entity that looks like a REIT, the Internal Revenue Code could provide that the entity is not a REIT. Such an entity would not be entitled to deduct its dividends, but instead it would be taxable as a C corporation. State laws, such as Delaware corporate income tax laws, provide that REITs as defined in the Internal Revenue Code are exempt from corporate income tax.[98] Therefore, modifying the definition of a REIT in the Internal Revenue Code may eliminate tax advantages of captive REITs in cases such as the WMREIT.

Another problem is that states have difficulty anticipating the next creative tax-planning strategy devised by accountants for large corporations. This type of proactive anticipatory behavior by states may not be possible, given the large amount resources and incentives available to large corporations as compared to state departments of revenue. Often numerous years may pass between the birth of a new corporate tax-planning strategy and discovery by a state department of revenue. [99] If the statute of limitations has elapsed for some of those tax years before discovery by the state department of revenue, the possible tax collection for those years is "lost." Lengthening of the statutes of limitations is one simple law change that could help states collect taxes when a possible violation has occurred. A result of a longer statute of limitations would be that the state would have less likelihood of having numerous "lost tax years" before discovering the violation.

[98] DEL. CODE ANN. tit. 30, § 1902 (2008).

[99] *See, e.g.,* Wal-Mart Stores East, Inc. v. Hinton, No. 06-CVS-3928 (Wake Co. NC Super. Ct. 2007) *available at* ERLINK"http://taxprof.typepad.com/taxprof_blog/2008/01/wal-mart-loses.html"http://taxprof.typepad.com/taxprof_blog/2008/01/wal-mart-loses.html (follow Wal-Mart Stores, Inc. v. Hinton hyperlinks).

STRENGTHENING STATE DOG FIGHTING LAWS IN THE WAKE OF THE MICHAEL VICK CASE

by LOUIS ALFRED TROSCH, SR.*

I. INTRODUCTION

When they raided *Bad Newz Kennels*, "[o]fficers found equipment associated with dogfighting, blood stains on the walls of a room and a bloodstained carpet stashed on the property. They reportedly removed more than [sixty] dogs from the property," some badly injured, along with evidence that poor performing pit bulls were "executed by various methods, including hanging, drowning and/or slamming at least one dog's body into the ground." Another dog was electrocuted after losing a fight.[1] Grisly as this scene was, it is typical of what investigators find when they uncover organized dogfighting rings. In fact, "the reality of the dogfighting underworld is even worse than most people can imagine . . . and cruelty shrouds every aspect of the dog's life."[2] Not only is dogfighting far more vicious than the general public realizes, but it is also far more common. Once confined to isolated rural areas, dogfighting has spread to every corner of America. The Humane Society

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[1] Mark Maske, *Falcons' Vick Indicted in Dogfighting Case: Star QB Alleged to Have Been Highly Involved*, WASH. POST, July 18, 2007, at E1.

[2] Tom Weir, *Vick Case Sheds Light on Dark World of Dogfighting*, USA TODAY, July 18, 2007, at C1.

estimates that at least 40,000 so-called "dogmen" operate in high-stakes organized rings, while another 100,000 engage in crude street fights.[3] As the dogfighting underworld exploded over the past twenty years, many ordinary citizens, however, remained blissfully unaware of the growing menace.[4] In public perception dogfighting was a cruel remnant of less civilized times, gradually falling out of favor in modern society.[5] Lawmakers and law enforcers, alike, shared this view. As a result, they often ignored animal advocates' pleas for stiffer penalties and tougher enforcement.[6] Dogfighting's growth, therefore, went virtually unchecked for decades.

Bad Newz Kennels changed everything. The specifics of the operation were horrific, but nothing extraordinary for a dogfighting ring.[7] Its proprietorship, however, was something altogether different. NFL superstar Michael Vick owned *Bad Newz Kennels* and the property on which it operated.[8] Suddenly, dogfighting had a universally

[3] Humanesociety.org, *Dogfighting Fact Sheet*, http://www.hsus.org/acf/fighting/dogfight/dogfighting_fact_sheet.html (last visited Mar. 7, 2008); *see* Nancy Lawson, *The Costs of Dogfighting,* ANIMAL SHELTERING, Nov.-Sept. 2007, at 34. Over 250,000 pit bulls, the dog of choice for "dogmen" and street level fighters alike, were involved in dog fights. Humanesociety.org, *supra*; *see* 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, 2879 (2006).

[4] Weir, *supra* note 2, at C2. Mark Plowden, a spokesman for the South Carolina Attorney General's task force of dogfighting, simply states, "People are just generally unfamiliar with the extent of the problem." *Id*.

[5] *Id*. "'Up until 10 or 15 years ago, this was pretty much an entirely rural activity,' [John] Goodwin, [a Humane Society dogfighting expert], 'Now, there's still a lot of dog fighters in the rural areas, but they've been kind of overtaken by an urban crowd.'" *Morning Edition: A History of Dogfighting* (NPR radio broadcast July 20, 2007), *available at* http://www.npr.org/templates/story/story.php?storyId=12104472.

[6] Traditionally, most animal protection laws are met with skepticism and ridicule. "[B]eware . . . [history] demonstrates too that anyone who advocates a positive change in legal doctrine affecting animals is likely to be laughed at. And it is no small matter that 'do-gooders' concern for animals, independent of the animals' usefulness to humans for entertainment or food, strikes many people as funny, outlandish, absurd, ridiculous. Ridicule hurts; it is the most acceptable idea killer." Daniel M. Warner, *Environmental Endgame: Destruction for Amusement and a Sustainable Civilization,* 9 S.C. ENVTL. L.J. 1, 36 (2000). Legislation aimed at ending dogfighting is no exception: "Animal rights activists say Virginia legislators reacted with skepticism, even jokes, when they tried in past years to advocate for harsher laws against animal fighting." Anita Kumar, *After Vick Case, Dogfighting Bills*, WASH. POST, Jan. 15, 2008, at B1, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2008/01/14/ AR2008011402419.html.

[7] Vick's case was a 'textbook example' of how investigators stumble upon dogfighting operations and the horrors they find within. Weir, *supra* note 2, at C1.

[8] Indictment, United States v. Michel Vick, No. 3:07CR274 (E.D. Va. July 17, 2007). Specifically, "[o]n or about June 29, 2001, VICK paid approximately $34,000 for the purchase of property located at 1915 Moonlight Road, Smithfield, Virginia. From this point forward, the defendants, aided and assisted by others known and unknown to the

recognizable face. The predictable media circus turned the spotlight on the dogfighting underground and "allegations against the NFL star forced mainstream America to confront the grisly image of canine death matches."[9] Tragically, Vick and his *Bad Newz Kennels* represented only the tip of the iceberg.[10] Organized dogfighting has become a half a billion dollar industry in its own right, with less structured street fighting adding countless millions spent in furtherance of this blood-sport.[11]

This underworld heavily contributes to many other vices; ranging from drugs, gambling, and guns to animal cruelty and violent crimes.[12] Just last year this author published an article linking dogfighting to the recent rise in vicious dog attacks.[13] Cumulatively, dogfighting and its associated societal ills demand immediate action. In the wake of Michael Vick's conviction lawmakers across the country have finally taken notice of the enormity of the problem.[14] States across the country are considering legislation to increase penalties for dogfighting.[15]

Grand Jury, used this property as the main staging area for housing and training the pit bulls involved in the dogfighting venture and hosting of dog fights." *Id.* at 4.

[9] Weir, *supra* note 2, at C1.

[10] *Id.; see* Humanesociety.org, *supra* note 3.

[11] Bill Burke, *Dogfighting Sees a Cultural Shift*, CHARLOTTE OBSERVER, June 29, 2007, at A21. High stakes gambling fuels dogfighting and organizers continue to find new avenues to increase betting. "The newest craze, is to broadcast fights on the Web, so people can bet on them offshore." *Id.; see also* Humanesociety.org, *supra* note 3 (describing the growing numbers of dogs involved in this 'industry' and the lengths to which dogfighting organizers go to avoid detection from law enforcement).

[12] *See infra*, notes 42-52 and accompanying text.

[13] Louis A. Trosch, Sr., *North Carolina's Vicious Dog Law is All Bark and No Bite*, Bus. L.J., Spring 2007, at 83. "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." *Id.* at 92.

My previous article's focus on North Carolina is similarly applicable to dogfighting. "'It's fair to say that North Carolina is a hotbed of activity in dogfighting," said Robert Reder, state director for the Humane Society. But knowing dogfighting occurs is one thing; prosecuting it is another. . . . [O]ften, authorities are left with battered dogs, fighting paraphernalia and hearsay. State legislators passed a felony dogfighting law in 1997. After a flurry of arrests over the next six years, the number of charges and convictions has dwindled." Nate DeGraff, *Dogfighting Hidden But State's a Hotbed*, GREENSBORO NEWS & REC., July 29, 2007, at B1.

[14] Dena Potter, *Vick Dogfighting Case Spurs Legislative Action*, CHARLOTTE OBSERVER, at A4.

[15] Nationwide, bills to increase criminal penalties for dogfighting are pending in 25 states. "The wave of legislative action this year follow the 2007 case against football star Michael Vick, who pleaded guilty to federal dogfighting charges." Humanesociety.org, *Animal Advocates Celebrate Historic Milestone: Dogfighting Now a Felony in All 50 States*, http://www.hsus.org/acf/news/pressrel/dogfighting_felony_in_50_states_ 030508 .html (last visited Mar. 9, 2008).

Furthermore, as of March 5, 2008, Wyoming became the fiftieth state to make participation in dogfighting a felony offense.[16]

Stiffer penalties are a cause for celebration and a critical component to ending dogfighting in this country.[17] At the same time, they are but part of an effective solution. After exploring the history and current state of dogfighting in the United States, this article will outline a three step approach to eradicate dogfighting. In addition to uniformly stiffer penalties for all associated activities, this author proposes closing legal loopholes that make prosecuting dogfighters difficult and implementing new enforcement strategies to infiltrate the secretive world of the dogmen. Together these steps hold the best hope for stopping this barbaric practice once and for all.

II. THE MODERN DOGFIGHTING SUB-CULTURE

Although the Michael Vick case thrust dogfighting into the national spotlight, it's hardly a new phenomenon. Professional dogmen simply went underground when legislators criminalized dogfighting. They have maintained a highly organized dogfighting underworld for over a century.[18] These organized rings are extremely profitable to the professional dogfighters.[19] They are also incredibly concealed. Utilizing clandestine journals, complicated networks of dogfighting enthusiasts, and, most recently, the internet, professional dogfighters cloak their "sport" in a veil of secrecy.[20] "Professional dogfighters are wealthy and experienced, often investing thousands of dollars on buying and training their dogs, and on transport to the fight venues. The fights are extremely well organized and difficult for law enforcement to find. Participants and spectators are often not told where the venues are until

[16] "Wyoming Gov. Dave Freudenthal signed a bill yesterday that made the cruel blood sport of dogfighting a felony crime—the 50th state to enact such a law. . . . Wyoming's action follows the signing of a similar felony law in Idaho on Feb. 25." *Id.*

[17] *Id.*

[18] Hanna Gibson, *Animal Legal & Hist. Ctr., Dog Fighting Detailed Discussion* 5 (2005), http://www.animallaw.info/articles/ddusdogfighting.htm. "Although dogfighting had become illegal in most states by the 1860's [sic], it continued to flourish as an American pastime through the early twentieth century." It has continued to thrive in the intervening years as an underground activity largely ignored by the general public and law enforcement. *Id.*

[19] *See supra* notes 3-11 and accompanying text. Many professional dogfighters in organized rings earn tens of thousands of dollars through gambling and breeding their animals. Lawson, *supra* note 3, at 37. A pit bull in its prime can be sold for $10,000 or more. Paul Duggan, *A Blood Sport Is Exposed in Court: Vick Case Sheds Light on Underground Dogfighting,* CHARLOTTE OBSERVER, Aug. 26, 2007, at A23.

[20] "Investigators say high-level dogfighting rings are harder to infiltrate than drug cartels." *Morning Edition*, *supra* note 5.

moments before the fight."[21] Historically, many dogfighting rings have been rooted in small towns and rural areas, where they become part of local tradition and culture.[22] Because of the remote locations and secretive nature of these professional dogfighting rings, they remained out of sight and mind of the general public and law enforcers for decades.

Everything changed in the last twenty years, as dogfighting's popularity rose across the country.[23] "Once a clandestine activity confined to rural areas of the South, it has spread to inner cities after being embraced as a macho symbol of urban hip-hop culture."[24] First used for protection by gang members and drug dealers, pit bulls became inexorably linked with inner city toughness.[25] In turn, pop culture icons, including rappers, advertisers, and professional athletes, embraced pit bulls and dogfighting as part of their rebel image.[26] Now, fighting dogs are necessary accessories for anyone wanting to demonstrate "street credibility". Dogfighting's latest urban vogue has led to an explosion of less organized street fights staged by adults and children alike.[27] "The figures [100,000 street fighters] seem impossibly high—until you see battle-scarred pit bulls cruising the streets of cities across America at the heels of kids young enough to be in grade school."[28]

A. Animal Cruelty

Regardless of where the dogfights take place or who stages them, the resulting damage is staggering. The dogs themselves suffer immeasur-

[21] Gibson, *supra* note 18, at 6.

[22] "In small towns where dogfighting is a tradition, [Rebecca] Corenfield [an animal control officer outside of Houston] says top trainers and breeders are established members of the community." *Morning Edition, supra* note 5.

[23] Jamey Medlin, Comment, *Pit Bull Bans and the Human Factors Affecting Canine Behavior*, DEPAUL L. REV. 1285, 1299-1302 (2007) (describing the brutal reality of a typical dogfight and the suffering imposed upon the fighting dogs). "It is an epidemic . . . ." Lawson, *supra* note 3, at 37.

[24] Lawson, *supra* note 3, at 34.

[25] Gibson, *supra* note 18, at 6.

[26] "Certainly, the glorification of dogfighting in the media and its endorsement by high-profile celebrites only exacerbate the problem. Rap stars glorify dogfighting in their videos. Similarly, Nike advertisements have featured images of snarling and fighting pit bulls." Medlin, *supra* note 23, at 1302.

Michael Vick was neither the only nor the first professional athlete involved in dogfighting. "For example, Qyntel Woods of the Portland Trailblazers was found guilty of animal abuse after his dog was found abandoned in Portland, with wounds that appeared to be from dogfighting." *Id.; see also Morning Edition*, *supra* note 5 (blaming dogfighting's latest vogue on pop culture icons, who glorify and embrace it).

[27] Medlin, *supra* note 23, at 1301. "Dogs that fall into the hands of street fighters are subjected to severe abuse and mistreatment. Even more alarming is that children as young as eight are subjecting their own dogs to street fights." *Id.*

[28] Lawson, *supra* note 3, at 37.

ably. "The abuse that the dogs endure—both in and out of the ring—is so gruesome that even seasoned investigators are consistently shocked by the barbarities they discover at raids."[29] Essentially, fighting dogs suffer lives that are nasty, brutish, and short.[30] Of course, these dogs are created through selective breeding for aggression and fighting skill.[31] The dogs that end up battling in the pits are, therefore, the pick of the litter. Pit bulls that fail to display sought after traits necessary for combat, unnatural strength, aggression, tenacity, gameness, and unflinching obedience to their human masters' commands,[32] are either

[29] Gibson, *supra* note 18, at 7. The pain that the animals suffer in the ring is overwhelming:

> His face is a mass of deep cuts, as are his shoulders and neck. Both of his front legs have been broken, but Billy Bear isn't ready to quit. At the referee's signal, his master releases him, and unable to support himself on his front legs, he slides on his chest across the blood and urine stained carpet, propelled by his good hind legs, toward the opponent who rushes to meet him. Driven by instinct, intensive training and love for the owner who has brought him to this moment, Billy Bear drives himself painfully into the other dog's charge . . . Less than 20 minutes later, rendered useless by the other dog, Billy Bear lies spent beside his master, his stomach constricted with pain. He turns his head back toward the ring, his eyes glazed (sic) searching for a last look at the other dog as he receives a bullet in his brain.

Id. (quoting C.M. Brown, *Pit*, ATLANTA MAG., 1982, at 66). Equally cruel is the way that animals are treated between fights, "the way dogs are maintained, kept out in the mud on a short chain, a lifetime of that. To me, that's crueler than the fighting." Weir, *supra* note 2, at C1.

[30] "The average life span of the fighting dog is very, very short. For most fighters, the dogs are considered disposable, a fact that is painfully obvious when the fights are over and everyone has left the crime scene. Inevitably, the mutilated carcasses of the losers of the evening's match will be left behind." Gibson, *supra* note 18, at 7.

[31] J.P. SCOTT & JOHN L. FULLER, GENETICS AND THE SOCIAL BEHAVIOR OF THE DOG, 25 (1965). Humans have practiced selective breeding for over a thousand years. "The Chinese *Book of* Rites (A.D. 800) mentioned three classes of dog [breeds]: hunting dogs, watch dogs, and food dogs. By A.D. 1,000, another category had been added—that of pampered pet." MARK DERR, DOG'S BEST FRIEND: ANNALS OF THE DOG-HUMAN RELATIONSHIP 43 (1997), *quoted in* Trosch, *supra* note 13, at 90 n.56. The evolution of fighting dogs followed this same selective breeding process from the Romans forward. *See* Monica Villavicencio, *A History of Dogfighting*, NPR, July 19, 2007, http://www.npr.org/templates/story/story.php?storyID=12104472.

[32] Hussain, *supra* note 3, at 2853. Pit bull is a generic term for three related dog breeds, the American Staffordshire Terrier, the Staffordshire Bull Terrier, and the Bull Terrier. DERR, *supra* note 31, at 131-32. These breeds were originally created by combining bull-baiting dogs and aggressive terriers. DAWN M. CAPP, AMERICAN PIT BULL TERRIERS: FACT OR FICTION 9 (2004). The resulting "pit bulls" were meant to combine strength, fearlessness, brutal aggressiveness, tenacity, and agility. DERR, *supra* note 31, at 134.

destroyed, used as bait dogs, or abandoned.[33] Irresponsible breeding practices only exacerbate the problem further, creating sickly dogs along with other increasingly vicious but unstable dogs.[34] The unchecked quest to feed the dogfighting industry with bigger, stronger, more aggressive dogs has also resulted in a severe dog overpopulation crisis.[35]

Our nation's animal shelters are bursting at the seams with abandoned pit bulls. In 1999, for example, Philadelphia animal control officers found over 4,000 pit bulls abandoned in streets and alleys.[36] Nationwide, pit bulls make up at least one third of all dogs being cared for in animal shelters.[37] The costs for housing these dogs are staggering.[38] Nationwide animal shelters, supported by local taxpayers and private donors, spend tens of millions every year caring for abandoned pit bulls.[39] While the enormous financial costs are troubling, the ongoing suffering of the rescued dogs is heartbreaking. Because the dogs must be kept separate at all times to avoid savage attacks, they live completely isolated existences. "The greatest cost is to the animals themselves. Though shelter workers provide exercise and toys, dogs living in solitary conditions eventually deteriorate. . . . Their immune systems are compromised, their muscles atrophy, and they often develop lick granulomas—a condition [likened] to bed sores."[40] Ultimately, an estimated three million of these abandoned pit bulls are euthanized each year.[41]

B. Vicious Dogs and the Dog Bite Epidemic

Beyond the direct suffering of the animals, dogfighting is a scourge upon our entire society. Over the last twenty years the number of

[33] Medlin, *supra* note 23, at 1305. Michael Vick pled guilty in part to participating in the destruction by hanging, electrocuting, and drowning of dogs that failed to demonstrate the desired traits for fighting dogs. *See supra* notes 1-2 and accompanying text.

[34] Julie Richard, *Dangerous Breeds?*, BEST FRIENDS, Sept.-Oct. 2004, at 12, 15.

[35] KAREN DELISE, FATAL DOG ATTACKS: THE STORIES BEHIND THE STATISTICS 53 (2002); *see* Medlin, *supra* note 23, at 1305-06.

[36] DELISE, *supra* note 35, at 86.

[37] *Id.* In some urban centers the percentage of pit bulls can reach as high as seventy percent. Lawson, *supra* note 3, at 35.

[38] "Last year, the Houston Humane Society in Texas spent $133,000 to care for pit bulls seized from a single property. Taxpayers in Franklin County have footed a nearly $520,000 bill to house dogfighting victims since 2002." Lawson, *supra* note 3, at 35.

[39] *Id.*

[40] *Id.* "'I really like pit bulls. They're wonderful dogs. They're very loyal; they have wonderful personalities,' [Animal Shelter Director, Mark Kumpf], says. 'But they are just being absolutely corrupted and destroyed by these people in the fighting industry, and then we in the shelter are left to care for them in a situation that turns them into victims a second time." *Id.* at 35-36.

[41] Medlin, *supra* note 23, at 1305-06.

severe dog attacks on human beings has reached crisis levels.[42] Last year I wrote an article in this journal detailing the staggering scope and severity of the problem.[43] Simply put, there has been a thirty-seven percent increase in non-fatal dog bites since 1986 and 800,000 of the estimated 4.5 million victims require medical attention.[44]

The link between these vicious attacks and dogfighting is inexorable. Unregulated and irresponsible breeders intentionally select for aggressive traits in fighting dog breeds, [45] most notably pit bulls.[46] Owners, whether they are dog-fighting enthusiasts, gang members, drug dealers, or "wanna-be" tough guys, further reinforce this aggression through "revolting and painful techniques used to bring the animals to the verge of bloodlust."[47] Wrapped in a sub-culture that glorifies violence and criminal enterprise, the dogfighting industry thus, results in ever more fearsome dogs that increasingly turn their aggression upon innocent bystanders.[48] Pit bulls have become the snarling, foaming face of this "dog bite epidemic."[49] What has happened over the last several decades, however, "says as much about the nature of American society

[42] *See* Kenneth M. Phillips, *Dog Bite Statistics*, http:11www.dogbitelw.com/PAGES/statistics.html (last visited Mar. 1, 2008).

[43] Trosch, *supra* note 13, at 88-92.

[44] *Compare* Jeffrey J. Sacks, Marcie-Jo Kresnow & Barbara Houston, *Dog Bites: How Big a Problem?*, 2 INJURY PREVENTION 52, 54 (1996) *and* Harold B. Weis, Deborah Friedman & Jeffrey H. Coben, *Incidence of Dog Bite Injuries Treated in Emergency Departments,* 279 JAMA 51, 53 (1998) *with* Daniel Sosin, et.al., *Causes of Nonfatal Injuries in the United States*, *1986*, 24:6 ACCIDENT ANALYSIS & PREVENTION 685, 686 (1992).

[45] *See infra* notes 54-59 and accompanying text.

[46] Early in this century the pit bull was considered America's dog. The Little Rascal's sidekick Pete was a pit bull. Theodore Roosevelt kept a pit bull in the White House and in the most famous comic strip of the era, Buster Brown's floppy eared pal was a pit bull. E.M. Swift, *The Pit Bull: Friend and Killer,* SPORTS ILLUSTRATED, July 27, 1987, at 72, 77. Once the dogfighting and the gang sub-culture glorified the pit bull as the ultimate killing machine and began breeding ever more vicious animals, "the pit bull's wholesome image as an all American dog was tarnished beyond repair." Trosch, *supra* note 13, at 89.

[47] Larry Cunningham, *The Case Against Dog Breed Discrimination by Homeowners' Insurance Companies,* 11 CONN. INS. L.J. 1, 36 (2004).

[48] "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." Trosch, *supra* note 13, at 84-92.

> [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.

Cunningham, *supra* note 47, at 35-36.

[49] Trosch, *supra* note 13, at 89.

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. . . ."[50]

C. Gambling, Guns and Drugs

A whole host of other vices are closely connected with the dogfighting underworld. Most notably, gambling is the financial engine that under girds the entire enterprise.[51] Spectators pay an entry fee for the event, usually $100 per person, and then gamble upon the fights.[52] Both participants and spectators wager excessive amounts and it is not uncommon for tens of thousands of dollars to change hands during the course of an evening.[53] The winners of the fights also earn their owners purses ranging from several hundred dollars to upwards of $50,000 or more.[54] Gambling, of course, increases the threat of violence among spectators, as winners attempt to collect their money from losers.

Given the overwhelming popularity of dogfighting among gang members, drug dealers, and other violent criminals, it is no surprise that drugs and guns can be found in large quantities throughout the dogfighting underworld. "During the twenty something raids he has conducted in the last three years [Dogfighting Lead Investigator] Mack Dickinson says, 'We've seized AK-47s, explosive devices, a kilo of crack. The drugs and weapons associated with this sport are unbelievable."[55] Criminals also utilize the dogs outside the fighting rings to further a variety of other criminal activities. Drug dealers force the dogs to guard their wares.[56] Gang leaders use them for security and to intimidate

[50] Swift, *supra* note 46, at 74. Many cities and states have recently attempted to solve the dog bite crisis by banning pit bulls and other aggressive dog breeds. *See, e.g.,* OHIO REV. CODE ANN. 955.11 (2006) (defining all pit bulls as vicious dogs and inherently dangerous). These well meaning attempts to curb dog attacks are largely ineffective for a variety of reasons. Most centrally, banning one breed simply results in irresponsible owners switching their attention to a different breed of dog. "What the proponents of bans of specific breeds fail to recognize is that a given breed is incidental to the cruder human impulse it is 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." David Burstein, *Breed Specific Legislation: Unfair Prejudice and Ineffective Policy*, 10 ANIMAL L. 313, 324 (2004). The bottom line is that the vicious dog problem is one caused by human behavior rather than our dogs.

[51] Humanesociety.org, *supra* note 3.

[52] Lester Munson, *Federal Involvement is Not Good news for Vick*, ESPN.com, June 15, 2007, http://sports.espn.go.com/espn/print?id=2905920&type=story.

[53] Gibson, *supra* note 18, at 7.

[54] *Id.*

[55] Weir, *supra* note 2, at C1.

[56] "Drugs are often stashed in container to which the dogs are chained in yards or vacant fields. The dogs also provide excellent security inside drug houses and warehouses." Gibson, *supra* note 18, at 7.

rivals. Many criminals keep the dogs as loaded weapons to attack anyone crossing them or their illegal businesses.[57]

At the dogfights drugs, guns, gambling, and hard core criminals combine to create a lethal mix. Hanna Gibson describes the violent atmosphere in the arena during the scheduled dog fights:

> The fights themselves are generally of the depraved carnival variety, set in remote barns or warehouses. Refreshments, entertainment, and gambling provide a backdrop for the bloody main event. Drug dealers distribute their illicit merchandise, wagers are made, weapons are concealed, and the dogs mutilate each other in a bloody frenzy as crowds cheer on. The gambling that is inherent at dog fights amplifies the already violent atmosphere. Violence often erupts among the usually armed gamblers, as debts must be collected and paid. . . .
> . . . .
> Dogfighting is an insidious underground organized crime and all dog fighters, regardless of their level embrace many peripheral crimes and gang activities including drug dealing and consumption, gambling, theft, and violence against humans. Dogfighting is an incredible source of income for gangs and drug traffickers.[58]

D. A Culture of Violence

Perhaps the most insidious impact of the dogfighting underworld is the role it plays in coarsening our entire culture. Certainly, those exposed to dogfighting become desensitized to many forms of violence. Studies, for example, of children regularly witnessing dogfights demonstrate a corresponding failure to appreciate animal abuse.[59] Tragically, too many children attend dog fights and/or emulate the dogfighting culture by staging their own crude street fights.[60] These children view cruelty towards animals as simply normal behavior.[61] Over time they not only accept this animal cruelty, but embrace it.

[57] Recently, many criminals are debarking the dogs by severing their vocal chords. The dogs then "act as silent alarm and attack systems against unsuspecting invaders. The presence of the silent killers poses a significant threat to law enforcement personnel entering these premises." *Id.*

[58] *Id.*

[59] Medlin, *supra* note 23, at 1301-02.

[60] "At some raids where spectators have fled into the woods as police invaded, abandoned toddler-sized chairs and nearby milk and cookies suggest some people consider dogfighting family entertainment." Weir, *supra* note 2, at C1. Not only do children attend dogfights, but investigators note that children as young as eight stage streetfights with their own dogs. Medlin, *supra* note 23, at 1301.

[61] A Chicago Police Sergeant reported that he has seen children snap a puppy's neck and on another occasion a fifth grader told him about a dogfight where "the losing dog urinated and defecated upon itself before it died, he was the only one in the crowd who did not explode with laughter." Medlin, *supra* note 23, at n179.

Children are not the only ones negatively impacted by dogfighting. Anyone repeatedly witnessing animal cruelty numbs to violence of all kinds.[62] Violence towards other living beings is cyclical in nature, one form of abuse leading inevitably to another. Frequently, witnessing and then participating in animal abuse is the first step into this violent cycle. Kara Gerwin noted studies that correlate how abusing animals often leads to the abuse of fellow human beings:

> Numerous studies have shown that those who abuse animals are currently or will soon become violent towards other humans. Adults who abuse animals are often abusing their spouses, their children, or elderly people for whom they are caring. Children who grow up in households where they encounter animals being abused are likely being abused themselves or are witnessing the abuse of a sibling or a parent. Children who act violently towards animals are often doing so because they are being abused, and they often turn their abuse towards human victims later in life.[63]

Unchecked violence towards animals, therefore, begets violence towards humans. The sadistic world of dogfighting epitomizes this concept and leads to brutality in many forms.[64] "[T]he children that grow up exposed to it are conditioned to believe that the violence is normal; they are systematically desensitized to the suffering, and ultimately become criminalized. Dog fighters [themselves] are violent criminals that engage in a whole host of peripheral criminal activities."[65] Allowing dogfighting to continue coarsens our entire society. Not only have we allowed dogfighting, animal abuse, and the related criminal activities to become deeply ingrained in American society, but our pop icons have glorified these activities in their songs, music videos, advertisements, and lifestyle.[66] Mahatma Gandhi once said, "The greatness of a nation and its moral progress can be judged by the way its animals are treated."[67] Until the stain of dogfighting is removed once and for all, our culture faces a harsh judgment.

[62] The link between animal cruelty and domestic violence is strong and borne out by research. Warner, *supra* note 6, at 48-50

[63] Kara Gerwin, *There's (Almost) No Place Like Home: Kansas Remains in the Minority on Protecting Animals from Cruelty,* 15 KAN. J.L. & PUB. POL'Y 125, 125 (2005).

[64] *See* Gibson, *supra* note 18, at 10-11 (listing thirty crimes typically associated with dogfighting).

[65] *Id.* at 2.

[66] *See supra* notes 47-51 and accompanying text.

[67] Gerwin, *supra* note 63, at 124. Other philosophers ranging from John Locke to Immanel Kant and Tomas Aquinis have made similar pronouncements. Warner, *supra* note 6, at 43-44.

III. MICHAEL VICK'S PROSECUTION AND ITS AFTERMATH

On August 27, 2007 Michael Vick formally pled guilty in the Federal Courthouse in Richmond, Virginia to violations of the Animal Welfare Act,[68] specifically that he conspired to travel in Interstate Commerce in Aid of Unlawful Activities and to Sponsor a Dog in an Animal Fighting Venture.[69] Vick admitted that he funded the dogfighting operation known as *Bad Newz Kennels* and the gambling associated with it. He also admitted that he was complicit in the killing of poorly performing dogs.[70] Less than six months later on December 10, 2007, Vick, after turning himself into authorities, appeared in the same courthouse before U.S. District Court Judge Henry E. Husdon for sentencing.[71] Dressed in a black-and-white prison uniform, Vick apologized to the Court, his family, and fans for his actions, reiterated his new-found understanding that dog fighting is a terrible practice, and indicated his readiness to accept the consequences for his actions.[72] Judge Hudson sentenced Vick to twenty-three months in federal prison, fined him $5,000, and ordered him to pay almost a million dollars for the care of the forty-seven pit bulls seized from his property.[73] Vick will also spend three years on post release supervision following his release from prison.[74]

Had he been indicted only two months before July, 2007, Michael Vick would have faced far less severe consequences. Until President Bush signed the Animal Fighting Prohibition Enforcement Act (AFPEA) on May 3, 2007, using the interstate commerce to further an animal

[68] Specifically, the Animal Welfare Act was supplemented by the Animal Fighting Prohibition Enforcement Act of 2007, which amended Title 7 section 2156 of the United States Code and added section 49 to Title 18. 7 U.S.C.S. § 2156; 18 U.S.C.S. § 49 (LexisNexis 2008).

[69] Plea Agreement, United States v. Michel Vick, No. 3:07CR274, at 1 (E.D. Va. August 24, 2007).

[70] Statement of Facts, United States v. Michael Vick, No. 3:07CR274, at 1, 5 (E.D. Va. August 24, 2007). "VICK agrees that the 'Bad News Kennels' business enterprise involved gambling activitites in violation of the laws of the Commonwealth of Virginia as set forth in the indictment. In general, only those accompanying the opposing kennels and 'Bad Newz Kennels' associates were allowed to attend the fights. For a particular dog fight, the opponents would establish a purse or wager for the winning side, ranging from the 100's up to 1,000's of dollars." *Id.* at 3.

While he admitted to providing the money for his co-conspirators to use in gambling, Vick denied gambling himself. *Id.* at 4. Many have speculated that this denial was connected to the N.F.L.'s strict policies against gambling, for which Vick could have received a lifetime ban. Michael S. Schmidt, *Vick Pleads Guilty in Dog-Fighting Case*, N.Y. TIMES, August 27, 2007, at C1.

[71] *See* Juliet Macur, *Vick Receives 23 Months and a Lecture*, N.Y. TIMES, Dec. 11, 2007, at D1.

[72] *Id.*

[73] *Id.*

[74] *Id.*

fighting enterprise was merely a misdemeanor offense.[75] The minor penalties under the former law discouraged federal prosecutors from pursuing any type of animal fighting ring.[76] Since 1976, only a handful of convictions had occurred and the penalties were little deterrent to dogmen, who make huge profits transporting fighting dogs across state lines to customers across the country.[77] The lack of significant federal penalties also enabled dogfighting organizations to easily move from state to state in order to avoid prosecution in jurisdictions with severe penalties for dogfighting. [78] Animal advocates tirelessly lobbied for years to put some teeth into the federal anti-animal fighting laws.[79] With passage of the AFPEA, each violation of federal law may result in up to three years in jail and a $250,000 fine.[80] Prohibited conduct

[75] The former penalties were as follows: "Any person who violates subsection (a), (b), or (c) shall be fined not more than $15,000 or improsioned for not more than 1 year, or both, for each such violation." 7 U.S.C.A. § 2156(e) (2006).

[76] Though this article has focused upon dogfighting, illegal cockfighting is also an enormous problem in the United States.

> Cockfighting is an activity where two or more roosters are placed in a pit and baited to fight each other to the death as spectators watch and place bets on the outcome. To ensure a brutal match, cockfighters breed roosters for aggression, drug them with stimulants to increase aggression levels, and attach knives or gaffs to their legs.

Laurie Fulkerson, Note, *2001 Legislative Review*, 8 ANIMAL L. 259, 263-64 (2002). The lives of the fighting roosters are no less cruel than their canine counterparts. They frequently suffer gouged eyes, punctured lungs, and broken limbs. *Id.* The AFPEA prohibits using interstate commerce to promote cockfighting, except in states where it is legal. 7 U.S.C.S. § 2156(g)(5) (LexisNexis 2008). Unfortunately, cockfighting remains legal in Louisiana, despite ongoing pressure to outlaw it. In many other states it remains a misdemeanor offense and perpetrators are unfazed by the minimal penalties they face on the rare occasions they are successfully prosecuted. Rahul Kukreti, Note, *2005-2006 Legislative Review,* 12 ANIMAL L. 277, 286-87 (2006).

[77] Press Release, The Humane Society of the United States, Fact Sheet: Support H.R. 137/S. 261—The Animal Fighting Prohibition Enforcement Act (April 1, 2007) (on file with author).

[78] Humanesociety.org, *The President Signs Landmark Animal Fighting Legislation*, May 3, 2007 http://www.hsus.org/legislation_laws/federal_legislation.html. For example, South Carolina's dogfighters simply moved across state lines when South Carolina began aggressively investigating and prosecuting dogfighting operations. Bill Burke, *Dogfighting Sees a Cultural Shift: N.C. Is Dogfighting Central?,* CHARLOTTE OBSERVER, June 29, 2007, at A21.

[79] In addition to the many arguments documented throughout this article, proponents of the AFPEA argued that unchecked animal fighting significantly increased the possibility of a global avian flu pandemic. "In 2004, the World Health Organization linked the spread of avian flu to cockfighting and claimed that as many as eight confirmed human avian flu cases may have been caused by participation in the sport." Kukreti, *supra* note 76, at 286. Furthermore, the transporting of birds across state lines and from other countries, which occurs regularly in cockfighting rings, increases the likelihood that avian flu will spread into the United States. *Id.* at 287.

[80] 18 U.S.C.S. § 49 (LexisNexis 2008).

includes importing and exporting fighting animals, implements, and using interstate commerce to further animal fighting activities.[81] Michael Vick and his co-defendants were among the first prosecuted under this new statute. Their stiff sentences sent a strong message.

From football superstar to federal inmate, it was a stunning fall from grace for Michael Vick.[82] In a five page pre-sentencing letter to the court, Vick apologized for his actions and explained, "he grew up exposed to 'numerous illegal activities' and saw people arrested for guns and drugs, but never for dogfighting. 'No one really cared or called the police so I grew up not knowing the severity of the crime.'"[83] These words, more than any others, demonstrate Vick's similarities with people who become desensitized to the immorality of dogfighting.[84] In the world in which Michael Vick was raised, dogs fighting to the death ceased to be seen as cruel and inhumane.[85] On the streets dogfighting was just an every day part of life.

[81] 7 U.S.C.S. §2156 (LexisNexis 2008).

[82] Vick initially denied his involvement in the dogfighting ring before his co-defendants cooperated with federal investigators and further implicated Vick. In part, this led to Vick being more severely punished than his co-defendants, whose sentences ranged from eighteen to twenty-one months. *Id.*

In addition to the federal criminal penalties Vick continues to face the specter of state prosecution for his actions, though any state penalty will likely run concurrent with his federal sentence. D. Orlando Ledbetter, *Vick May Get Second Chance in NFL*, ATLANTA J. CONST., Dec. 11, 2007, at 1C. More damaging will be the financial losses that Vick is likely to incur. Vick stands to lose a total of $141 in income as a result of his conviction: $71 million in salary, $20 million in previously paid bonuses, and an estimated $50 million in endorsement income. Dan Pompei, *Persona Non Grata? Not in the NFL: Michael Vick Will Find Spot in Forgiving League After Stint in Prison*, CHI. TRIB., Dec. 11, 2007. A federal judge, however, has ordered that Vick can keep $16.5 million of the bonus money that has already been paid to him. The NFL has appealed the decision. White v. NFL, No. 4-92-906(DSD), 2007 U.S. Dist. LEXIS 8140, at 22 (D. Minn. filed Feb. 4, 2008).

[83] Jim Nolan, *Vick, George Foreman, Others Pleaded for Leniency in Letters,* RICHMOND TIMES, Dec. 14, 2007, at B1.

[84] *See supra* notes 83-91 and accompanying text.

[85] The Michael Vick case, not only raised public awareness of cruelty to animals and dogfighting, but it also raised sensitive issues of race and class. "The differences between those sporting Michael Vick jerseys and those urging his swift conviction on dogfighting is glaring: Vick's supporters are mostly black; his critics are mostly white." Dionne Walker, *Michael Vick Dogfighting Case Opens Racial Divide*, NWI.com, Aug. 4, 2007, at 1, http://nwitimes.com/articles/2007/08/04/sports/pro_sports.

Many African-Americans argued that Michael Vick was being severely punished in large part, because of his race and celebrity, rather than for his dogfighting activities. Comedian Jamie Foxx states, "It's a cultural thing, I think. Most brothers didn't know that, you know. I used to see dogs fighting in the neighborhood all the time. I didn't know that was Fed time. So, Mike probably just didn't read his handbook on what not to do as a black star." Tony Zizza, *Take Race Out of the Michael Vick Dogfighting Case,* MAGIC CITY MORNING STAR, Aug. 26, 2007, at 1, *available at* http://www.magic-city-news.com/Tony-Zizza.

Meanwhile, most other Americans simply pretended that dogfighting no longer existed in this country.[86] Against this cultural ignorance and apathy, a small group of advocates have dedicated themselves to ending dogfighting forever through education and legislation.[87] Perhaps, the silver lining in the Michael Vick tragedy is that Americans from all walks of life had to recognize both that dogfighting exists and that it is morally repugnant.[88] The spotlight is shining upon the dogfighting underworld and Americans do not like what they see.[89] The resulting pressure on lawmakers has finally spurred them into action.[90] At least twenty five state legislatures will consider strengthening dogfighting laws this year alone.[91] While stiffer penalties for dogfighting activities are a step in the right direction, they are but a step. Three major obstacles continue to stand in the way of eradicating dogfighting. Dogfighting penalties remain hopelessly inconsistent from state to state; legal loopholes make prosecuting dogmen extremely difficult, and enforcement methods are under funded

[86] *See supra* notes 4-11 and accompanying text.

[87] From increasing debate and challenges over non-economic damages for injury to pets to force-feeding geese so their livers become diseased and subsequently fatty for the delicacy foie gras; from shutting down slaughterhouses sending horse meat to cultures not sharing America's equine sentimentalities to trying to ban elephants from circuses, animal law advocates have developed the bite and tenacity of a pack of pit bulls—a breed they're quick to claim has been unfairly profiled.

Terry Carter, *Beast Practices: High-Profile Cases Are Putting Plenty of Bite into the Lively Field of Animal Law*, A.B.A.J., Nov. 2007, at 39. Some animal rights advocates are even pushing for a change in the basic legal tenets treating animals as property. *Id.*

[88] "The public's perceptions [over animal cruelty issues], for example, became more sharply focused after: . . . [s]aturation news coverage detailed the investigation, indictment and slow-motion lead-up to a guilty plea for football star Michael Vick over his illegal dogfighting hobby." *Id.*

[89] *See supra* notes 7-16 and accompanying text.

[90] "Animal Advocates around the nation hope that public outrage over dogfighting and puppy mill scandals in Virginia will force state and federal lawmakers to pass tougher animal abuse laws." Potter, *supra* note 14, at A4.

[91] Most of these bills increase penalties for participating in dogfighting, breeding and/or training fighting dogs, and possessing implements of dogfighting. *See supra* notes 15-16 and accompanying text; *see also* Gibson, *supra* note18, at 3 (describing a variety of training devices used to develop the dogs' gameness). Courts have also taken notice of the broader implications of the Vick prosecution.

> The guilty pleas recently entered into by Michael Vick and his cohorts for their barbarous acts serve as a grim reminder that a humane nation considers cruelty to animals so abhorrent that it criminalizes such conduct. The silver lining in that sordid affair has been the expression by many Americans that the inherent decency of a people must embracer the kindly treatment of pets.

184 W. 10th St. Corp. vs. Marvits, 18 Misc. 3d 46, 50, N.Y. LEXIS 7672, *8 (decided Nov. 20, 2007) (McKeon, J., concurring).

and poorly executed. Until these obstacles are removed, the ugly reality of canine gladiators fighting to the death will continue unabated.

IV. UNIFORMLY STIFF PENALTIES FOR ALL DOGFIGHTING ACTIVITIES

A. An Inconsistent Legal Framework

Since the first state made dogfighting a felony in 1976, tremendous progress has occurred. All states now make staging, organizing, or participating in a dogfight a felony offense.[92] While the actual penalties range widely among the states, designating dogfighting a felony sends a strong message that this activity is abhorrent and will not be tolerated.[93] In addition, utilizing interstate commerce to further this pursuit is a felony offense under federal law.[94] Together the stiffer state and federal penalties form a solid first step in the war against dogmen. Previously, dogfighting rings set up shop and operated from the relative safety of a state where criminal penalties were minimal.[95] Because federal penalties were also minimal, they freely transported their fighting dogs across the nation. They also crossed state lines for big events, before slipping back to their home base, always one step ahead of law enforcement. [96] This freedom is no longer possible now that all states punish dogfighting as a felony[97] and the federal government forbids with heavy sanctions crossing state lines in furtherance of animal fighting enterprises.[98]

[92] *See supra* notes 14-17 and accompanying text.

[93] Fines range anywhere from $1,000 to $125,000 across the country and maximum jail sentences vary from ten months to ten years. Humanesociety.org, *Ranking of State Dogfighting Laws*, http://www.hsus.org/acf/fighting/dogfight/ranking_state_dogfighting_laws.html (last visited Mar. 4, 2008).

Furthermore, each state's truth in sentencing laws and parole procedures is unique, so the true range in sentences from jurisdiction to jurisdiction is difficult to determine. Richard S. Frase, *Theories and Policies Underlying Guideline Systems: State Sentencing Guidelines: Diversity, Consensus, and Unresolved Policy Issues,* 105 COLUM. L. REV. 1190, 1191 (2005). "State [sentencing] guidelines systems differ in their goals, scope of coverage, design, and operation." *Id.*

[94] "[I]t shall be unlawful for any person to knowingly sponsor or exhibit an animal in an animal fighting venture, if any animal in the venture was moved in interstate or foreign commerce." 7 U.S.C.S. § 2156(a)(1) (LexisNexis 2008).

[95] For example, Virginia's minimal cockfighting laws have made it a magnet for participants from neighboring states where the activity is a felony. Larry O'Dell, *Panel Endorses Animal Fighting Legislation*, ASSOCIATED PRESS, January 28, 2008, at 1. Similarly, North Carolina began to attract increased dogfighting activity after South Carolina began aggressively prosecuting dogfighting rings. North Carolina's simultaneous lax enforcement made it a haven. Burke, *supra* note 11, at A21.

[96] *See* Weir, *supra* note 2, at C1.

[97] *See infra* note 133 and accompanying text.

[98] *See Weir supra* note 2 at C2.

However, criminal dogfighting penalties across the country still are not uniform. Specifically, an examination of laws directed at activities associated with dogfighting reveals a crazy quilt of inconsistencies. Simply put, there are three main activities associated with dogfighting: (1) staging and/or participating in the actual fights; (2) possessing and/or training dogs for fighting; and (3) attending a dogfight as a spectator. While all states punish staging in a dogfight as a felony, they are all over the board regarding the other activities.[99] Organized dogfighters expertly maneuver through these inconsistent laws to thwart prosecution.

B. Uniform Punishments for All Activity Associated with Dogfighting

Seventeen states punish all three activities associated with dogfighting as felonies,[100] while four states still allow citizens to possess fighting dogs and/or to attend dogfights without recrimination.[101] The other twenty nine states fall somewhere in between. Thus, they criminalize all three activities, but utilize only misdemeanor penalties for possession and/or spectating. [102] Because of the secretive nature of the dogfighting underworld, it is extremely difficult to infiltrate a dogfighting ring to begin with.[103] When investigators succeed, but can not threaten everyone involved with a felony offense, the dogmen simply slip through their fingers.[104]

A comparison between Georgia and its neighbors Florida and South Carolina is instructive. All three states make participation in a dogfight a felony, but they diverge significantly for associated conduct.[105] South

[99] The Humane Society rates each state's dogfighting laws based on the treatment of each of these three categories. Humanesociety.org, *Ranking of State Dogfighting Laws*, *supra* note 93.

[100] These states, in rank order, include; New Jersey, Alabama, Colorado, Mississippi, Arizona, Ohio, North Carolina, Pennsylvania, New Hampshire, Nebraska, Washington, Connecticut, Florida, Vermont, Michigan, Rhode Island, and New Mexico. *Id.*

[101] Montana and Hawaii make it a felony to possess fighting dogs, but have no criminal penalties for spectators. Nevada, on the other hand, has misdemeanor penalties for attending a dogfight and legalizes possession of fighting dogs. Georgia, the bottom ranked state, allows both possession and spectating at dogfights. *Id.*

[102] *Id.*

[103] *See* Gibson, *supra* note18, at 12-13.

[104] Editorial, *Close Oregon's Dogfighting Loophole; Legislators Should Give Law Enforcement,* THE OREGONIAN, Jan. 16, 2008, at D10.

[105] *See* FLA. STAT. § 828.122 (LexisNexis 2007) (criminalizing the following, with felony sentences up to five years in prison and $5,000 fines, participating, staging, training, owning, promoting, and attending a dogfight); GA. CODE ANN. §16-12-37 (LexisNexis 2007) (defining dogfighting solely as "caus[ing] or allow[ing] a dog to fight another dog for sport or gaming purposes or maintain[ing] or operat[ing] any event at which dogs are allowed or encouraged to fight one another" and listing felony punishments ranging from one to five years in prison and up to $5,000 in fines); S.C. CODE ANN. § 16-27-30, 40 (LexisNexis

Carolina has felony penalties for possessing fighting dogs, but spectators at a dogfight face only a misdemeanor offense.[106] As a result, "police who raid a dogfight have an extremely difficult time figuring out who should be charged with felony violations and who should be charged with misdemeanors. That's the case because every violator at the bust claims to be there as a spectator."[107] Without the threat of felony prosecution it is also very difficult to convince spectators to testify against the fight organizers.[108] When given the choice between a minimal fine or probationary sentence and retribution from the dogmen, most spectators choose to stand silent.

Georgia does not criminalize either attending a dogfight as a spectator or knowingly possessing fighting dogs.[109] Thus, enforcement agents face even greater difficulties when they raid a dogfight in Georgia. No penalties for spectators, essentially means no prosecution for anyone at the dogfight. Furthermore, Georgia investigators have virtually no opportunity to successfully infiltrate dogfighting rings. Anyone accused of organizing or staging dogfights can avoid prosecution by claiming to be a fighting dog breeder. Lacking criminal penalties for possessing fighting dogs makes it impossible to prosecute dogfighters, unless investigators catch them in the act.[110] Of course, this too is impossible without criminal penalties for spectators.[111]

In Florida, law enforcers have a much easier time gathering evidence against dogfighting rings and then successfully prosecuting those responsible. While it is still difficult to penetrate the secretive underworld of the dogmen, Florida laws do not create additional hurdles and loopholes. All conduct associated with dogfighting is a felony

2007) (making possession and participation felony offenses punishable by fines up to $5,000 and prison sentences up to five years, while attendance at a dogfight is punished as a misdemeanor offense only).

[106] "Any person who: is present at any structure, facility, or location with knowledge that fighting or baiting of any animal is taking place or is about to take place there is guilty of a misdemeanor." S.C. CODE ANN § 16-27-40 (LexisNexis 2008). Upon a third conviction a spectator faces felony penalties equivalent to participating in dogfighting. *Id.*

[107] Editorial, *supra* note 104, at D10.

[108] *Id.*

[109] GA. CODE ANN. § 16-12-37 (LexisNexis 2008).

[110] Tami Santelli, *2004 Legislative Review,* 11 ANIMAL L. 325, 351-52 (2005).

[111] Led by State Senator Chip Rogers, who has sponsored dogfighting bills for four straight years, Georgia legislators are currently considering legislation to impose criminal penalties for both possessing fighting dogs and spectators. Lori Yount, *Legislature takes on Economic Challenges,* CHATTANOOGA TIMES FREE PRESS, Mar. 16, 2008, at NG3. It appears that public pressure following the Michael Vick prosecution has finally forced legislators to act. *Id.* "The Senate has passed the tougher penalties three times now, but it took a House bill this year that downgraded the crime of dogfight spectator from a felony to a misdemeanor to clear House members." *Id.*

offense.[112] "According to the Humane Society of the United States, states with stiffer penalties for dogfight spectators [and possessors] see significantly less such crime. . . . [P]rosecutors have a legal club they can use to get spectators to testify against those actually fighting their dogs."[113] Both prohibitions have consistently withstood Constitutional challenges.[114] Hence, the first step towards eradicating dogfighting is for

[112] Florida law includes all conduct associated with dogfighing within its criminal provisions:

> (2) As used in this section, the term:
>
> (a) "Animal fighting" means fighting between roosters or other birds or between dogs, bears, or other animals.
>
> (b) "Baiting" means to attack with violence, to provoke, or to harass an animal with one or more animals for the purpose of training an animal for, or to cause an animal to engage in, fights with or among other animals. In addition, "baiting" means the use of live animals in the training of racing greyhounds.
>
> (c) "Person" means every natural person, firm, copartnership, association, or corporation.
>
> (3) Any person who knowingly commits any of the following acts commits a felony of the third degree, punishable as provided in s. 775.082, s. 775.083, or s. 775.084:
>
> (a) Baiting, breeding, training, transporting, selling, owning, possessing, or using any wild or domestic animal for the purpose of animal fighting or baiting;
>
> (b) Owning, possessing, or selling equipment for use in any activity described in paragraph (a);
>
> (c) Owning, leasing, managing, operating, or having control of any property kept or used for any activity described in paragraph (a) or paragraph (b);
>
> (d) Promoting, staging, advertising, or charging any admission fee to a fight or baiting between two or more animals;
>
> (e) Performing any service or act to facilitate animal fighting or baiting, including, but not limited to, providing security, refereeing, or handling or transporting animals or being a stakeholder of any money wagered on animal fighting or baiting;
>
> (f) Removing or facilitating the removal of any animal impounded under this section from an agency where the animal is impounded or from a location designated by the court under subsection (4), subsection (5), or subsection (7), without the prior authorization of the court;
>
> (g) Betting or wagering any money or other valuable consideration on the fighting or baiting of animals; or
>
> (h) Attending the fighting or baiting of animals.

FLA. STAT. § 828.122 (LexisNexis 2008).

[113] Editorial, *supra* note 104, at D10.

[114] All statutes outlawing spectators have a scienter requirement that the defendants knowingly attend the dogfight. As a result, they have withstood both overbreadth and vagueness challenges. *See, e.g.,* Commonwealth v. Craven, 572 Pa. 431, 436, 817 A.2d 451, 454 (2003); State v. Arnold, 147 N.C. App. 670, 674-75, 557 S.E.2d 119, 123-24 (2001).

Likewise, statutes outlawing the possession of fighting dogs or fighting implements have consistently been upheld as Constitutional. *See, e.g.,* Ash v. State, 290 Ark. 278, 279, 718 S.W.2d 930, 931 (1986).

all fifty states to make all conduct associated with dogfighting a serious felony offense.[115]

V. EFFECTIVELY ENFORCING TOUGHER DOGFIGHTING LAWS

Once state legislatures put sufficient criminal penalties in place and remove legal loopholes, the task of eradicating dogfighting rings falls upon the shoulders of the criminal justice system. Because of the secretive nature of the dogfighting underground, law enforcement still must employ their best and most creative tactics to investigate and successfully prosecute dogmen.[116] Unfortunately, law enforcement efforts have remained woefully inadequate in many states.[117] Prosecutors and judges are little better, often refusing to take this crime seriously or punish it adequately.[118] Without more attention from law enforcement agencies, prosecutors, and judges, dogfighting will continue to thrive, regardless of the laws passed to deter it. Several states, even before Michael Vick's prosecution, have drastically revamped their approach to dogfighting in recent years with dramatic results.[119] Their strategies are effective and relatively simple to implement.

[115] Of course, some felony offenses are punished more severely than others. In general, most states penalize dogfighting at the lower end of the spectrum. In North Carolina, for example, felonies are categorized by classes from A to I, with class A offenses being the most serious and class I offenses being the least severely punished. N.C. GEN. STAT. § 15A-1340.17 (LexisNexis 2007). Dogfighting is currently a lower level class H felony. N.C. GEN. STAT. § 14-362.2 (LexisNexis 2007). Now that all states have established dogfighting as a felony, their next step should be to increase penalties to a minimum of two full years in prison and $10,000 in fines. *See supra* note 16.

[116] *See supra* notes 18-22 and accompanying text. Dogfighting rings are difficult to infiltrate. Organizers of dogfights frequently utilize the internet to surreptitiously change locations of fights and police radios to monitor law enforcement activity. Spectators have to show identification to gain entrance and armed guards are ever present. Evidence that will stand up in court is also difficult to gather. Medlin, *supra* note 23, at 1303.

[117] Many police officers simply throw their hands up when so much effort results in such meager results. *Id.*

[118] Imagine a many layered sifter, through which dogfighting cases must pass before severe criminal sanctions are meted out. At each level, the justice system wrongfully sifts out far too many defendants. First, Police do not aggressively pursue dogfighting rings, so many dogfighters never get investigated. Second, dogfighting rings are difficult to infiltrate and evidence is difficult to gather. Thus, even when police properly investigate, many dogmen slip away. Prosecutors have great difficulty proving criminal activity and focus their efforts on other crimes. More dogfighters avoid penalties at this stage. Finally, even when dogfighters are convicted, judges simply slap their wrists with minimal sentences. This fails to deter the dogmen and further discourages law enforcement agencies from pursuing dogfighting rings. *Id.*

[119] Efforts in Ohio and South Carolina stand out as particularly effective. *See infra* notes 124-31 and accompanying text.

A. Adequate Resources

First and foremost, law enforcement agencies must have adequate resources to successfully investigate dogfighting rings. No matter how comprehensive dogfighting laws are, "a lack of adequate funding can render it difficult to effectively enforce [those] laws."[120] Historically, efforts to enforce animal cruelty laws are "grossly under-budgeted and understaffed."[121] Funds to train enforcement agents on the specialized underworld of dogfighters are also nonexistent.[122] Understaffed, under trained, and under budgeted, law enforcement agencies are helpless to enforce dogfighting laws. Many states, especially since the Michael Vick prosecution, have recently provided more money to animal control agents.[123] The impact is undeniable. "Once helpless to do anything, [animal control officers] celebrate recent decisions to devote police manpower to dogfighting investigations as one of the best things to ever happen to animal control. . . . When law enforcement gets involved, dogfighters pay attention."[124]

Equally important as increased funding, a firm commitment from top state justice officials is critical to transforming law enforcement efforts. "Though hesitant to say so on record, some police and animal control officers handling animal abuse investigations have faced scorn from judges, prosecutors, and superiors."[125] To change this culture of skepticism in Ohio, Attorney General Marc Dann threw the entire weight of his office behind efforts to combat dogfighting.[126] In 2006 Mr. Dann initially led one of the largest and most successful dog fighting busts in United States history.[127] He continued to pour money into dogfighting investigations, created an anonymous TIPS hotline, and partnered with the Humane Society, the Ohio Sheriff's Association, and the Ohio Chiefs' of Police to offer a $5,000 reward for information leading to the conviction of anyone involved in illegal animal fighting. In addition, he has actively participated in public service announce-

[120] Hussain, *supra* note 3, at 2876.
[121] *Id.*
[122] *Id.*
[123] Lawson, *supra* note 3, at 36-37. Some states have provided money to provide rewards for information leading to arrests, others have provided training money, while still others have provided additional local funding to animal control agents along with special statewide task forces to oversee investigations of dogfighting rings. *Id.* at 35-39.
[124] *Id.*
[125] *Id.* at 36.
[126] *Ohio Attorney General Marc Dann, The Humane Society of the United States Announce New Animal Fighting Reward Program*, US STATES NEWS, Nov. 7, 2007, *available at* http://www.lexis.com.
[127] *Id.*

ments about the horrors of dogfighting.[128] Not only was Attorney General Dann honored by the Humane Society as the Law Enforcer of the Year in 2007, but his efforts have demonstrated to law enforcement and the general public that dogfighting will no longer be tolerated in Ohio.

B. Task Forces

Similar to Ohio, South Carolina has renewed anti-dogfighting efforts since 2003, when the Society for the Prevention of the Cruelty to Animals (SPCA) made a presentation to Attorney General Henry McMaster.[129] In response he formed a statewide task force to combat dogfighting. The task force leads raids on dogfighting operations, coordinates law enforcement efforts across the Palmetto State, and trains local officers on improved investigation techniques.[130]

The end goal is to drive dogfighting out of South Carolina. The message to dogfighters is clear, "[w]e don't want that type of barbaric activity going on in South Carolina."[131] The results speak for themselves.[132] Raids are now commonplace, as are convictions and hefty sentences.[133] As a result, dogfighters are leaving South Carolina in droves, headed to states less committed to enforcing dogfighting laws.[134] Other states have implemented task forces with similar success.[135] Absent coordination, law enforcement agencies are fragmented and less effective.

C. Public Education and Rewards

Even when law enforcement efforts are effectively coordinated, apprehending dogmen requires information from ordinary citizens. Dogfighting rings remain clandestine and extremely difficult to

[128] *Id.*

[129] Weir, *supra* note 2, at C2.

[130] *Id.*

[131] Burke, *supra* note 11, at A21.

[132] Since 2003, the Attorney General's Office has prosecuted well over twenty cases, with more in the pipeline awaiting trial. Duggan, *supra* note 19, at A23. "The granddaddy of all dogfighting cases, in terms of punishment, was prosecuted in South Carolina three years ago. there, as in other states, the maximum prison term for one count is five years. A breeder named David Ray Tant, then 57, pleaded guilty to 41 counts—and was sentenced to 30 years." *Id.*

[133] Prior to the SPCA presentation, state officials, like the general public, "'were just generally unfamiliar with the extent of the problem,'" [Attorney General spokesman] Mark Plowden says. Weir, *supra* note 2, at C2.

[134] Burke, *supra* note 11, at A21. Neighbors North Carolina, which has tough laws but lax enforcement, and Georgia, which has the weakest dogfighting laws in the country, have absorbed most of the exodus from South Carolina. *Id.*

[135] Lawson, *supra* note 3, at 36-37.

infiltrate. Without tips from the general public, these underground organizations frequently remain hidden from the authorities.[136] The Michael Vick saga offers a tremendous opportunity to educate the public about the horrors of dogfighting. Once informed, most Americans stand ready to help eradicate this cruel sport. Across the country, many state agencies are trying to take advantage of this opportunity with public service announcements, hotlines, and reward programs. "For example, the Nebraska Humane Society has a dogfighting hotline where citizens can report suspected dogfighting activity; tipsters can remain anonymous and collect a cash reward. Because of the difficulty in uncovering dog-fighting rings, cooperation between authorities and the community is crucial."[137]

Local communities are also joining in the effort. In Chicago the "Safe, Humane Chicago" is a grassroots campaign to educate the community and enlist help in reporting animal abuse.[138] "It begins with children: teaching kids about respect and empathy for other creatures is critical."[139] The campaign also reaches out to the public through churches, service groups, humane societies, and law enforcement. "Education is the first step to vigilance. Neighbors have eyes and ears. Mail carriers, refuse collectors, meter readers, utility workers, church members, and retired persons can all play a role in reporting suspected dog-fighting or animal abuse."[140] The Chicago Police Department and Humane Society have also partnered in Chicago to offer a $5,000 reward for dogfighting tips.[141] Together with an improved legal framework and well funded committed law enforcement agencies, an informed public should be the goal of every state in the union.

VI. CONCLUSION

The Michael Vick case has created a golden opportunity for America to finally rid itself of the sickening world of dogfighting. Forced to take their collective heads out of the sand, Americans have realized the ugly reality that in the twentieth century dogs still fight to the death in horrific conditions. With carefully crafted uniform laws, stiffer criminal penalties, coordinated law enforcement, and an informed public, dogfighting in all its forms can be effectively targeted and eliminated. Whether lawmakers will take advantage of this golden opportunity remains to be seen.

[136] Medlin, *supra* note 23, at 1316.
[137] *Id.*
[138] Rosemary Thompson, *The Cruel Web of Dogfighting: Breaking the Chain of Violence,* 21 CHI. BAR ASS'N 14, 14 (NOV. 2007).
[139] *Id.*
[140] *Id.*
[141] *Reward Offered for Tips on Dogfighting Rings*, CHI. TRIB., Jan. 11, 2008, at C3.

TO "DISMISS AT PLEASURE": AN EXAMINATION OF IMPLIED PREEMPTION OF STATE-LAW BASED DISCRIMINATION CLAIMS UNDER FEDERAL BANKING STATUTES

by JOEL C. TUORINIEMI*

I. INTRODUCTION

In 1864 and 1913, Congress enacted the National Bank Act[1] and Federal Reserve Bank Act,[2] respectively. Amongst the powers contained in each Act, a subject bank may "dismiss at pleasure" its officers and employees. Given the plethora of anti-discrimination laws that presently exist, an issue arises as to whether the "dismiss at pleasure" language set forth in each Act hampers the ability of a plaintiff to bring a state-law based discrimination claim against a subject bank. Part II of this paper outlines the statutory language which has created this issue. Part III sets forth the current status of this issue as it applies to federal-law based discrimination claims. Part IV presents the four separate approaches that have been adopted by federal and state courts when applying the "dismiss at pleasure" language to state-law based discrimination claims. Part V argues that proper interpretation of the "dismiss at pleasure" language requires adoption of no greater hurdle than retail preemption for plaintiffs bringing state-law based discrimination claims against subject banks.

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[1] 12 U.S.C. §21 et. seq.

[2] 12 U.S.C. §221 et. seq.

II. THE "DISMISS AT PLEASURE" STATUTES

The statutory language which creates the implied preemption issue is found in the National Bank Act of 1864 and the Federal Reserve Bank Act of 1913. The language from each respective Act is as follows:

> *The National Bank Act, 12 U.S.C. §24(Fifth)*
> To elect or appoint directors, and by its board of directors to appoint a president, vice president, cashier, and other officers, define their duties, require bonds of them and fix the penalty thereof, DISMISS SUCH OFFICERS OR ANY OF THEM AT PLEASURE, and appoint others to fill their places.[3]
> *The Federal Reserve Bank Act, 12 U.S.C. §341(Fifth)*
> To appoint by its board of directors a president, vice presidents, and such other officers and employees as are not otherwise provided for in this Act, to define their duties, require bonds for them and fix the penalty thereof, and TO DISMISS AT PLEASURE SUCH OFFICERS OR EMPLOYEES.[4]

Hereinafter, this Article refers to the National Bank Act statute as "Section 24(Fifth)" and to the Federal Reserve Bank Act statute as "Section 341(Fifth)."

III. FEDERAL-LAW BASED DISCRIMINATION CLAIMS VERSUS THE "DISMISS AT PLEASURE" STATUTES

Courts have unanimously agreed that Section 24(Fifth) and Section 341(Fifth) do not affect a plaintiff's ability to pursue a federal-law based discrimination claim. Federal anti-discrimination laws, enacted subsequent the "dismiss at pleasure" statutes, have been found to have "impliedly amended"[5] both Section 24(Fifth) and Section 341(Fifth). Such was the case in *Fasano v. Federal Reserve Bank of New York*.[6] In *Fasano*, the Third Circuit noted that the Americans with Disabilities Act (ADA) and an applicable federal banking whistleblower statute were enacted in 1990 and 1991, respectively, while Section 341(Fifth) and its "dismiss at pleasure" language became effective in 1913.[7] Cautioning that a judicial finding of implicit amendment was rare, the *Fasano* court nonetheless found that Section 341(Fifth) was in "irreconcilable conflict"

[3] 12 U.S.C. §24 (bolded emphasis added).

[4] 12 U.S.C. §341(bolded emphasis added).

[5] *See* Bernadette Bollas Genetin, *Expressly Repudiating Implied Repeals Analysis: A New Framework for Resolving Conflicts Between Congressional Statutes and Federal Rules*, 51 Emory L.J. 677 (Spring 2002) for further discussion of repeals by implication.

[6] *Fasano v. Fed. Res. Bank of New York*, 457 F.3d 274 (3rd Cir. 2006).

[7] *Fasano*, 457 F.3d at 284-285.

with the ADA and federal whistleblowing statute.[8] It stated in support of this holding:

> Section 341(Fifth) grants Federal Reserve Banks the absolute, unlimited power to dismiss an employee. The ADA and 12 U.S.C. § 1831j, on the other hand, *prohibit* a Federal Reserve Bank from dismissing an employee on the ground of a covered disability, from refusing to grant an employee's request for an accommodation, or from dismissing an employee for having filed a complaint alleging a violation of law. Thus, a Federal Reserve Bank's absolute unconditioned legal right to dismiss under § 341(Fifth), is made *illegal* under the ADA and 12 U.S.C. § 1831j. Such a fundamental conflict is not "merely cosmetic," or one "that relates to anything less than the operative legal concepts."

The Ninth Circuit, in *Kroske v. US Bank Corporation*,[9] has also held that the "dismiss at pleasure" language in Section 24(Fifth) and Section 341(Fifth) has been impliedly amended by subsequently enacted federal anti-discrimination laws.[10] Noting that anti-discrimination provisions of federal laws conflict with the authority to "dismiss at pleasure," the *Kroske* court held that the authority of subject banks to "dismiss at pleasure" its employees did not "encompass the right to terminate … in a manner that violates the prohibitions against discrimination."[11]

IV. STATE-LAW BASED DISCRIMINATION CLAIMS VERSUS THE "DISMISS AT PLEASURE" STATUTES

Courts have split when addressing the issue of whether Section 24(Fifth) or Section 341(Fifth) impliedly preempts state-law based discrimination claims, with four approaches having emerged – complete preemption, wholesale preemption, retail preemption, and no preemption. This section of the paper presents each approach.

A. Complete Preemption—The Sixth Circuit

In 1987, the Sixth Circuit decided *Ana Leon T. v. Federal Reserve Bank of Chicago*.[12] In *Leon T.*, plaintiff brought discrimination claims under Title VII of the Civil Rights Act of 1964 and the Michigan Elliott-Larsen Act.[13] The *Leon T.* court held, without any analysis or citations to prior case law, that the "dismiss at pleasure" language set forth in

[8] Id. at 285.

[9] *Kroske v. US Bank Corp.*, No. 04-35187, 2006 U.S. App. LEXIS 3367 (9th Cir. Feb. 13, 2006).

[10] *Kroske*, at *26-29.

[11] *Id*. at 28-29.

[12] *Ana Leon T. v. Fed. Res. Bank of Chicago*, 823 F,2d 928 (6th Cir. 1987).

[13] *Ana Leon T.*, 823 F.2d at 929.

Section 341(Fifth) preempts any state-created employment right to the contrary.[14]

In *Arrow v. Federal Reserve Bank of St. Louis*,[15] a 2004 decision, the Sixth Circuit once again addressed the issue of whether Section 341(Fifth) preempted an employee's rights created under state law. The plaintiff in *Arrow* brought claims alleging gender and disability discrimination, as well as a retaliatory discharge claim for filing a disability claim, all in violation of Kentucky law.[16] The *Arrow* court found the Section 341(Fifth) language operated as a complete preemption of plaintiff's state-law based claims.[17] While citing its previous decision in *Leon T.* and a series of decisions that scrutinized nearly identical "dismiss at pleasure" language found in Section 24(Fifth) in support of its holding, the *Arrow* court, as was the case in *Leon T.*, did not provide any further analysis on the doctrine of implied preemption to support its holding.[18]

B. Wholesale Preemption—The Third Circuit

In *Fasano v. Federal Reserve Bank of New York*,[19] a 2006 decision, plaintiff brought claims under New Jersey's Conscientious Employee Protection Act (CEPA) and Law Against Discrimination (LAD).[20] Given the language set forth in Section 341(Fifth), the *Fasano* court addressed the issue of whether plaintiff's state-based discrimination claims were preempted by federal law. The defendant bank argued the "dismiss at pleasure" language (1) completely bars application of state discrimination or whistleblower laws that restrict "at pleasure" dismissal—"complete preemption", or (2) at a minimum, entirely preempts such state laws if additional burdens are imposed beyond federal

[14] Id. at 930. The *Leon T.* court did note, however, that plaintiff could bring a federal-law based Title VII claim, although in the present case such claim was dismissed as being untimely.

[15] *Arrow v. Fed. Res. Bank of St. Louis*, 358 F.3d 392 (6th Cir. 2004).

[16] *Arrow*, 358 F.3d at 393.

[17] *Id.* at 394.

[18] *See also Nicolosi v. Federal Reserve Bank of Cleveland*, No. 1:06CV2462, 2007 U.S.Dist. LEXIS 13578 (N.D.—Ohio Feb. 28, 2007). The *Nicolosi* decision continued the dubious trend in the Sixth Circuit of courts not providing any legal analysis of the implied preemption doctrine. Instead, the Nicolosi court merely concluded it was precedentially bound by the *Arrow* and *Leon T.* decisions. It did, however, acknowledge the split among federal circuits regarding whether the "at pleasure" language in federal banking statutes preempts state-law based discrimination claims.

[19] *Fasano*, 457 F.3d 274 (3rd Cir. 2006).

[20] *Fasano*, 457 F.3d at 279.

discrimination or whistleblower laws – "wholesale preemption."[21] The *Fasano* court elected to adopt wholesale preemption,[22] reasoning:

> Federal Reserve Act § 341(Fifth), as impliedly amended by the ADA and 12 U.S.C. § 1831j, preempts *any* state employment law that goes beyond the remedies and protections provided by those federal laws. Such "additional" provisions—including provision for unlimited punitive damages, individual liability on the part of employees, and coverage of less severe disabilities—would conflict with Congress's intent to provide Federal Reserve Banks with the broadest latitude possible in carrying out their statutory duties, while giving due recognition to the applicability of the ADA and 12 U.S.C. § 1831j's requirements. In this sense, additional state remedies surely stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.[23]

The *Fasano* court acknowledged that states have a strong interest in protecting employees from discrimination.[24] New Jersey's anti-discrimination laws, however, provided broader remedies than those available under federal law.[25] Applying the wholesale preemption approach, the *Fasano* court thus held state anti-discrimination laws that provide additional protections and remedies than their federal counterparts are entirely preempted by Section 24(Fifth) and Section 341(Fifth) and cannot be applied against subject banks.[26]

C. Retail Preemption—The Ninth Circuit

In 2006 the Ninth Circuit decided *Kroske v. US Bank Corporation*,[27] a discrimination case brought by a bank branch manager under Washington's Law Against Discrimination (WLAD).[28] The manager alleged the proffered reason for termination (poor job performance) was a mere pretext to improper age discrimination.[29] Amongst the issues addressed by the Ninth Circuit in *Kroske* was whether plaintiff's state-

[21] *Id*. at 280-281.

[22] *Id*. at 287. The *Fasano* court extensively cited *Evans v. Fed. Res.Bank of Philadelphia*, No. 03-4975, 2004 U.S. Dist. LEXIS 13265 (E.D. Penn July 8, 2004) a district court opinion arising from the Third Circuit. The judge in *Evans* held "the 'dismiss at pleasure' language in the Federal Reserve Act preempts the application of state anti-discrimination laws which expand the rights and remedies available under federal anti-discrimination laws." *Evans*, at *6.

[23] *Id*. at 288.

[24] *Id*. at 290.

[25] *Id*.

[26] *Id*.

[27] *Kroske v. US Bank Corp.*, No. 04-35187, 2006 U.S. App. LEXIS 3367 (9th Cir. Feb. 13, 2006).

[28] *Kroske*, at *4.

[29] *Id*. at *3.

law based discrimination claim was preempted by the "dismiss at pleasure" language contained in Section 24 (Fifth). In resolving this issue, the *Kroske* court first rejected the "complete preemption" approach adopted by the Sixth Circuit, writing:

> We disagree with the Sixth Circuit's summary conclusion that state anti-discrimination statutes enacted under a state's police powers are preempted by the banking laws simply because they are part of a general category of "state-created employment right[s]." Unlike the cases involving state common law employment claims, here we are confronted with a state statute prohibiting discrimination, which is modeled after and incorporated into the federal anti-discrimination laws. Thus, federal preemption of the WLAD must be considered in light of Congress's enactment of relevant federal employment discrimination laws and the cooperative state-federal anti-discrimination scheme.[30]

The *Kroske* court then noted similarities between the federal Age Discrimination in Employment Act (ADEA) and the state age discrimination law. It opined that the state-law based age discrimination claim at issue was substantively the same as a federal age discrimination claim and, given the collaborative anti-discrimination scheme, was not preempted by the "dismiss at pleasure" language of Section 24 (Fifth).[31] The *Kroske* court made clear, however, that it was adopting a "retail preemption" as opposed to "no preemption" approach:

> We … recognize that state law prohibitions against discriminatory termination that are not consistent with federal anti-discrimination laws may frustrate the congressional purpose of uniform regulation reflected in the National Bank Act. Nonetheless, the fact that some state law provisions prohibit termination on grounds that are more expansive than the grounds set forth in federal law does not undermine our conclusion that Kroske's age discrimination claim under the WLAD, which substantively mirrors a claim under the ADEA, is not preempted.
>
> In sum, we conclude that the congressional enactment of the ADEA has placed limits on the Bank's authority to dismiss officers "at pleasure" under § 24(Fifth). In light of the ADEA's prohibition against age discrimination and the integral role of state anti-discrimination laws in the federal anti-discrimination scheme, we conclude that Congress did not intend for § 24(Fifth) to preempt the WLAD employment discrimination provisions, at least insofar as they are consistent with the prohibited grounds for termination under the ADEA.[32]

[30] *Id*. at *28-29 (citing *Moodie v. Fed. Res. Bank*, 831 F.Supp. 333 (S.D. N.Y. 1993) (concluding that "Congress did not intend 12 U.S.C. §341(5) to preempt state anti-discrimination laws that are consistent with federal anti-discrimination legislation).

[31] *Id*. at *30-31.

[32] *Id*. at 35-36.

D. No Preemption—The State of Ohio

In *White v. Federal Reserve Bank*,[33] a 1995 appellate court decision from Ohio, an employee was terminated after he failed to provide documentation of his medical condition.[34] The employee brought a state-law based claim of handicap discrimination, and the defendant bank argued that such a claim was preempted by Section 341(Fifth).[35] The *White* court found that the legislative history was void of any congressional intent to expressly or impliedly preempt state-law based discrimination claims, interpreting the language of Section 341(Fifth) as "nothing more than another means of expressing an 'at will' employment agreement."[36] Noting that a violation of public policy operates as a clear exception to the at-will employment doctrine, the *White* court stated "Discharge of an employee in violation of a statute is the clearest form of public policy for purposes of creating an exception to an at-will employment agreement."[37] It further opined that such an exception was consistent with federal law, given that federal banks were still subject to federal discrimination laws.[38]

Summarized, four approaches have emerged when addressing the issue of whether the "dismiss at pleasure" language set forth in Section 341(Fifth) or Section 24(Fifth) impliedly preempts state-law based discrimination claims. Under the "complete preemption" approach, as adopted by the Sixth Circuit, the "dismiss at pleasure" language operates as a complete preemption of state-law based discrimination claims, regardless of whether the protections afforded under state law are greater or less than those afforded under federal law. The "wholesale preemption" approach, embraced by the Third Circuit, entirely bars state-law discrimination claims against subject banks only where the state law grants greater protections than that permitted under federal law. The "retail preemption" approach found in the Ninth Circuit bars state-law discrimination claims only to the extent that such laws grant greater protections than their federal counterparts. Finally, the "no preemption" approach, adopted by the State of Ohio, rejects the argument that the "dismiss at pleasure" language found in Section 341(Fifth) or Section 24(Fifth) preempts state-law based discrimination claims.

[33] *White v. Fed. Res. Bank,* 103 Ohio App. 3d 534 (1995).
[34] *White*, 103 Ohio App. at 536.
[35] *Id*. at 536.
[36] *Id*. at 538.
[37] *Id.*
[38] *Id*. at 539.

V. INTEPRETATION OF THE "DISMISS AT PLEASURE" STATUTES REQUIRES ADOPTION OF NO GREATER A HURDLE THAN RETAIL PREEMPTION

Given the foregoing, questions arise as to (1) whether one of the four approaches should become a uniform standard, and (2) if so, which of the four approaches should be adopted. Exploring Congressional intent of the "dismiss at pleasure" statutes in relation to the at-will employment doctrine, the collaborative environment that needs to exist between federal and state laws to promote protections from discrimination, and the implied preemption doctrine, this section argues that proper interpretation of the "dismiss at pleasure" statutes requires adoption of no greater a hurdle for plaintiffs bringing state-law based discrimination claims against subject banks than retail preemption.

A. The "Dismiss at Pleasure" Statutes Represent a Codification of the At-Will Employment Doctrine

As noted in *White*, proper interpretation of the "dismiss at pleasure" language set forth in Section 24(Fifth) and Section 341(Fifth) would recognize that such language merely represents a codification of the "at will" employment doctrine. In other words, by enacting the "dismiss at pleasure" language, Congress was expressing its intent that subject banks were limited in their ability to employ individuals other than "at will." Courts have commented on the rationale behind the "dismiss at pleasure" language, citing a desire by Congress to define the discretion which federal banks may exercise in the discharge of employees.[39] In *Westervelt v. Mohrenstecher*,[40] an 1896 decision, the Eight Circuit explained the purpose of the "dismiss at pleasure" language found in Section 24(Fifth) as follows:

> Observation and experience alike teach that it is essential to the safety and prosperity of banking institutions that the active officers, to whose integrity and discretion the moneys and property of the bank and its customers are intrusted, should be subject to immediate removal whenever the suspicion of faithlessness or negligence attaches to them….
> It sometimes happens that, without any justification, a suspicion of dishonesty or carelessness attaches to a cashier or a president of a bank, spreads through the community in which he lives, scares the depositors, and threatens immediate financial ruin to the institution. In such a case it is necessary to the prosperity and success – to the very existence – of a banking institution that the board of directors should have the power to remove such an officer, and to put in his place another, in whom the community has confidence. In our opinion, the

[39] *Arrow v. Fed. Res. Bank of St. Louis*, 358 F.3d 392, 394 (6th Cir. 2004).
[40] *Westervelt v. Mohrenstecher*, 76 F. 118 (8th Cir. 1896).

> provision of the act of congress to which we have referred was inserted, ex industria, to provide for this very contingency.[41]

This explanation was again proffered in *Mueller v. First National Bank of the Quad Cities*,[42] a 1992 federal district court opinion, in which the court found that Congress intended the "dismiss at pleasure" language to mean "at will" as applied to common law contractual-based claims. [43] The *Mueller* court emphasized:

> The public policy concern underlying [Section 24(Fifth)] involved the banking community's ability to remove inefficient, incompetent or dishonest officers "at will" without contractual challenges stemming from oral representations, employee handbooks, and ambiguous contractual language. The legislature recognized that a bank's inability to dismiss such officers would undermine the public's confidence in the national banking system.[44]

Accepting this interpretation, courts have unanimously concluded that subject banks are immune from employment claims regarding breach of contract.[45] It is troubling, however, that courts have extended this codification of the "at will" employment doctrine into a finding that the "dismiss at pleasure" language can limit in any respect the ability of a plaintiff to bring a state-law based discrimination claim.[46]

Employers who enter into "at will" agreements should be subject to federal-law and state-law based discrimination claims because engaging in a discriminatory practice represents an undisputed exception to the "at will" employment doctrine. The Equal Employment Opportunity Commission has concluded that subject banks should be treated as private employers for the purposes of federal discrimination claims.[47] A logical extension of this pronouncement, which the *White* court found

[41] *Westervelt*, 76 F. at 122.

[42] *Mueller v. First Nat'l Bank of the Quad Cities*, 797 F.Supp. 656 (C.D. Ill 1992).

[43] *Mueller*, 797 F.Supp at 663.

[44] *Id*..

[45] *See Mahoney v. Crocker Nat'l Bank*, 571 F.Supp. 287 (N.D. Cal. 1983); *Kemper v. First Nat'l Bank in Newton*, 94 Ill. App. 3d 169 (1981); *Bollow v Res. Bank of San Francisco*, 650 F.2d 1093 (9th Cir. 1981); *Jaffe v. Fed.Res. Bank of Chicago*, 586 F.Supp. 106 (N.D. Ill. 1984); *Leon T.*, supra at Note 13.

[46] *See* Sharon A. Kahn and Brian McCarthy, *At-Will Employment in the Banking Industry: Ripe for a Change*, 17 Hofstra Lab. & Emp. L.J. 195 (Fall 1999) for further discussion of this point.

[47] *White*, 103 Ohio App. at 538 (citing *EEOC Enforcement Guidance on Coverage of Federal Reserve Banks*, EEOC Decision No. N-915-002 (Oct. 20, 1993). *See also Katsiavelos v. Fed. Res. Bank of Chicago*, No. 93C7724, 1995 U.S. Dist. LEXIS 2603 (N.D. Ill. Mar. 3, 1995).

compelling, is that subject banks should be deemed private employers for all discrimination claims, whether based on federal or state law.

B. The Cooperative Environment Needed With Federal and State Anti-Discrimination Laws

The *Kroske* court, in support of the retail preemption approach, cited the need for a collaborative environment to exist with federal and state anti-discrimination laws.[48] It is difficult to accept that the objective of eradicating discriminatory practices from the workplace can be best achieved if the "dismiss at pleasure" language set forth in Section 24(Fifth) and Section 341(Fifth) is interpreted to exempt subject banks from state-law based discrimination claims. The United States Supreme Court has expressed the important role state law serves in the enforcement of Title VII claims.[49] Scholars have also noted how state anti-discrimination laws existing in conjunction with their federal counterparts have allowed for a full development of legal protections available in discrimination claims.[50]

One may also question the impact caused by the complete preemption and wholesale preemption approaches, each which effectively grant subject banks immunity from state-law based discrimination claims. It is indeed difficult to rationalize how the "dismiss at pleasure" language set forth in federal statutes enacted decades prior to federal and state anti-discrimination laws can be construed to protect subject banks from theories of recovery that were not even contemplated at the time. If such an interpretation is indeed the intent of Congress, an appropriate amendment could be made to Section 24(Fifth) and Section 351(Fifth) to achieve such protection. Absent such express amendment, however, courts would be better served to adopt, at most, the retail preemption approach set forth in *Kroske*. In doing so, public policy would be better served through the promotion of a cooperative environment between the federal and state governments in addressing discrimination.

C. Implied Preemption

Clearly Congress has the power to preempt state law, expressly or by implication. In general, the Supremacy Clause and resultant preemption doctrine mandate that if it is properly determined there is a

[48] *See* supra at notes 28-33.

[49] *See Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 101 (1983) (citing *Kremer v. Chemical Construction Corp.*, 456 U.S. 461, 468-469, 472, 477 (1982), *New York Gaslight Club, Inc. v. Carey*, 447 U.S. 54, 63-645 (1980).

[50] *See* Alex Long, *State Anti-Discrimination Law as a Model for Amending the Americans With Disabilities Act*, 65 U. Pitt. L. Rev. 597 (Spring 2004); Sally F. Goldbarb, *The Supreme Court, The Violence Against Women Act, and The Use and Abuse of Federalism*, 71 Fordham L. Rev. 57 (October 2002).

conflict between federal and state law, certainly the "state law must give way."[51] Nothing in the "dismiss at pleasure" statutes suggest express preemption. As such, courts have applied the implied preemption doctrine in determining whether state-law based claims are preempted by the "dismiss at pleasure" statutes. One scholar has described the implied preemption doctrine as follows:

> Congressional intent to preempt may also be inferred when an implied conflict exists. An implied conflict arises whenever a person cannot comply with both federal and state laws simultaneously or if the state law stands as an obstacle to accomplishing Congress' purpose in enacting the federal law.[52]

Courts have summarized the implied preemption issue in stating "Where implied preemption is alleged, the basic inquiry is whether 'the state law undermines the intended purpose and 'natural effect' of … the federal Act."[53] As such, when exploring this issue an initial query is: What was the intended purpose and natural effect of the "dismiss at pleasure" language found in Section 24 (Fifth) and Section 341(Fifth)? As set forth above in Part V.A., a proper reading of the "dismiss at pleasure" language leads to a conclusion that it was enacted to codify the "at will" employment doctrine into federal banking laws. The National Bank Act and Federal Reserve Bank Act were created well before any statutory environment existed regarding discrimination claims, whether at the federal or state level.[54] Therefore, one may conclude that the intended purpose and natural effect of the "dismiss at pleasure" language had nothing whatsoever to do with limiting exposure to discrimination claims.

Moreover, the *Fasano* and *Kroske* courts have opined that any hurdle established as to federal-law based discrimination claims in the "dismiss at pleasure" statutes has been removed through subsequent enactment of federal anti-discrimination laws. These subsequent laws have "repealed by implication" any such barriers. Considering the argument set forth above in Part V.B., it is difficult to conclude that such "repeal by implication" is only effective when applied to federal-law based discrimination claims. Rather, unless a federal discrimination law can be found to have expressly or impliedly preempted a state-law

[51] *Fasano*, 457 F.3d at 290 (citing *Surrick v. Killion*, 449 F.3d 520, 534 (3rd Cir. 2006)).

[52] *See* Theresa J. Pulley Radwan, *Meeting the Objectives of the MDA: Implied Preemption of State Tort Claims By The Medical Device Amendments*, 10 J.L. & Health 342 (1995/1996).

[53] *See James v. Fed. Res. Bank of New York*, 471 F.Supp.2d 226 (E.D. N.Y. 2007).

[54] *See* Long and Goldbarb, supra at note 50, for further discussion of the evolution of state and federal anti-discrimination laws.

based discrimination claim, a plaintiff should be able to proceed against a subject bank, regardless of the "dismissal at pleasure" language currently set forth in Section 24(Fifth) and Section 341(Fifth).

Given the foregoing, the "dismiss at pleasure" language cannot be construed in a manner that would allow subject banks to terminate employment without regard to discrimination protections afforded individuals under both federal and state law. The complete preemption standard adopted by the Sixth Circuit is untenable. Nowhere do Sixth Circuit courts set forth a reasoned analysis as to how the "dismiss at pleasure" language can be construed to bar state-law discrimination claims against subject banks. Criticism by the *Kroske* court regarding the summary conclusion reached by the Sixth Circuit is warranted. Interpretation of the "dismiss at pleasure" statutes can lead to a conclusion that contractual-based claims by plaintiffs cannot be brought against subject banks, given the existence of the common law "at-will" employment doctrine at the time such statutes were enacted. Extending such interpretation, however, to find that subject banks are immune from statutory-based claims of discrimination under state law that did not exist at the time the "dismiss at pleasure" statutes were enacted operates as an inappropriate application of implied preemption.

While the wholesale preemption approach adopted in the Third Circuit addresses the issue of implied preemption, its conclusion is tenuous for two reasons. First, in order to conclude that wholesale preemption is proper, the *Fasano* court declared state-law based discrimination claims "conflict with Congress's intent to provide Federal Reserve Banks with the broadest latitude possible in carrying out their statutory duties."[55] This neglects entirely the notion that Congressional intent in enacting the "dismiss at pleasure" statutes was merely to codify the "at will" employment doctrine. Second, the wholesale preemption approach requires state-law based claims to be barred entirely against subject banks if any protection afforded under such state law exceeds that which is available under the federal scheme. Such a harsh approach serves as an injustice to the collaborative environment desired between federal and state anti-discrimination laws.

If one accepts that the Congressional intent in enacting the "dismiss at pleasure" language was only to codify the "at-will" employment doctrine, the "no preemption" stance taken by the *White* court appears meritorious. The analysis conducted in *White*, however, did not take into consideration the "repeal by implication" argument addressed in *Fasano* and *Kroske*, and may also be viewed as deficient in its consideration of the implied preemption doctrine. Therefore, the "no preemption" finding by the *White* court is debatable.

[55] *See Fasano*, supra at note 23.

The maximum hurdle that should be placed before plaintiff's bringing state-law based discrimination claims against subject banks is under the retail preemption approach. Retail preemption recognizes that the "dismiss at pleasure" language was not intended by Congress to exempt subject banks from state-law based discrimination claims in finding that such language served to protect such banks from contractual-based claims through a codification of the "at-will" employment doctrine. The retail preemption approach also recognizes and advances the collaborative environment desired with federal and state anti-discrimination laws in that it only excludes state-law based claims to the extent such claims provide protections beyond those authorized under federal law. This treatment is preferred over the wholesale preemption approach, which bars the state-law based claims entirely.

VI. CONCLUSION

The "dismiss at pleasure" language set forth in Section 24(Fifth) and Section 341(Fifth) should not be construed to exempt subject banks from state-law based discrimination claims. Such language was intended to merely codify "at will" employment principles into federal and national banks in order to reinforce the ideal that an employee could not bring a contractual-based claim.[56] Furthermore, federal discrimination laws have repealed by implication the "dismiss at pleasure" language, thus allowing plaintiffs to proceed against subject banks on federal-law based claims. Congress has not expressed intent that the "dismiss at pleasure" statutes preempt state anti-discrimination laws. Rather, federal and state laws have co-existed in a cooperative environment advancing the public policy of eradicating the workplace of discriminatory practices. Even if an argument of implied preemption is made, the maximum hurdle that should be placed before a plaintiff is one of retail preemption. By allowing plaintiffs to proceed with state-law based discrimination claims against federal and national banks to the extent such claims do not exceed their federal counterparts in terms of protections afforded and remedies provided, the retail preemption approach best serves and advances public policy.

[56] *See* discussion *supra* Part V.A.

TO LIVE, TO WORK, TO PROSPER: DO ILLEGAL ALIENS HAVE LEGAL RIGHTS?

by BRUCE W. WARREN* AND LEONID GARBUZOV**

I. INTRODUCTION

No topic has been more explosive or controversial in recent memory than the current situation regarding immigration. This is clearly evident in considering the pronounced impact of immigration law upon the 2008 Presidential election. The campaigning in the national elections regarding immigration is illustrative of the divisiveness and controversy surrounding the subject. Hillary Rodham Clinton, in a recent debate in Philadelphia,[1] after having some difficulty answering a question as to illegal aliens and drivers licenses, saw her poll numbers decline as a result of what has been characterized as her changing positions on this topic. John McCain temporarily derailed his presidential bid by joining Senator Ted Kennedy in a now defunct immigration bill.[2] Mike Huckabee has been severely criticized regarding the policies he

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[1] Democrats Focus Attacks on Clinton at Debate by Susan Milligan, http://www.boston.com/news/nation/articles/2007/10/31/democrats_focus_attacks_on_clinton_at_debate/ (last visited March 6, 2008).

[2] Immigration Stance Is Costly for McCain by Michael Shear, http://www.washingtonpost.com/wp-dyn/content/article/2007/06/27/AR2007062702823.html (last visited March 6, 2008).

followed pertaining to immigration during his tenure as Governor of Arkansas.[3]

The topic of immigration spans the gamut from the domain of this presidential election and politics to practically every other aspect of American culture. Questions loom as both legislators and judges seek to define the precise responsibilities of employers towards alien employees. The subject of rights of illegal aliens is multifaceted with such additional sub-topics as border security, visas and identification for illegal aliens, workplace discrimination against illegal and undocumented workers, and rights and privileges of illegal aliens within the mainstream society. Indeed, the current policy makers and government officials must decide what is to be done in regard to the estimated twelve million illegal immigrants currently in the United States.[4] The federal authorities plan to identify and deport at least 200,000 this year.[5] North Carolina community colleges were recently ordered to allow illegal aliens into the system, overturning a policy of individual decision making as to applicants.[6] Several states across the country have enacted new laws in 2008, whereby an employer could lose his/her business license for intentionally hiring illegal aliens.[7] In Minnesota, Federal Immigration and Customs Enforcement authorities have arrested Olga Franco, an illegal alien from Guatemala who allegedly drove her van through a stop sign causing the death of four school children.[8]

Perhaps no topic in immigration law has stirred as much political and social debate as that of employment rights of undocumented workers and the ethical treatment of illegal aliens in the workplace. Questions on this highly controversial topic inevitably start with whether illegal aliens have any legal right to pursue work opportunities regardless of the means used to arrive in this country. However, with an estimated

[3] Huckabee Unveils Immigration Plan, http://www.cbsnews.com/stories/2007/12/07/politics/main3590102.shtml?source=related_story (last visited March 6, 2008).

[4] ICE: Tab to Remove Illegal Residents Would Approach $100 Billion by Mike Ahlers, http://www.cnn.com/2007/US/09/12/deportation.cost/index.html (last visited March 6, 2008).

[5] U.S. to Speed Deportation of Criminals in Jail, by Julia Preston, http://www.nytimes.com/2008/01/15/us/15immig.html?pagewanted=print (last visited March 6, 2008).

[6] North Carolina's Community Colleges Are Told to Admit Illegal Immigrants by Charles Huckabee, http://chronicle.com/news/article/3503/north-carolinas-community-colleges-are-told-to-admit-illegal-immigrants (last visited March 6, 2008).

[7] Latest Update on State Immigration Laws by Frances Rayer, http://www.bipc.com/news.php?NewsID=2516 (last visited March 6, 2007).

[8] Immigration Puts Hold on Illegal in Fatal Bus Crash, http://www.worldnetdaily.com/index.php?fa=PAGE.view&pageId=57365 (last visited March 6, 2008).

twelve million illegal aliens presently living in the United States,[9] any discussion about legal rights must also necessarily take into account such issues as the ethical treatment of illegal aliens, the moral and ethical rights and obligations of employers towards their workers, and the extent to which society and the legal system permits workplace discrimination, harassment, or other unethical treatment and/or exploitation of alien workers.

Federal statutes broadly regulate and restrain employment of illegal aliens, by prohibiting the bringing or attempting to bring to the United States any alien,[10] as well as the attempted or actual concealment, harboring, or shielding from detection of illegal aliens.[11] Federal law further imposes criminal liability upon any individual who knowingly utilizes false or forged documents (visas, work permits, and other documents), to satisfy the requirements of the federal employment laws and statutes,[12] and who knowingly hires and employs illegal aliens.[13] As such, under federal law an employer arguably has an affirmative obligation to verify the legal status of its potential employees, including the validity and authenticity of the documents presented to the employer.

A number of states have likewise tried to impose civil and criminal penalties for employers of illegal aliens. For example in 2006, the County of Luzerne, Pennsylvania, enacted several ordinances, including the so-called City of Hazleton Illegal Immigration Relief Act Ordinance 2006-18 and the Tenant Registration Ordinance 2006-13. Citing federal law, the Ordinance 2006-18 imposed fines on landlords who rented to illegal immigrants, and suspended licenses of companies that hired them.[14] A lawsuit was eventually filed by illegal immigrants and Hispanic groups to challenge these ordinances,[15] and they were struck down for their imposition on and interference with federal immigration law.[16] However, the Mayor of Hazleton, Louis Barletta, "vowed to appeal the case all the way to the Supreme Court of the United States," if

[9] ICE: Tab to Remove Illegal Residents Would Approach $100 Billion by Mike Ahlers, http://www.cnn.com/2007/US/09/12/deportation.cost/index.html (last visited March 6, 2008).

[10] 8 U.S.C. § 1324 (a)(1)(A)(i) (2005).

[11] 8 U.S.C. § 1324 (a)(1)(A)(iii) (2005).

[12] 18 U.S.C. § 1546(b) (2002).

[13] 8 U.S.C. § 1324(a)(3) (2005).

[14] http://www.hazletonchamber.org/chamber/images/1006_city_ordinance.pdf (last accessed January 28, 2007).

[15] Lozano v. City of Hazleton, 2007 U.S. Dist. LEXIS 54320 (M.D. Pa., July 26, 2007).

[16] *Lozano*, 2007 U.S. Dist. LEXIS 54320, *231-232. (M.D. Pa., July 26, 2007).

necessary.[17] Moreover, given that in the twelve-month span between August of 2006 and August of 2007, 41 states had enacted 171 laws relating to illegal aliens, there is every reason to believe other cities across the county may try to implement similar measures.[18]

The above-mentioned laws and regulations aimed at illegal aliens have a tremendous effect on American businesses and organizations, as employers must be informed of both the legal consequences and ethical obligations in regards to the employment of undocumented workers, and illegal aliens need to be aware of their rights inside and outside of the workplace. Even though state and federal legislators have tried to impede and impair the rights of illegal immigrants, the judicial branch has often stepped in not only to protect both the fundamental human rights of illegal aliens, but also to impair legislation that promotes inhumane or unethical treatment of individuals based solely upon their citizenship status. This article will examine and discuss the federal and state regulations of illegal aliens, the scope of their legal rights with regard to employment, and their rights to other social and public benefits while residing in the United States in light of the Supreme Court's ruling in *Hoffman Plastic Compounds v. National Labor Relations Board*,[19] and other recent state and federal cases.

II. HOFFMAN PLASTIC COMPOUNDS: THE SUPREME COURT'S STANCE ON EMPLOYMENT RIGHTS OF ILLEGAL ALIENS

In 2002 the United States Supreme Court addressed the issue of illegal aliens' rights to employment and workplace benefits in *Hoffman Plastic Compounds, Inc. v. National Labor Relations Board*,[20] where the Petitioner Hoffman Plastic Compounds Corporation (Hoffman) hired an illegal alien employee named Jose Castro,[21] who had presented "documents that appeared to verify his authorization to work in the United States," which later turned out to be false.[22] However, the employee was subsequently laid off after supporting and aiding a labor union and participating in labor union activities.[23] The National Labor

[17] Judge Overturns Pennsylvania City's Illegal Immigrant Ordinance by Randy Hall, http://www.cnsnews.com/ViewNation.asp?Page=/Nation/archive/200707/NAT20070727a.html

[18] Hispanic Growth Extends Eastwards: Areas Unfamiliar With Diversity by Haya El Nasser and Brad Heath, http://www.usatoday.com/news/nation/census/2007-08-09-hispanic-growth_N.htm (last visited March 6, 2008).

[19] 535 U.S. 137 (2002).

[20] *Hoffman Plastic Compounds, Inc.,* 535 U.S. at 137.

[21] Hoffman Plastic Compounds, Inc. v. National Labor Relations Board, 237 F.3d 639, 641 (D.C. App. 2001).

[22] *Hoffman Plastic Compounds, Inc.*, 535 U.S. at 140.

[23] *Id.*

Relations Boards (NLRB), found that Hoffman had chosen the employee Castro and several others for layoff "in order to rid itself of known union supporters" in violation of the National Labor Relations Act (NLRA).[24] It ordered the Petitioner to cease and desist from future violations of the Act, to post a notice as to the Board's order, and to give back pay and reinstatement to the affected employees.[25]

A hearing was conducted before an Administrative Law Judge (ALJ) to determine the amount of backpay owed, at which Castro admitted that he had was not authorized to work in the United States and was not a legal resident.[26] The ALJ ruled that an award of backpay to Castro was barred by the Immigration Reform and Control Act of 1986 (IRCA),[27] which prohibited the employment of illegal aliens in the United States.[28] The NLRB reversed with respect to backpay and stated that a terminated employee could receive backpay, which should be calculated from the date of wrongful termination to the date that the employer learns about the illegal status of the employee.

The United States Supreme Court reversed the NLRB's decision, holding that NLRB had exceeded its authority in awarding backpay to the employee. The Supreme Court further stated that the NLRB had no authority to enforce immigration policy,[29] and that an award of back pay to an illegal alien was in contravention of policies underlying the IRCA. The United States Supreme Court expressly stated that IRCA's aim is the "establishing [of] an extensive 'employment verification system,' designed to deny employment to aliens who (a) are not lawfully present in the United States, or (b) are not lawfully authorized to work in the United States."[30] The Court further stated that that no individual is permitted to be employed within the United States without a valid social security card or other documentation authorizing employment within the United States.[31] Therefore, the U.S. Supreme Court expressly held that awarding backpay in a case like this ran contrary to federal law, as it would encourage evasion of apprehension by immigration authorities, condone prior violations of federal immigration laws, and potentially lead to future violations of federal law.[32]

[24] The National Labor Relation Act is codified as 29 U.S.C. §§ 151-169.
[25] *Hoffman Plastic Compounds* at 140-141.
[26] 314 N.L.R.B. 683, 685 (1994).
[27] 8 U.S.C. § 1324. (2005).
[28] 314 N.L.R.B. 683, 685 (1994).
[29] *Hoffman Plastic Compounds*, 535 U.S. at 151 (2002).
[30] *Id.* at 147. (Internal citations omitted).
[31] *Id.* at 148.
[32] *Id.*

III. ILLEGAL ALIENS' RIGHTS TO WORKPLACE AND EMPLOYMENT BENEFITS

Since the Supreme Court's ruling in *Hoffman Plastic Compounds*, the case has been cited in hundreds of decisions in various jurisdictions throughout the United States. These jurisdictions have expressed a variety of views on whether the Supreme Court's decision should be read broadly to prohibit all benefits to alien workers, or narrowly, to prevent awards of backpay in cases analogous or factually similar to *Hoffman Plastic Compounds.* Although initially it seems that the Supreme Court decision in *Hoffman Plastic Compounds* broadly prohibits judicial relief to illegal aliens seeking to recover workplace benefits and unpaid wages, many courts have construed the holding of Hoffman Plastic Compounds narrowly, thereby recognizing that employment rights for illegal aliens exist and may be enforced despite the strict federal laws and regulations prohibiting their employment within the United States.

A. Egregious Violations of Workplace Ethics

A narrow reading of the Supreme Court's ruling in *Hoffman Plastic Compounds* is especially prevalent in cases involving egregious violations of workplace ethics as well as inhumane mistreatment of alien workers. In *Chellen et al. v. John Pickle Co., Inc.*, [33] fifty two employees from India were joined as plaintiffs by the Equal Employment Opportunity Commission (EEOC) in a lawsuit against the defendant company and its owners. The complaint alleged egregious violations of the Fair Labor Standards Act (FLSA),[34] racial discrimination,[35] deceit, false imprisonment, and intentional infliction of emotional distress. In its findings of fact the United States District Court for the Northern District of Oklahoma determined that the defendants had recruited plaintiffs by means of deceit to work in the United States. The *Chellen* Court further found that the employees were subjected to egregious and inhumane treatment by their employers; were housed and fed separately; were subjected to numerous discriminatory comments about their ancestry, ethnic background, culture, and country; were subjected to disparate testing requirements; and were given undesirable jobs and lower job classifications.[36] Additionally, employers required the alien employees live in substandard housing; gave them inadequate food of

[33] 446 F. Supp. 2d 1247 (N.D. Okla. 2006).

[34] 29 U.S.C. §§ 201-219 (1938).

[35] Plaintiff's racial discrimination claim was brought under 42 U.S.C. § 1981, which grants all "persons" within the United States "the same right in every State and Territory to make and enforce contracts, to sue, be parties, give evidence, and to the full and equal benefit of all laws and proceedings for the security of persons and property. . . ."

[36] *Chellen et al.*, 446 F. Supp. 2d. at 1284 (N.D. Okla. 2006).

poor quality; and restricted their movement, communications, worship opportunities, and access to health care.[37] The defendants had stipulated that plaintiffs were not paid minimum wages--with their salaries ranging from $2.89 to $3.17 per hour--but stated that they were entitled to offsets for the food, medicine, lodging, and phone calls afforded to the illegal alien workers.[38]

The Court granted judgment against the defendant employer and in favor of the EEOC and the plaintiffs on the racial discrimination claims, deceit and false imprisonment. Additionally, the Court ruled that plaintiffs were entitled to compensatory, liquidated, and punitive damages totaling $1,293,480.53, including prejudgment interest.[39] In doing so, the Court expressly held that the Supreme Court's decision in *Hoffman Plastic Compounds* "does not preclude an award for work actually performed by the Chellen plaintiffs."[40] In its ruling, the Court also made a number of determinations as to the rights of illegal alien workers under the federal law. The Court determined that the defendants explicitly disregarded the citizenship status of the plaintiffs, and committed a violation of Title VII of the Civil Rights Act of 1964[41] by creating a "working environment dominated by racial slurs."[42] Citing the Court of Appeals for the Eleventh Circuit,[43] the Court held that the FLSA's definition of "employee" imposes no limitation predicated upon nationality or immigration status. The Court further held that federal law did not prevent or prohibit an award of liquidated damages to the plaintiff, as they were not a penalty imposed by law, but rather, "compensation to the employee occasioned by the delay in receiving wages due. . . ."[44] The Court further stated that liquidated damages were proper, since the retention of a workman's pay could result in damages too obscure and difficult to prove or estimate.[45]

B. Enforcement of Employment Contracts

Prior to the Supreme Court's decision in *Hoffman Plastic Compounds*, courts had held that illegal aliens have legal rights and remedies relating to enforcement of employment and/or professional contracts. In *Anderson v. Conboy et. al.*[46] employer Local 17 of the United Brotherhood

[37] *Id.*
[38] *Id.* at 1257.
[39] *Id.* at 1294.
[40] *Id.* at 1277.
[41] *See*, 42 U.S.C. § 2000e et seq. (1964).
[42] *Chellen et al.*, 446 F. Supp. 2d at 1285.
[43] Patel v. Quality Inn South, 846 F. 2d 700, 706 (11th Cir. 1988).
[44] *Chellen et al.*, 446 F. Supp. 2d at 1279-1280. (Internal citations omitted).
[45] *Id. at 1279.* (Internal citations omitted).
[46] 156 F.3d 167 (2nd Cir. 1998).

of Carpenters and Joiners (UBC) fired Anderson, a citizen of Jamaica, upon learning that he was not a legal citizen of the United States. When Anderson filed a discrimination claim against the employer, he alleged that all persons within the United States have the right to enter into legally enforceable employment contracts.[47] As such, plaintiff alleged that the employment contract between himself and UBC was enforceable, notwithstanding his citizenship status. The U.S. District Court for the Southern District of New York, ruled against him, holding that not only was Conboy entitled to absolute immunity from suit, but that the employer was not liable because 42 U.S.C. § 1981 does not prohibit discrimination against aliens by private actors.[48] Reversing the District Court, the United States Court of Appeals for the Second Circuit, explained that 42 U.S.C. § 1981 prohibited alien discrimination "in the making and enforcement of contracts, and extends to private as well as state actors in that regard."[49] The Court stated that such discrimination based upon the alienage status of the party was prohibited.[50]

Cases decided in the last five years have likewise upheld the right of illegal aliens to enforce employment contracts, notwithstanding the Supreme Court's decision in *Hoffman Plastic Compounds*. For example, in *Garcia v. Pasquareto et. al.*[51] a group of undocumented employees sought review of judgments that found the employees were not entitled to recovery of alleged wages under an employment contract with the defendant. Two lower court decisions had held that that the employment contract between an undocumented employee and an employer could not be enforced, and an appeal was filed. The Supreme Court of New York reversed. In its brief opinion, the Supreme Court of New York stated the undocumented aliens' status did not prevent them from maintaining small claims actions to recover unpaid wages from the defendant employer.[52] Citing a series of cases,[53] the Supreme Court of New York explained that many courts throughout the country have consistently held that the United States Supreme Court's holding in Hoffman Plastic Compounds does not preclude claims for wages earned

[47] 42 U.S.C. § 1981 provides in pertinent part that all "persons within the jurisdiction of the United States shall have the same right in every State and Territory to make and enforce contracts. . . ."

[48] Anderson v. Conboy, 1997 WL 177890 at *4-8 (S.D. N.Y. Apr. 14, 1997).

[49] *Anderson*, 156 F.3d at 170. (Internal citations omitted).

[50] *Id.* at 180.

[51] 812 N.Y.S.2d 216 2004 (N.Y. 2004).

[52] *Id.* at 216.

[53] Flores v Amigon, 233 F. Supp. 2d 462 (E.D. N.Y. 2002); Zeng Liu v. Donna Karan Intl., Inc., 207 F. Supp. 2d 191 (S.D. N.Y. 2002).

but not paid.[54] The Court further held that the public policy considerations favored enforcement of wage and hour laws on behalf of all workers.[55] The Court ruled that the policies underlying 8 U.S.C. § 1324(a) were not inconsistent with the payment of wages to undocumented workers under New York law.[56] The New York Supreme Court thus concluded that the illegal immigrant workers were entitled to new trials, so that under New York wage law[57] the workers could present evidence on their wages to the Court.[58]

C. Public Policy—Minimum Wage Laws

Other courts throughout the United States have ruled that notwithstanding the IRCA, illegal aliens may be entitled to remedies and relief under state statutes and regulations when such state law reinforces important public policy. In *Reyes v. Van Elk, Ltd. et. al.*[59] Plaintiffs were illegal aliens employed on welding-related projects in and around the Los Angeles area, who sued Van Elk, Ltd. for failing to pay prevailing wages pursuant to California's prevailing wage law.[60] The Superior Court granted summary judgment for defendants, stating that undocumented workers were precluded by federal law from maintaining an action for prevailing wages.[61] The Superior Court further held that "California statutes declaring immigration status irrelevant to claims under California's labor, employment, civil rights and employee housing laws" were preempted by the Supremacy Clause of the United States Constitution.[62]

In reversing the Superior Court, the California Court of Appeals explained that while "the power to regulate immigration is unquestionably exclusively a federal power, ... the court has never held that every state enactment which in any way deals with aliens is a regulation of immigration and thus *per se* preempted . . . ."[63] The Court of Appeals therefore held that the IRCA did not preempt "California statutes declaring immigration status irrelevant to claims under California's labor, employment, civil rights and employee housing laws."[64] The Court

[54] *Garcia*, 812 N.Y.S. 2d at 217.
[55] *Id.*
[56] *Id.*
[57] N.Y. Lab. Law § 198 (2002).
[58] *Garcia*, 812 N.Y.S. 2d at 217.
[59] 148 Cal. App. 4th 604 (2007).
[60] California wage laws are codified in Lab. Code, §§ 1720-1861.
[61] *Reyes*, 148 Cal. App. 4th at 608.
[62] *Id.*
[63] *Id.* at 616, citing De Canas v. Bica, 424 U.S. 351, 354–355 (1976).
[64] Cal. Lab. Code, § 1171.5 (2003); Cal. Civ. Code, § 3339 (2003); Cal. Gov. Code, § 7285 (2002).

further held that the "IRCA did not preempt the California prevailing wage law." especially since California law actually removed "a major incentive to hiring undocumented workers."[65] For these reasons, the Court stated that where the work had already been performed, federal law did not prohibit undocumented workers from having standing to raise claims for prevailing wages.[66]

The *Reyes* Court also made several important rulings regarding the state of California's legitimate interests and public policy considerations in protecting the rights of workers regardless of their immigration and citizenship status. Citing the California Constitution,[67] the Court of Appeals expressly held that non-citizens are guaranteed the same property rights as U.S. citizens. Citing public policy concerns, the Court of Appeals explained that California had an important interest in vigorously enforcing its minimum labor standards. Enforcement of these standards, said the Court, is necessary:

> in order to ensure employees are not required or permitted to work under substandard unlawful conditions or for employers that have not secured the payment of compensation, and to protect employers who comply with the law from those who attempt to gain a competitive advantage at the expense of their workers by failing to comply with minimum labor standards.[68]

Since the Supreme Court decision in *Hoffman Plastic Compounds*, many courts have expressly held that federal law does not prevent an award to illegal aliens for employers' violations of minimum wage laws. In *Renteria v. Italia Foods, Inc.*[69] plaintiffs, a group of former employees of a frozen food manufacturing company, brought suit against the defendant employer for violating the Fair Labor Standards Act of 1938[70] (FLSA) and the Illinois Minimum Wage Law,[71] by failing to pay overtime wages. Two of the plaintiffs, Socorro and Gabriela Olivera (Oliveras) were undocumented aliens. Because these plaintiffs did not have authorization for legal employment in the United States, the defendants argued these aliens were "therefore not entitled to back pay, front pay, or compensatory damages."[72] The United States District Court for the Northern District of Illinois, held that while the undocumented status

[65] *Reyes*, 148 Cal. App. 4th at 618.
[66] *Id.*
[67] Cal. Const., Art. I, § 20 provides that: "[n]oncitizens have the same property rights as citizens."
[68] *Reyes*, 148 Cal. App. 4th at 611, 612.
[69] 2003 U.S. Dist. LEXIS 14698 (N.D. Ill. 2003).
[70] 29 U.S.C.S. § 201 et. seq. (1938).
[71] 820 ILCS § 105 (2003).
[72] *Renteria,* 2003 U.S. Dist. Lexis 14698 *17 (N.D. Ill. 2003).

of the Oliveras could preclude the claims for front and back pay, the claims for compensatory damages were not precluded as they did not assume the undocumented employees' continued illegal employment. Citing *Hoffman Plastic Compounds*, the Court concluded that under the FLSA, retaliatory discharge remedies remained available to undocumented employees.

> In *Hoffman Plastic,* the Supreme Court did not preclude the NLRB from taking *any* remedial action for the employer's improper firing of an undocumented worker; it expressly preserved the NLRB's ability to issue injunctive and declaratory relief. The remedy of compensatory damages, unlike those of back pay and front pay, does not assume the undocumented worker's continued (and illegal) employment by the employer. We therefore agree . . . that compensatory damages for retaliatory termination under the FLSA remain available to undocumented workers.[73]

Some cases have held that while certain contractual rights and remedies may be preempted by federal law, an undocumented worker is nevertheless entitled to recovery under the state minimum wage laws, contract law, or even under statutory penalties arising under state law. In *Coma Corp. v. Kansas Dept. of Labor*,[74] appellant Cesar Martinez Corral was an undocumented alien employed by appellee Coma Corp. Although Corral had not been allowed to complete the entire twenty-four week period of employment specified in his contract with Coma Corp, he sought to collect wages for the entire duration of the contract. The Kansas Department of Labor (KDOL) ruled that Defendant was owed undocumented worker wages and interest, and assessed a civil penalty against the employer.[75] The Sedgwick District Court for the District of Kansas reversed in part, holding that an undocumented worker was entitled only to minimum wages, and not to a penalty or contractual remedies. The Supreme Court of Kansas affirmed the ruling on the availability of minimum wage recovery, but reversed the lower court's findings that Corral's contract was illegal under the IRCA and that the civil penalties against the employer were barred.

The Supreme Court of Kansas expressly stated that an employment contract involving an undocumented worker was enforceable under the Kansas Wage Payment Act (KWPA).[76] Citing K.S.A. 44-313(b) of the KWPA, the Court stated that the KPWA expansively defines the employee as "any person allowed or permitted to work by an employer."[77]

[73] *Id.* at *19-20. (Internal citations omitted).
[74] 283 Kan. 625 (2007).
[75] *Coma Corp.*, 283 Kan. at 626.
[76] KS ST § 44-312 et. seq. (1923).
[77] *Coma Corp.*, 283 Kan. at 630. (Internal citations omitted).

As Coma Corp. had permitted Corrall to be its employee, Coma Corp. incurred an obligation to pay "*all* wages due to an employee. . . ."[78] The Kansas Supreme Court expressly held that appellees had not overridden the presumption against federal preemption of state law afforded by U.S. Const. Art. VI based upon other jurisdictions' case law rejecting the IRCA's preemption of state labor laws and a narrow reading of pertinent federal case law.[79] Citing cases from other jurisdictions,[80] the Court concluded that KWPA applies to earned, but unpaid wages of an undocumented worker, thus distinguishing the case from *Hoffman* because "the plaintiffs had already performed the work for which unpaid wages were being sought."[81] The Court further dismissed the notion that the contract between Coma Corp. and Corrall was preempted by federal law, and stated that to hold the contract illegal would have violated Kansas "strong public policy of protecting wages."[82]

D. Workers' Compensation

Besides contractual remedies and unpaid wages, some Courts have even gone so far as to require employers to pay workers' compensation to illegal aliens.[83] In *Farmer Brothers Coffee v. Workers' Compensation Appeals Board*,[84] two illegal aliens filed a lawsuit against their employer seeking workers' compensation. The defendant employer argued that plaintiffs had violated California law,[85] and that their recovery was barred because the illegal aliens had presented false documents to obtain employment.[86] The employer also contended that sections of California law setting forth the definition of "employee,"[87] and declaring immigration status irrelevant to the issue of liability to pay compensation to an injured employee,[88] were preempted by the IRCA.[89]

[78] *Id.*

[79] *Id.* at 635.

[80] Zavala v. Wal-Mart Stores, Inc., 393 F. Supp. 2d 295 (N.J. 2005); *Flores v. Amigon*, 233 F. Supp. 2d 462 (E.D. N.Y. 2002); Zeng Liu v. Donna Karan Intern., Inc., 207 F. Supp. 2d 191, 192 (S.D. N.Y. 2002).

[81] *Coma Corp.*, 283 Kan. at 635.

[82] *Id.* at 645.

[83] Some cases that have expressly found that federal law did not interfere with or preempt state workers compensation law, include: Dowling v. Slotnik, 244 Conn. 781, 791 (1998); Mendoza v. Monmouth Recycling Corp., 672 A. 2d 221, 224–225 (N.J. Super. 1996).

[84] Farmer 133 Cal. App. 4th 533 (2005).

[85] Specifically, employer alleged that illegal alien employee had violated Cal Ins. Code § 1871.4 (2005), which makes it a criminal offense to make a knowingly false or fraudulent material representation for the purpose of obtaining workers' compensation benefits.

[86] *Farmer Brothers Coffee*, 133 Cal. App. 4th at 543.

[87] Cal. Lab. Code, §3351(a) (1996).

[88] Cal. Lab. Code § 1171.5 (2003).

[89] *Farmer Brothers* Coffee, 133 Cal. App. 4th at 542.

The California Appellate Court disagreed with the employer stating that under California law the legality of the worker did not affect recovery of workers' compensation.[90] Moreover, the Court ruled that the California's Worker's Compensation Act was not preempted by federal law.[91] The Appellate Court stated that federal law precludes and supercedes a state statute in a particular legislative field whenever it is plausible to conclude that Congress intentionally left no room for the states to supplement the federal law.[92] Citing *Florida Avocado Growers v. Paul*[93] the Court stated that there must be "such actual conflict between the two schemes of regulation that both cannot stand in the same area . . . because the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[94] As such, in the context of California's worker's compensation laws, there was no preemption since these laws did not interfere with the objectives of Congress.[95]

E. Safe Working Environment

A small number of cases decided since *Hoffman Plastic Compounds* have recognized that any employer that hires and employs illegal aliens has a duty to maintain a reasonably safe working environment to adequately protect the health and well being of the alien workers. In *Madeira v. Affordable Housing Foundation, Inc.*,[96] an illegal alien named Jose Raimundo Madiera was employed as a roofer at a construction site owned by Affordable Housing Foundation (AHF). Over the course of his employment, he sustained serious injuries after falling off the roof at an AHF construction site.[97] His injuries were substantial and required multiple surgeries and several months of hospitalization.[98] He filed suit against his employer, the contractor, and other defendants, alleging that the equipment at the worksite was unsafe and defective in violation of New York law,[99] and seeking compensatory damages for lost earnings.[100] Defendants argued federal immigration law and the IRCA, as well as the Supreme Court's holding in *Hoffman Plastic Compounds* "necessarily precluded any damages award under New York law that compensated

[90] *Id.* at 540.
[91] *Id*. at 542.
[92] *Id.* at 540.
[93] 373 U.S. 132, 141 (1963).
[94] *Farmer Brothers* Coffee, 133 Cal. App. 4th at 540.
[95] *Id.*
[96] 469 F.3d 219 (2nd Cir. 2006).
[97] *Id*. at 224.
[98] *Id.*
[99] N.Y. Lab. Law § 240(1) (1989).
[100] Madeira v. Affordable Hous. Found., Inc., 315 F. Supp. 2d 504 (S.D. N.Y. 2004).

an undocumented worker for lost earnings. . . ."[101] The United States District Court for the Southern District of New York had instructed the jury that it was not to consider plaintiff's immigration status when assessing liability, but that it could consider it for purposes of awarding compensatory damages for lost earnings.[102] The jury determined that an enforceable employment contract existed between plaintiff and defendants and the jury awarded Madeira "$638,671.63 in total compensatory damages consisting of $92,651.63 in incurred expenses, $46,000 for past pain and suffering, $40,020 in past lost earnings, $230,000 for future pain and suffering (over the course of forty-two years), and $230,000 for future lost earnings (over the course of twenty-six years)."[103] The District Court denied defendants' motion for a judgment notwithstanding the verdict under Fed.R.Civ.P. 50(b), and the defendants appealed the verdict.[104]

The United States Court of Appeals for the Second Circuit affirmed the district court's judgment.[105] In doing so, it expressly held that under the Supremacy Clause of the U.S. Constitution,[106] the IRCA did not preempt plaintiff's recovery under New York law.[107] Citing a decision by the Supreme Court of New York decision in *O'Rourke v. Long*[108] the United States Court of Appeals for the Second Circuit said that the purpose of the New York law is to provide a "swift and sure source of benefits to an injured employee",[109] and that New York law "imposes absolute liability upon a contractor or owner who fails to provide safety devices to a worker at an elevated work site where the lack of such devices is a substantial factor in causing that worker's injuries."[110] Notably, the Second Circuit Court of Appeals held that New York law was drafted with the express purpose of avoiding any conflict with federal immigration law, as the New York legislature did not want the alien's status to affect the amount of compensation that he/she is entitled to receive.[111] As such the Court specifically held Mr. Madieara was entitled to recovery of wages that he could have earned as an illegal worker in the United States, and that illegal aliens can recover damages

[101] *Madeira*, 469 F.3d at 223.
[102] *Id.* at 225.
[103] *Id.*
[104] *Id.* at 222-223.
[105] *Id.* at 254.
[106] U.S. Constitution (Art. VI, cl. 2).
[107] *Madeira*, 469 F.3d at 238-240.
[108] 41 N.Y.2d 219, 222, 359 N.E.2d 1347 (1976).
[109] *Madeira*, 469 F.3d at 229.
[110] *Id.* at 224 citing Zimmer v. Chemung County Performing Arts, Inc., 65 N.Y.2d 513, 519 (1985).
[111] *Id.* at 227-228; The same conclusion was reached by the New York Supreme Court in Balbuena v. IDR Realty LLC, 845 N.E.2d 1246, (N.Y. 2006).

for pain and suffering, out of pocket expenses, and lost wages regardless of the possibility of deportation.[112]

Finally, a small number of recent cases have upheld the right of illegal aliens to pursue causes of action relating to sexual harassment and retaliatory discharge. For example, in *Equal Employment Opportunity Commission v. The Restaurant Company*[113] the Equal Employment Opportunity Commission on behalf of an illegal alien, Torres, filed a lawsuit against her former employer, the Restaurant Company. Plaintiff alleged defendant violated Title VII of the Civil Rights Act[114] by subjecting her to sexual harassment and retaliatory discharge.[115] The employer filed for summary judgment, arguing that plaintiff had no standing to bring the lawsuit, and alleging that "since the IRCA prohibits undocumented aliens from being employees, Torres was not a 'person' or 'employee' protected by Title VII."[116] The United States District Court of Minnesota disagreed, finding that plaintiff had standing to bring a lawsuit.[117] The District Court explained that even though the employee's entitlement to certain remedies could be barred by her citizenship status, this did not affect the determination of whether the employer engaged in discrimination, and provided a hostile work environment.[118]

The above cases show that since the U.S. Supreme Court's decision in *Hoffman Plastic Compounds*, many jurisdictions have interpreted ambiguous statutes and controversial legislation to recognize basic employment and workplace rights of illegal aliens.

IV. ILLEGAL ALIENS' RIGHT TO PUBLIC BENEFITS

As set forth above, since the Supreme Court's ruling in *Hoffman Plastic Compounds*, courts throughout the United States have recognized a variety of employment and workplace rights for illegal aliens. However, are these legal rights limited exclusively to the realm of employment? In other words, at the end of the workday, does an illegal alien have any rights to the other benefits commonly enjoyed by United States citizens, including the right to a good education, safe housing, and medical treatment?

[112] *Id.* at 229-230.
[113] 2007 U.S. Dist. LEXIS 39887 (D. Minn. 2007).
[114] 42 U.S.C. § 2000e et. seq.(1964).
[115] EEOC, 2007 U.S. Dist. LEXIS 39887 at *1.
[116] *Id.* at *10.
[117] *Id.* at *13.
[118] *Id.*

A. Welfare Benefits

In *Alvarez v. Shalala et. al.*[119] the United States Court of Appeals for the Seventh Circuit addressed the issue of whether an illegal alien may be eligible to apply for and receive welfare benefits. Chicago city officials brought suit against the Secretary of Health and Human Services challenging the provisions of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (Welfare Act),[120] which affected both legal and illegal aliens by restricting their eligibility for welfare benefits. Plaintiffs alleged that the Welfare Act violated the Due Process Clause of the Fifth Amendment of the United States Constitution.

The United States District Court for the Northern District of Illinois dismissed the action, and the United States Court of Appeals for the Seventh Circuit affirmed the dismissal.[121] The Court of Appeals first determined that due to the plenary power of Congress to regulate aliens, the Court had to apply "rational basis" scrutiny in analyzing the constitutionality of the Welfare Reform Act.[122] As such, the Court then held that the Act's provisions were rationally related to the legitimate governmental purpose of encouraging aliens' self sufficiency, and that the statute was not rendered irrational because it affected some aliens who were unable to work.[123] As such, in affirming the District Court's decision, the Second Circuit held the citizenship requirements of the Welfare Reform Act did not offend equal protection, and was therefore constitutional.[124]

B. Educational Benefits

In addition to denial of welfare benefits, at least some courts have expressly upheld educational restrictions on admission of illegal aliens. The United States Supreme Court has stated in *De Canas v. Bica*[125] that Courts should apply a three-part test for determining whether an immigration-related state statute, action, or policy is pre-empted by federal law. The first test is whether the state enactment or policy is an attempt to regulate immigration. If not, it may still be pre-empted under the second test, upon a showing that it was the clear and manifest purpose of Congress to effect a complete ouster of state power, or to "occupy the field" the state policy or statute attempts to regulate. Finally, under the third test, a state law is pre-empted if it "stands as an

[119] 189 F.3d 598 (7th Cir. 1999).
[120] Pub. L. No. 104-193, 110 Stat. 2105 (1996).
[121] *Alvarez,* 189 F.3d at 600.
[122] *Id.* at 604.
[123] *Id.* at 606-607.
[124] *Id.* at 609.
[125] De Canas v. Bica, 424 U.S. 351 (1976).

obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[126]

Courts throughout the United States have consistently applied the above-mentioned test in upholding state statutes that prevent admission to illegal aliens. In *Equal Access Education v. Merten et. al.*,[127] a group of illegal aliens sued a number of Virginia's post secondary educational institutions, alleging that the clauses denying admission to illegal and undocumented aliens were unconstitutional, and in violation of the Constitution's Supremacy Clause, Commerce Clause, and the Due Process Clause. The United States District Court of Virginia ruled in favor of defendants, holding that the Supremacy Clause of the United States Constitution did not bar defendants from adopting and enforcing admission standards limiting or denying admission to illegal aliens.[128] The Court expressly held that the state university did not violate the Supremacy Clause of the United States Constitution, so long as the admission standards were consistent with the federal immigration standards.[129] In applying the *De Canas* test, the Court held that the Virginia institutions' admission standards did not impermissibly interfere with federal laws regulating immigration.[130] The Court held that "access to public higher education is not a benefit governed by the PRWORA[131] nor is it a field completely occupied by the federal government."[132] The educational regulations did not violate the Due Process Clause of the Fifth and Fourteenth Amendments of the United States Constitution, stated the Court, because the illegal alien plaintiff did not have a constitutionally protected liberty or property interest, and as such, has he has not been deprived of such a protected interest by some form of state action.[133]

C. Admission of Attorneys to State Bar Associations

Other regulations, such as those prohibiting admission of alien attorneys from participation and membership in state bar associations have likewise been upheld. In *Leclerc v. Webb et. al.*[134] two groups of non-immigrant aliens sought review of the Constitutionality of the

[126] *Id.* at 363.
[127] 305 F. Supp. 2d 585 (E.D. Va. 2004).
[128] *Id.* at 614.
[129] *Id.* at 603.
[130] Id. 605-606.
[131] Pub. L. No. 104-193, 110 Stat. 2105 (1996).
[132] *Equal Access Education*, 305 F. Supp. 2d at 605.
[133] *Id.* at 611. The same standard was set forth by the United States Court of Appeals for the Fourth Circuit in Johnson v. Univ. of Md. Med. Sys. Corp., 855 F.2d 167, 172 (4th Cir. 1988).
[134] 419 F.3d 405 (5th Cir. 2005).

Louisiana Supreme Court's Rule,[135] which required that "every applicant for admission to the Bar of this state shall . . . be a citizen of the United States or a resident alien thereof."[136] In resolving two conflicting rulings by the lower courts, the United States Court of Appeals for the Fifth Circuit upheld the Louisiana Supreme Court's rule. Citing the United States Supreme Court's decision of *In Re Griffiths,*[137] the Court specifically ruled that non-immigrant aliens are not a suspect class, and thus regulations affecting aliens required only rational basis review. In applying "rational basis" review, the United States Court of Appeals for the Fifth Circuit held that the Louisiana Supreme Court's regulation of the legal profession did not violate the Equal Protection Clause of the United States Constitution, since it bore "a rational relationship to legitimate state interests—Louisiana's substantial interest in regulating the practice of those it admits to its bar."[138]

D. Medical Care

Another controversial area involving the rights of illegal aliens has been in regards to the issue of rights to medical care or treatment. In *Lewis v. Perales*,[139] the United States Court of Appeals for the Second Circuit had to tackle the difficult issue of whether the Department of Health and Human Services in New York had to provide Medicaid coverage for prenatal care to illegal alien pregnant women. The United States District Court for the Eastern District of New York refused to lift "a long-standing injunction barring the denial of prenatal care to these aliens."[140]

The United States Court of Appeals for the Second Circuit concluded the denial of prenatal care was not unconstitutional and did not violate the Equal Protection Clause.[141] The Court also determined that it could not "interpret," whether the Personal Responsibility and Work Opportunity Reconciliation Act of 1996[142] "permit[s] automatic Medicaid coverage at birth for citizen children of alien mothers denied Medicaid because of alienage."[143] As such, the Second Circuit reversed in part, affirmed in part, and remanded. The order was reversed to the extent that it continued the injunction requiring defendant "to provide prenatal Medicaid assistance to plaintiff" and affirmed to the extent that it

[135] La. Sup. Ct. R. XVII, § 3(B) (1979).
[136] *Leclerc*, 419 F.3d at 410.
[137] In Re Griffiths, 413 U.S. 717 (1973).
[138] *Leclerc*, 419 F.3d at 421.
[139] 252 F.3d 567 (2nd Cir. 2001).
[140] Lewis v. Grinker, 111 F. Supp. 2d 142 (E.D. N.Y. 2000).
[141] *Perales*, 252 F.3d at 569.
[142] Pub.L. 104-193, 110 Stat. 2105 (1996).
[143] *Perales*, at 589.

required automatic eligibility for Medicaid coverage to the citizen children of plaintiffs upon their birth, "on terms as favorable as those available to the children of citizen mothers."[144]

As shown in the above cases, despite recognizing employment and workplace rights of illegal aliens, courts throughout the country have frequently denied illegal aliens' attempts to obtain or retain other public benefits.

V. CONCLUSION

The aforementioned has been a review of the current status of immigration law as to federal and state regulations, rights to workplace and employment benefits and right to public benefits of illegal aliens in the United States and its significant impact on both employers and employees. This controversial subject will continue to evolve as the body of law pertaining to it continues to be debated and legislated especially in light of the vagaries of the current law.

Topics such as guest worker programs, policies and procedures for the illegal immigrants currently in the United States, policies and procedures as to the security of the United States borders, responsibilities of employers in terms of verifying perspective employee status prior to employment and ethical obligations of the employer towards this large group of illegal immigrants has yet to be clearly defined, interpreted and implemented. As the media, the judges and federal and state legislators attempt to address, resolve, and codify the rights and status of illegal aliens within the United States, immigration issues will continue to have a tremendous impact on our economy, the national election in 2008 and the future of the United States as a nation.

[144] *Id.* at 591.

EMPLOYER CREDIT CHECKS AND THE POTENTIAL FOR DISPARATE IMPACT DISCRIMINATION UNDER TITLE VII

by LORRIE WILLEY AND DEBRA BURKE*

INTRODUCTION

The major reporting agencies maintain credit files on over 150 million Americans, while the largest three agencies generate more than one billion credit reports annually.[1] Predictably, given such volume, studies reveal inaccuracies in a significant percentage of the reports considered.[2] In 1998, a study found that "29% of credit reports contained errors that could result in the denial of credit" and that "70% of reports contained an error of some kind."[3] A 1991 survey by the Consumers Union found that "20% of credit reports contained a major inaccuracy that could affect

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[1] Credit Reporting, National Consumer Law Center, http://www.consumerlaw.org/issues/credit_reporting/index.shtml (last visited May 14, 2008).

[2] *The Credit Repair Organizations Act: How Can It Be Improved: Hearing Before the S. Comm. on Commerce, Science and Transportation*, 110th Cong. (2007) (written statement of Joanne S. Faulkner, Esquire), available at http://commerce.senate.gov.public/_files?FaulknerCROAtestimony73107.pdf.

[3] John Golinger & Edmund Mierwinski, PRG: *Mistakes Do Happen: Credit Report Errors Mean Consumers Lose*, Public Interest Research Groups (March 1998) http://www.floridapirg.org/uploads/AJ/n1/AJn15trnm8zsOkOgf3FCSQ/mistakesdohappen3_98.pdf (last visited June 17, 2008).

the consumer's eligibility for credit..."[4] Also, files from the three major reporting agencies were inconsistent as to the numbers of late payments made by the consumer, the reporting of account balances, and the posting of dates relative to accounts.[5]

Nevertheless, the use of credit checks by employers increased over fifty-five percent over the last five years, as employers beyond the financial services sector are routinely including a credit check in their applicant screening process.[6] An estimated thirty-five percent of employers check applicants' credit scores, an increase of nineteen percent since 1996.[7] Over forty percent of retail employers used credit history checks for new employee hiring.[8] Frequently, authorization for credit checks are required at the application process, which can discourage persons with poor credit rating from seeking employment.[9] Moreover, the request is often accompanied by a waiver of liability arising from such an inquiry,[10] which likely would be subject to challenge if the practice is unlawful under federal anti-discrimination law.

Employers use credit scores in an attempt to discern whether or not prospective employees possess such desirable traits as honesty and responsibility. But does an applicant's poor credit rating translate into a lack of integrity any more than a good credit rating translates into ethical behavior and organizational skills? Quite often a low credit score is the result of unfortunate circumstances that are beyond the control of the prospective employee, such as medical bills, layoffs, family emergencies, and even identity theft. Employers are unwise to discourage these persons from applying, or to eliminate them summarily before an interview may provide a reasonable explanation of their special circumstances. While employers are justified in hiring the best

[4] *Id*. The Consumer Federation of America study in 2002, found that omissions from the credit report files involving positive account information, for example, the consumer never having been late on a payment, were more common that omissions of a negative nature. *Id.*

[5] *Credit Score Accuracy and Implications for Consumers*, Consumer Federation of America and National Credit reporting Association (December 17, 2002) http://www.ncrainc.org/documents/CFA%20NCRA%20Credit%20Score%20Report.pdf. (last visited June 17, 2008).

[6] Diane E. Lewis, *Qualification: Must Have a Good Credit History*, THE BOSTON GLOBE, Sept. 5, 2006, at E1.

[7] Ben Arnoldy, *The spread of the credit check as a civil rights issue*, CHRISTIAN SCI. MONITOR, Jan. 18, 2007, at 1.

[8] Adam T. Klein, *Meeting on Employment Testing and Screening*, The U.S. Equal Employment Opportunity Commission (May 16, 2007), http://www.eeoc.gov/abouteeoc/meetings/5-16-07/klein.html (last visited June 17, 2008).

[9] Roni F. Noland, *Employers Can Ask About Age But Be Wary of Implications*, THE BOSTON GLOBE, April 9, 2006, at G11.

[10] Elaine Varelas, *Employer has right to background check, but you can question extent*, THE BOSTON GLOBE, July 15, 2007, at G14.

candidates available for a position, the credit report may not provide the information the employer is seeking.

Credit histories are quintessentially an important privacy concern that should be considered only if the criterion is performance related. However, there are no conclusive studies which validate credit scores as predictors of specific job traits.[11] Paradoxically, the research findings of two Eastern Kentucky University psychology professors, who examined the credit reports and job performance appraisals of 178 employees working in the financial services industry, found no correlation between credit blemishes and low performance reviews.[12] On the other hand, studies do document that African Americans and Hispanics have credit scores ranging from five to thirty-five percent worse that Caucasians.[13] Therefore, minority applicants likely will be disqualified based upon their credit scores at a higher rate than other applicants. Could this correlation between lower credit scores and protected classes under Title VII result in liability for employers under federal anti-discrimination law, particularly in light of the dearth of documentation correlating exemplary performance to good credit scores, or alternatively deficient performance to poor credit scores?

This article first discusses legal framework of disparate impact discrimination under Title VII, and its application to an instructive analogy, the employer's use of criminal background checks. It then examines the practical justifications for the employer's use of credit scores and the requirements of the Fair Credit Reporting Act. Last, it surveys cases addressing the use of credit checks, and concludes that, while there have been no recent cases on point, the practice is suspect because evidence suggests that while there is a correlation between poor credit scores and some protected classes, there is no proof that the score supports any legitimate employment decision.

TITLE VII AND DISPARATE IMPACT DISCRIMINATION

Title VII of the Civil Rights Act of 1964 makes it an illegal practice for employers, employment agencies and labor organizations "(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 or applicants for employment in any way which would deprive or tend to deprive any individual of employment

[11] Klein, *supra* note 8.

[12] Stacy A. Teicher, *Judged by the content of your credit report*, CHRISTIAN SCI. MON., March 1, 2004.

[13] Arnoldy, *supra* note 7.

opportunities or otherwise adversely affect his status as an employee, because of such individual's race, color, religion, sex, or national origin."[14] As initially interpreted by courts, Title VII precluded intentional disparate treatment based upon race, color, religion, sex, or national origin of members of these protected classes, motivated by a discriminatory animus.

The Supreme Court in *McDonnell Douglas Corp. v. Green* set forth the respective burden of proof requirements for situations in which there is no direct proof of a discriminatory intent.[15] A prima facie disparate treatment case requires proof by a preponderance of evidence that the plaintiff suffered an adverse employment decision, and that the employer did not treat race, color, religion, sex, or national origin neutrally in making the decision. If that burden is met, then the defendant may rebut the plaintiff's case by articulating some legitimate, nondiscriminatory reason for the adverse employment action. If the employer is successful, the employee must offer evidence that the employer's justification is a mere pretext for discrimination. The employer need not establish its defense by a preponderance of evidence, but need only produce evidence that the adverse action was the result of a legitimate, nondiscriminatory reason, since the plaintiff maintains the burden of persuasion.[16]

Disparate Impact Discrimination

In 1971 the Supreme Court recognized another alternative theory of recovery under Title VII, disparate impact. In *Griggs v. Duke Power Company* the employer required applicants either to possess a high school diploma or to pass a standardized general intelligence test as a condition of employment, when neither standard was significantly related to successful job performance and concurrently disqualified racial minorities at a substantially higher rate than other applicants. In noting that "Congress directed the thrust of the Act to the consequences of employment practices, not simply the motivation" the Court concluded that the "absence of discriminatory intent does not redeem employment procedures or testing mechanisms that operate as 'built-in headwinds' for minority groups and are unrelated to measuring job capability."[17]

Therefore, in contrast to disparate treatment cases, there is no need to show any specific intent to discriminate in disparate impact cases. In order to establish a prima facie case, the plaintiff must (1) identify the specific, seemingly neutral, employment practice, (2) show a

[14] 42 U.S.C. § 2000e-2(a) (2006).
[15] 411 U.S. 792 (1973).
[16] Texas Dep't of Cmty Affairs v. Burdine, 450 U.S. 248 (1981).
[17] Griggs v. Duke Power Co., 401 U.S. 424, 432 (1971).

demonstrably disproportionate adverse impact on one of the groups protected under Title VII, and (3) show the existence of a causal relationship between the identified practice and the disparate impact.[18] For example, a company policy which eliminates applicants from the pool based on a bad credit score would be actionable if that employment qualification has a disparate effect on members of a protected class, and is neither job related nor consistent with business necessity. In contrast, there would be no liability under a disparate treatment analysis since persons with poor credit ratings do not constitute a protected class under Title VII.

Subsequent cases refined this theory of unintentional discrimination. In *Albemarle v. Moody* the Court determined that even if an employer established that the questionable practice could be justified by business necessity, the employee nevertheless could prevail by establishing that other selection devices could accomplish the same goal without the undesirable discriminatory impact, thus recognizing a pretext rebuttal for employees.[19] In *Dothard v. Rawlinson*, the Court clarified that a prima facie case could be established by proof that the "facially neutral standards in question select applicants for hire in a significantly discriminatory pattern" by relying upon generalized national statistics without the need to produce comparative statistics concerning actual applicants. The Court also asserted that the business necessity defense not only should be able to establish that the suspect criteria is essential to effective job performance, but also produce measurable documentation of that link.[20]

The Equal Employment Opportunity Commission ('EEOC") responded to the developments by adopting the *Uniform Guidelines on Employee Selection Procedures* ("UGESP") in 1978. These guidelines permit the business necessity defense to be demonstrated by data showing that 1) the content of a selection procedure is representative of important aspects of performance on the job, 2) the selection procedure measures the degree to which candidates have identifiable characteristics which have been determined to be important for successful job performance, or 3) the selection procedure is predictive of or significantly correlated with important elements of work behavior as proven by empirical data.[21] The Guidelines provide technical standards for validation studies,[22] and indicate that employer best practices should include verification of whether or not a selection procedure is predictive of job success, as well

[18] Watson v. Fort Worth Bank & Trust, 487 U.S 977 (1988).
[19] Albemarle v. Moody, 422 U.S. 405 (1975).
[20] Dothard v. Rawlinson, 433 U.S. 321 (1977).
[21] 29 C.F.R. § 1607.16 (1978).
[22] *Id.* § 1607.14.

as whether or not an equally effective alternative selection procedure is equally predictive but with less of an adverse impact on protected classes.[23] In any analysis of adverse impact, how the relevant and qualified applicant pool is defined is of critical importance.[24] While EEOC Guidelines adopt a "four-fifths" rule to gauge adverse impact, that is, the EEOC regards a selection rate for any race, sex, or ethnic group which is less than four-fifths of the rate for the group with the highest selection rate as evidence of adverse impact,[25] not all courts have embraced this rule of thumb.[26] Some courts ascertain instead if the disparity is sufficiently large enough to be something other than random.[27] Under both approaches the statistical analysis of impact is significant and usually complex.

Subsequent to the adoption of the UGESP, however, Supreme Court decisions seemed to frustrate the doctrinal foundations of disparate impact theory.[28] This trend culminated in the Court's decision in *Wards Cove Packing Co. v. Atonio*, which enunciated two significant addendums to disparate impact cases. First, the Court held that plaintiffs alleging disparate impact under Title VII "must demonstrate that it is the application of a specific or particular employment practice that has created the disparate impact under attack."[29] Second, the Court concluded that an employer could satisfy the business necessity rebuttal by offering evidence that the practice "serves in a significant way the legitimate goals of the employer," without the need to establish that it is essential or indispensable.[30] Furthermore, this *justification*, as opposed to necessity, defense was no longer a burden of proof requirement for employers, but merely a burden of production. In other words, if the employer counters the plaintiff's prima facie case by producing evidence that its action was based on a reasonable non-discriminatory factor, the plaintiff then bears the burden of disproving that assertion.

Congress reacted to the Court's decision in *Ward's Cove* by passing the Civil Rights Act of 1991, which essentially codified prior case law for the

[23] *Employment Tests and Selection Procedures*, Fact Sheet, EEOC, http://www.eeoc.gov/policy/docs/factemployment_procedures.html (last visited June 17, 2008).

[24] Scott Baker, *Defining "Otherwise Qualified Applicants": Applying an Antitrust Relevant Market Analysis to Disparate Impact Cases*, 67 U. CHI. L. REV. 725 (2000).

[25] 29 C.F.R. § 1607.4(D) (1978).

[26] Clady v. County of Los Angeles, 770 F.2d 421 (9th Cir. 1985).

[27] Timothy Tommaso, Comment, *Disparate Impact and the ADEA: So Who is Going to be in the Comparson Group?*, 39 J. MARSHALL L. REV. 1475 (2006).

[28] Linda Lye, Comment, *Title VII's Tangled Tale*: *The Erosion and Confusion of Disparate Impact and the Business Necessity Defense*, 19 BERKLEY J. EMP. & LAB. L. 315 (1998).

[29] 490 U.S. 642, 657 (1989).

[30] *Id*. at 759.

parties' respective burdens of proof, but maintained *Wards Cove's* requirement that *each* alleged discriminatory practice cause an illegal outcome. Federal law now provides that it is an unlawful employment practice based on disparate impact for employers to use "a particular employment practice that causes a disparate impact on the basis of race, color, religion, sex, or national origin" without *demonstrating* "that the challenged practice is job related for the position in question and consistent with business necessity."[31] As used in the statute, the term "demonstrates" means meets the burdens of production and persuasion.[32] Under the 1991 legislation, plaintiffs must "demonstrate that each particular challenged employment practice causes a disparate impact," unless the employer's decision-making process is not capable of separation for analysis, in which case it may be analyzed as one employment practice.[33] If the employer can demonstrate that a specific employment practice does not cause the alleged disparate impact, that is negate the plaintiff's prima facie case, then the business necessity defense need not be established.[34] Alternatively, if the employer is unable to negate the plaintiff's prima facie case, but is able to establish the business necessity defense, then the plaintiff may demonstrate that the employer has refused to adopt an alternative employment practice which would satisfy the employer's legitimate interests without having a disparate impact on a protected class.[35] The application of this legal matrix to criminal background checks is instructive as to wisdom of using credit checks to screen employees.

Criminal Background Checks

Criminal background checks have become increasingly economical and easy to obtain. Perhaps this development, along with the growing potential for employer liability for negligent hiring that result in harm to third parties and co-workers, has resulted in substantial percentages of employers utilizing criminal background checks as a screening devise for prospective employees.[36] As a result, it is often difficult for ex-offenders to secure employment, even though unemployment is likely to trigger a recidivist cycle.[37] Some states have laws which regulate the use

[31] 42 U.S.C. § 2000e-2(k)(1)(A)(i) (2007).
[32] *Id.* § 2000e(m).
[33] *Id.* § 2000e-2(k)(1)(B)(i).
[34] *Id.* § 2000e-2(k)(1)(B)(ii).
[35] *Id.* § 2000e-2 (k)(1)(A)(ii).
[36] John E. Matejkovic & Margaret E. Matejkovic, *Whom to Hire: Rampant Misrepresentations of Credentials Mandate the Prudent Employer Make Informed Hiring Decisions*, 39 CREIGHTON L. REV. 827 (2006).
[37] Jennifer Leavitt, Note, *Walking a Tightrope: Balancing Competing Public Interests in the Employment of Criminal Offenders*, 34 CONN. L. REV. 1281 (2002).

of conviction records in hiring decisions.[38] Moreover, because minorities are more likely to encounter this impediment to employment, [39] employers also face potential liability for disparate impact discrimination under Title VII in using background checks as a screening device.[40]

Case law suggests a cautious approach, distinguishes between arrest records and conviction records, and evaluates the nature of the conviction in considering the business necessity defense. In *Gregory v. Litton Systems, Inc.*, the Ninth Circuit determined that a questionnaire used in hiring by a sheet-metal company had a disparate impact on African-American job seekers by requiring applicants to reveal arrest records which could not be overcome by a showing of a business purpose.[41] In *Green v. Missouri Pacific Railroad Co.,* the Eighth Circuit held that the employer's policy refusing employment to anyone with a conviction other than minor traffic violations also had a disparate impact on minorities that could not be overcome by a showing of business necessity.[42]

In a recent case, *El v. Southeastern Pennsylvania Transportation Authority (SEPTA)*, the Third Circuit affirmed a jury's conclusion that the employer's hiring policy, which disallowed hiring drivers with a violent criminal conviction for paratransit buses for disabled persons, satisfied the business necessity defense.[43] Of importance to the appeals court's decision was the fact that the policy excluded only persons with convictions that have "the highest and most unpredictable rates of recidivism and thus present the greatest danger to its passengers."[44] Since the plaintiff produced no evidence of an alternative policy that would accomplish the employer's legitimate goals as effectively with less of a discriminatory impact, the employer prevailed.

EEOC policy provides that an employer must show that it considered three factors to determine whether its decision was justified by business necessity: 1) the nature and gravity of the offense or offenses; 2) the time that has passed since the conviction and/or completion of the sentence;

[38] Elizabeth A. Gerlach, Comment, *The Background Check Balancing Act: Protecting Applicants with Criminal Convictions While Encouraging Criminal Background Checks in Hiring*, 8 U. PA. J. LAB. & EMP. L. 981 (2006).

[39] Leroy D. Clark, *A Civil Rights Task: Removing Barriers to Employment of Ex-convicts*, 38 U.S.F. L. REV. 193 (2004).

[40] Steve Bedar, *Employment Law Dilemmas: What to Do When the Law Forbids Compliance*, 11 UTAH B.J. 15 (1998).

[41] Gregory v. Litton Systems, Inc., 316 F. Supp. 401 (C.D. Cal. 1970), *aff'd*, 472 F.3d 631 (9th Cir. 1972).

[42] Green v. Mo. Pac. RR Co., 523 F.2d 1290 (8th Cir. 1975).

[43] El v. Se. Pa. Transp. Auth. (SEPTA), 479 F.3d 232 (3d Cir. 2007).

[44] *Id.* at 245.

and 3) the nature of the job held or sought.[45] The EEOC also considers an absolute bar to employment based on the mere fact that an individual has a conviction record to be unlawful under Title VII, where there is evidence of adverse impact.[46] Moreover, when the rejection of applicants based on arrest records results in a disparate impact, "the arrest records must not only be related to the job at issue, but the employer must also evaluate whether the applicant or employee actually engaged in the misconduct."[47]

In sum, if adverse impact is established by an employer's criminal record policy, clearly a nexus is needed between that policy and its job relatedness, notwithstanding the potential tort liability for negligent hiring or negligent retention of employees. "Generally, employers will be able to justify their decision when the conduct that was the basis of the conviction is related to the position, or if the conduct was particularly egregious."[48] For example, recent convictions for DUI should be relevant when hiring bus drivers, and a background check for child care workers should be justified in order to ascertain if candidates had criminal records for child abuse or sexual misconduct. The consideration of criminal convictions is more likely to be relevant to legitimate employment criteria than creditworthiness, in addition to being more sensible, since the legal system condemns criminal activity under penal codes, yet forgives and rehabilitates debtors under bankruptcy laws. But is the use of credit worthiness as an employment criterion illegal or justifiable?

CREDIT SCORES AND DISPARATE IMPACT DISCRIMINATION

In the quest to learn as much as possible about job candidates, and to avoid the negative consequences associated with hiring, employers turn not only to criminal record checks, but to credit checks to screen prospective employees. It is the employer's hope that a credit check can uncover the applicant's unsavory characteristics and ensure a worker with integrity and personal responsibility. In fact, background checks are "[a]n elaborate mechanism …for investigating and evaluating the …character and general reputation of consumers."[49] The consumer reports complied as a possible pre-employment screen are defined as "…any written, oral or other communication of any information by a

[45] *EEOC Policy Statement on the Issue of Conviction Records under Title VII of the Civil Rights Act of 1964, as amended, 42 U.S.C. § 2000e et seq*. (Feb. 4, 1987), http://www.eeoc.gov/policy/docs/convict1.html (last visited June 17, 2008).

[46] *Id.*

[47] EEOC Compliance Manual, § 15-VII(B)(2) (Apr. 19, 2006), available at http://www.eeoc.gov/policy/docs/race-color.html#VIB2conviction.

[48] *Id.*

[49] 15 U.S.C. § 1681a(d)(1) (2007).

consumer reporting agency bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living…"[50]

Using credit reports is a popular practice in making employment decisions for many businesses. The Society for Human Resource Management found that thirty-five percent of those responding to a 2004 survey used credit reports as a part of the hiring and promotion decision making process.[51] Employees believe that reports of financial activity and behavior on the part of the potential applicant will provide insight into the prospective employee's job performance: "some employers believe if you are not reliable in paying your bills, then you will not be a reliable employee."[52] Goldman Sacks uses credit checks for all prospective employees "from the CEO down to the janitor and that the level of forgiveness is minimal."[53] The organization maintains that it has conducted and use credit checks "for over twenty-five years..."[54]

It has been asserted that persons with high debt or late payments "cannot manage their affairs,"[55] that "…credit reports offer valuable insight regarding the applicant's reliability and sense of responsibility…"[56] and that such a report…"can be an important indicator of financial responsibility …"[57] The terms "responsible and reliable"[58] appear often in writings on the topic. Experian, a major credit bureau, suggests that information contained within the credit report "as a general indicator of an applicant's financial honesty and personal integrity."[59] HR.com suggests "Employers are well advised to run credit reports on bookkeepers or others who handle significant amounts of cash."[60] Moreover, a credit report can serve to verify whether or not the

[50] *Id*.

[51] Liz Weston, *The Basics: How bad credit can cost you a job*, http://moneycentral.msn.com/content/Banking/Yourcreditrating/P87306.asp (last visited June 17, 2008).

[52] *Employment Background Checks: A Jobseeker's Guide, Part VII, par. 3,* Privacy Right Clearinghouse, http://www.privacyrights.org/fs/fs16-bck.htm (last visited June 17, 2008).

[53] Britt Erica Tunick, *Squeak E. Clean? Then Go to Goldman: Credit blemishes jinx job offers, but prospective employees do have rights*, INVESTMENT DEALERS DIG., March 3, 2003.

[54] *Id*.

[55] Les Rosen, *Credit Reports and Job Hunting*, Employment Screening Resources, http://www.esrcheck.com/articles/article7.php (last visited June 17, 2008).

[56] *Instant Credit Report for Employment Screening*, Info Cubic, http://www.infocubic.net/products/instant_credit_e.htm (last visited June 17, 2008).

[57] *Id*.

[58] Rosen, *supra* note 55.

[59] *Employment and credit: What you should know*, Experian, http://www.experian.com/life_events/employment.html (last visited June 17, 2008).

[60] Rosen, *supra* note 55.

applicant has lied on a resume or application. Studies show that fifty-six percent of resumes include false information.[61]

Obviously, employers may be concerned with new hires in their businesses for legitimate reasons, such as employee theft, vicarious liability, identity theft, and third party claims of negligent hiring. The Association of Fraud Examiners contends that businesses lose up to six percent of their revenues as a result of theft by employees.[62] A recent survey of 5,700 workers revealed that twenty-two percent admitted to stealing from their employer.[63] Many employers believe that careful background checks can spot potential thieves.[64] "Preemployment background checks are an excellent way to cut down on hiring dishonest employees."[65] Credit checks among retailers concerned with theft of inventory are considered a tool in identifying potential thieves and minimizing theft.[66] In 2003, Forty-one percent of surveyed retailers claimed to use credit checks in the pre-employment process.[67]

Respondeat superior, the legal theory that places the financial responsibility for injuries caused an employee to a third party on the employer when the employee acts within the scope and course of employment, is another reason for concern.[68] An employee's mishandling of money, incurring in loses to a client or customer, would render the employer liable. Liability for the employer can also extend to the criminal acts of the employee, if the act is of the kind the employee performs within the scope of employment.[69]

Employers also face risk of liability for injuries caused by an employee under the tort theory of negligent hiring which, in some states, extends employer liability beyond the scope and course of employment to harmful behaviors the employer could have foreseen about the employee.[70] Under this theory, an employer is liable for acts taken by the employee if the

[61] Nick Fishman, *Risky business: Making hiring decisions without background checks can lead to costly mistakes*, NATIONS' RESTAURANT NEWS, June 13, 2005, at 12.

[62] *Eight Tips to prevent Employee Theft and Fraud*, AllBusiness, http://www.allbusiness.com/print/3935-1-22eeq.html (last visited June 17, 2008).

[63] *Bad Behaviors by Workers: More Prevalent Than You Might Think*, HR FOCUS, October 2007, at 9.

[64] Fishman, *supra* note 61.

[65] *Eight Tips to Prevent Employee Theft and Fraud*, AllBusiness, http://www.allbusiness.com/print/3935-1-2eeq.html (last visited June 17, 2008).

[66] *A Dollar Spent is Money Earned in Loss Prevention*, SECURITY DIRECTOR'S REP. (Nov. 2005) (on file with author).

[67] Andrea Coombes, *Job Seekers Obstacle: Bad credit*, CBS MarketWatch (June 17, 2004), http://jobbankusa.com/News/Jobs/jobs61704a.html (last visited June 17, 2008).

[68] Heckenlaible v. Va. Peninsula Reg'l Jail Auth., 491 F. Supp. 2d 544 (E.D. Va. 2007).

[69] R.A. ex el v. First Church of Christ, 748 A.2d 692 (Pa. 2000).

[70] Patrick H. Hicks & Neil M. Alexander, *Negligent Hiring, Training Supervisions and Retention in Nevada*, 5 NEV. LAW. 10 (1997).

employer placed the employee is the position of doing harm and the employer knew, or should have known, of the employee's "propensities."[71] Many states include the wording "reasonable investigation" in discussing negligent hiring and many employers seem to believe that pre-employment use of a credit report, by itself or as part of a more comprehensive background check, will relieve them of liability.[72] This will only be the case if any information in the report identified negative "propensities" and the employer took no other reasonable steps in uncovering such information. The completion of a pre-employment check, or the lack of it, will not be, in and of itself, conclusive as to the issue of employer liability.[73] In Maryland, the failure to make "reasonable inquires" is a factor in claims of negligent hiring, provided specific information about how the employer failed this responsibility the failure is presented.[74] Moreover, for the employer to face liability, the act of the employee against the third party must have been the "sort of behavior which caused the injured party's harm" and behavior about which the employer "with knowledge of the employee's propensity."[75] This proximate cause requirement must link propensities with wrongful behavior. Negligent hiring could certainly be a concern for an employer in light of the potential for identity theft. With over 8.3 million victims of identity theft in 2005, employers would be wise to investigate employees handling credit cards, bank accounts, Social Security numbers, and other sensitive information.[76] But will a credit report give employers the information they need?

The information contained within a credit report indeed will give an employer substantial private financial information relative to the prospective employee, although there is some information that the Fair Credit Reporting Act ("FCRA") prohibits third party agencies from reporting. These restrictions involve negative information over seven years old, specifically, civil actions, paid tax liens, and accounts placed in collection.[77] The reporting of bankruptcy information is prohibited once ten years has passed.[78] Criminal convictions can be reported indefinitely.[79] An exception to these restrictions provides that information over the allowable time periods can be used in a report if the

[71] Interim Pers. of Cent. Va., Inc. v. Messer, 559 S.E.2d 704 (Va. 2002).
[72] *Id*.
[73] Majorana v. Crown Cent. Petrol. Corp., 539 S.E. 2d 426 (Va. 2000).
[74] Cramer v. Housing Opportunities Comm'n, 501 A.2d 35 (Md. 1985).
[75] Sandra M. v. St. Luke's Roosevelt Hosp. Cte., 33 A.3d 875 (N.Y. 2006).
[76] *FTC report says identity theft fell; results disputed*, USA TODAY, Nov. 28, 2007, at 4B.
[77] 15 U.S.C. § 1681c (2007).
[78] *Id*.
[79] *Id*.

individual about whom the report is requested will, or has the expectation, to receive a salary over $75,000.00 per annum.[80]

However, information contained within a credit report is not limited to total debt. The report will also identify inquiries that have been made to the credit bureau for information on the consumer. *Hard* inquiries include banks, vendors and other financial institutions and loan companies and those inquiries can impact the credit score associated with the report.[81] Also included on a report will be late payments, accounts that have been placed in collection and any unpaid debts identified with that report.[82] Other personal information can be maintained as well, such as the spouse's name and the consumer's date of birth,[83] although major credit bureaus, such as Experian, Equifax and Trans Union, do not include information such as marital status, year of birth, and account numbers, when providing reports for employment purposes.[84]

Fair Credit Reporting Act

While the extensive legislation known as the Fair Credit Reporting Act primarily regulates the obligations of credit bureaus in maintaining financial and other public information about consumers, this statute also defines other uses of this information. While credit reports are an essential component to lending decisions, the Act regulates background investigations and reports used for employment purposes including the hiring of new employees and in evaluating existing employee for advancement.[85] Criminal record checks, credit checks, interviews and investigative documentation collected by third parties are all within the domain of FCRA. Credit checks are just a portion of the information that can encompass an investigative consumer report, and, if performed by a third party at the bequest of a potential employer, specific requirements of the Act must be followed.

Consumer reports can be provided to employers by third party reporting agencies when the agency has reason to believe the

[80] *Id*. § 1681c(b)(3).

[81] *Reading Your Credit Report: Devil's in the Details*, Comsumeraffairs.com, http://www.consumeraffairs.com/credit_cards/plastic_prisons_03.html (last visited June 17, 2008).

[82] *Id*.

[83] *Clean Up Your Credit Report: Reading a Report*, Consumer Credit Counseling Service, http://www.cccsoc.org/pages/credit_guide/credit_guide_05.phtml (last visited June 17, 2008).

[84] Daniel Klein & Jason Richner, *In defense of the credit bureau*, 12 CATO J. (1992), available at http://www.cato.org/pubs/journal/cj12n2/cj12n2-6.pdf.

[85] *Using Consumer Reports: What Employers Need to Know*, FTC Facts for Business, http://www.ftc.gov/bcp/conline/pubs/buspubs/credempl.pdf (last visited June 17, 2008).

information contained within the report is to be used for employment purposes.[86] The employer obtaining the report must certify to the reporting agency that it will comply with the requirements of law in the use of the report and in advising the candidate of any adverse action taken on the basis of the report.[87] The Act specifically provides that the party using the report will not use the information contained therein in violation of "any applicable Federal or State equal employment opportunity law."[88]

Moreover, the request for a report must be approved by the job applicant and must be disclosed in a "clear and conspicuous writing"[89] that consists only of the disclosure regarding the procurement and use of the report.[90] The employer must obtain written authorization from the applicant permitting the request for the report. [91] The applicant has certain rights in regard to the use of the report, other than the requirement of consent. The employer must notify the applicant of any adverse action the employer plans to take as a result of information contained within the report, even if the report is responsible for only a part of the employer's actions. [92] Under this circumstance, the employer must provide the applicant with a copy of the report, or the name and address of the reporting agency, and information regarding the applicant's rights.[93]

Specifically, the notice of rights includes a summary of rights prepared by the Federal Trade Commission ("FTC"), the toll free number of the reporting agency, a list of federal agencies responsible for enforcement of FCRA with addresses and phone numbers, that the consumer may have additional rights under state law and that the third party agency is not required to remove form the report any derogatory information unless the information is out of date or unverified.[94] This "pre-adverse action disclosure" must be given prior to the employer's making a final hiring or promotion decision. However, when the application is made by telephone, mail, computer or electronically, only final notice of adverse action based in art or all on the report is required.[95] Certain information is required in this notice: the name of the third party agency that collected the date within the report, a

[86] 15 U.S.C. § 1681b(a)(3)(B) (2007).
[87] *Id*. § 1681b(b)(1)(a).
[88] *Id*. § 1681b(a)(3)(B).
[89] *Id*. § 1681b(b)(2)(A)(i).
[90] *Id*. § 1681b(b)(2)(A).
[91] *Id*. § 1681b(b)(2)(A)(ii).
[92] *Id*. § 1681b(b)(3)(A)(i).
[93] *Id*. § 1681b (b)(3)(A)(i).
[94] *Id*. §1681g(c)(2)(A)-(E).
[95] *Id*. §1681b(b)(3)(B)(i).

statement that the third party agency did not participate in the making of the adverse decisions and that the third party agency can not provide information regarding the reasons for the adverse decision.[96] Moreover, while the reports can be obtained to make hiring or promotion decisions, they can not be obtained after an employee has been terminated, when intent to do so has been announced or when the employee has resigned.[97]

While these provisions are meant to protect the consumer, note that the decision not to offer a position to an applicant can be made without ever having met the applicant or discussed any negative information on the report with the applicant. However, some courts have determined that these provisions do, in fact, protect the job applicant from inaccurate information being used as a factor in employment decisions.[98] Arguably, the applicant truly is protected only if the law required a prospective employer to reconsider any adverse decision once the inaccurate information was corrected; however, the FCRA does not require this result. Moreover, while the FCRA provides for damages as a remedy against those employer's who fail to comply with the law, nothing precludes an employer from claiming that the information contained within the report was not the basis of the adverse decision, or that the decision was based on the relatively higher qualifications of other applicants.

Unless the consumer reporting agency or the employer acts in a willful way to violate the provisions of the FCRA, an applicant must prove actual damages as a result of the violation, as well as court costs and attorney's fees.[99] Punitive damages are permitted in cases of intentional violations of the law.[100] There are also criminal penalties if a report is obtained under false pretenses.[101] However, considering the difficulty in collecting the information necessary to prove such a claim, the applicant's position is daunting. Furthermore, the FCRA does not apply to an employer who conducts pre-employment investigations internally, and because of this, the adverse notice and consent requirements are not applicable in those situations.[102] While the use of

[96] *Id*. §1681g (c)(3)(A)(i)(I)-(IV).

[97] Russell v. Shelter Fin Servs., 604 F. Supp. 201 (W.D. Mo. 1984). Special notice requirements apply to the collection of public information that the reporting agency believes will have an adverse impact on the consumer about whom the report is compiled. In that circumstance, the collecting agency must notify the consumer of the negative information and the name and address of the person requesting the information. 15 U.S.C. § 1681k(a)(1) (2007).

[98] Porter v. Talbot Perkins Children's Services, 355 F. Supp. 174 (S.D. N.Y. 1973).

[99] 15 U.S.C. § 1681n(a)(1)(A)-(3) (2007).

[100] *Id*. § 1681n(a)(2).

[101] *Id*. § 1681q.

[102] *Employment Background Checks: A Jobseeker's Guide*, *Part V, ¶ 7,* Privacy Right Clearinghouse, http://www.privacyrights.org/fs/fs16-bck.htm (last visited June 17, 2008).

credit checks in employment at still lawful, albeit suspect, another factor that undermines their use is the considerable potential for inaccurate information within the report.[103] While the FCRA allows the consumer to dispute and correct this information,[104] it still could be the basis of a negative hiring or promotion decision. The law does not require an employer to give the applicant a second chance after the decision not to hire is made, corrected errors notwithstanding; by the time corrections are made, the opportunity for the job or promotion will have long since passed.

The Case for Disparate Impact

The use of credit checks in the hiring and promotion process has been an employment discrimination concern for many years. Section 15 of the EEOC Compliance Manual identifies the use of credit histories as an area that is "subject to challenge" on the basis of disparate impact.[105] Some courts also have recognized the potential for financial/credit checks to be a discriminatory employment practice. A federal district court examined the actual consequences of an employer's policy of terminating employees whose wages were garnished, and determined that the practice discriminated against African Americans.[106] After reviewing wage garnishment information, the court concluded that the evidence that minority groups suffer garnishments substantially more than other sufficiently identified a disparate impact on minorities. [107] In 1974 police officers in Chicago claimed the City's policy of using background checks as a means to determine the qualifications of an employee considered for appointment as patrolmen was discriminatory.[108] While the City argued that the checks were utilized to determine whether or not an applicant was of "bad moral character, dissolute habits or [guilty] of immoral conduct…,"[109] the court issued the preliminary injunction requested by the officers. These practices in patrolmen hiring, as well as exams used for promotion decisions, "have operated to exclude greater percentages

[103] *See supra* notes 1-5 and accompanying text.

[104] 15 U.S.C. § 1681 (2007).

[105] EEOC Compliance Manual, § 15-VII(B)(2) (Apr. 19, 2006), available at http://www.eeoc.gov/policy/docs/race-color.html#VIB2conviction.

[106] Johnson v. Pike Corp. of Am., 332 F. Supp. 490 (C.D. Ca. 1971).

[107] *Id*. at 494. "Minority groups are more often in debt, are more frequently subject to questionable credit practices and harassment, and have less capacity to defend themselves." *Id*.

[108] United States v. City of Chicago et al., 385 F. Supp. 543 (N.D. Ill. 1974). The background check was extensive and included inquiries into education, employment, criminal convictions, arrest records of family members, military records and financial condition.

[109] *Id*. at 549.

of blacks and Hispanics than whites."[110] About ten years later, the same Illinois court heard a case in which a woman claimed that she was the subject of discrimination by an employer bank when she was denied employment partly due to a poor credit report.[111] While the court acknowledged that the use of credit reports could be discriminatory, in this case the plaintiff failed to present sufficient statistical evidence of discrimination to justify a summary judgment.[112] The Fifth Circuit reviewed a city of Dallas policy that provided for the discipline of employees who failed to pay their debts.[113] The plaintiff argued that African Americans were more likely to be poor than whites, and that poor people were more likely not to pay their debts; therefore, the policy discriminated against them. However, the court determined that the plaintiff failed to provide the requisite statistical proof that "black employees of the city of Dallas fail to pay their just debts more frequently than white employees of the city of Dallas."[114]

Empirical studies now exist to demonstrate that the use of credit reports discriminates against minorities. Two major studies addressed the question of whether or not the use of credit scores in underwriting insurance and setting premiums is discriminatory, and in both studies the conclusion was in the affirmative. Consider, for example, that Ninety-two percent of the largest insurance companies use credit information to provide new insurance; fifty-two percent used the same information to set rates.[115] In a Texas Department of Insurance two-million-person study, African Americans were found to have credit scores from ten to thirty-five percent worse that those of Caucasians, while scores of Hispanics were from five to twenty-five percent worse than Caucasians, and scores of Asians were found "to be the same or slightly worse than those for whites."[116] The State of Missouri

[110] *Id*. at 550.

[111] Howard v. Cont'l Ill. Nat'l Bank & Trust Co. of Chicago, No. 82C792, 1983 U.S. Dist. LEXIS 11923 (N.D. Ill. 1983).

[112] Although, the plaintiff asserted that blacks and unmarried female heads of households are disproportionately below the poverty level and, that as a result, more likely to suffer financial troubles, she failed to present "statistical evidence that blacks and women are more likely to suffer from poor credit ratings." *Id*. at *5.

[113] Robinson v. City of Dallas, 514 F. 2d 1271 (5th Cir. 1975).

[114] *Id*. at 1273. The plaintiff instead used census data on poverty and the population figures for the city to argue that "Negroes comprise a disproportionately large segment of the poor people in Dallas." *Id*. at 1273-74.

[115] *Guess Who's Looking at Your Credit Report*, Smartmoney.com (November 27, 2006), http://www.smartmoney.com/consumer/index.cfm?story=20010820 (last visited June 17, 2008).

[116] *Use of credit Information by Insurers in Texas*, Tex. Dept. of Ins., Rep. to the 79th Legis. (Dec. 2004), http://www.tdi.state.tx.us/reports/documents/creditrpt04.pdf (last visited June 17, 2008).

Department of Insurance study found that insurance credit scoring produced worse scores in high minority areas, low income areas and that "minority concentration proved to be the single most reliable predictor of credit scores" even after eliminating variable such as income education, marital status and unemployment rates.[117] The argument that the use of credit scores in setting insurance rates discriminates against minorities is supported by statistics; the analogy to employment pre-screening is obvious. Additional studies link low credit scores with minorities as well. Freddie Mac reported that "48% percent of Blacks and 34% of Hispanic consumers have poor credit records, compared with only 27% of Whites" regardless of income levels.[118] Of utmost concern, the study showed that race had a stronger correlation to a poor credit score than did income.[119] The Federal Reserve Board, in a recent report, found that racial groups do have *substantially* lower credit scores, although the report did not identify reasons for the disparity.[120]

Nevertheless, a prospective employee's credit score may have more to do with poverty than with poor character. The US Census reports that in 2004 black households had the lowest median incomes of all racial groups at $30,134, and that the poverty rate for blacks was 24.7 percent.[121] Obviously, the poor are more vulnerable to the adverse consequences of job loss or financial set backs, and have less access to resources that could assist them in handling debts, like Internet sites. Decades of poverty, credit discrimination, and the likelihood of errors in reports all serve to demonstrate that the use of credit reports has a disparate impact on those protected by Title VII. In documenting the poor credit and financial woes of minorities, credit reports illustrate the "broader patterns of exclusion and discrimination practiced by third parties and fostered by the whole environment in which most minorities must live."[122]

Should an applicant or employee statistically demonstrate disparate impact as the result of a specific hiring practice, such as the use of credit checks, then the employer must *demonstrate* what aspects of credit

[117] Brent Kabler, *Insurance Based Credit Scores; Impact on Minority and Low Income Populations in Missouri*, State of Missouri Department of Insurance (June 1004), http://www.insurance.mo.gov/reports/credscore.pdf (last visited June 17, 2008).

[118] Steven A. Holmes, *Survey Details Problems of Minorities and Credit*, N. Y. TIMES, Sept. 22, 1999.

[119] Klein, *supra* note 8.

[120] Kenneth Harney, *Patterns in credit payment histories*, SAN DIEGO UNION TRIB., Sept. 2, 2007.

[121] *Income Stable, Poverty Rate Increases, Percentage of Americans Without Health Insurance Unchanged*, US Census Bureau News Release (Aug. 30, 2005), http://www.census.gov/Press-Release/www/releases/archives/income_wealth/005647.html (last visited June 17, 2008).

[122] Johnson v. Pike Corp. of Am., 332 F. Supp. 49 (C.D. Ca. 1971).

history *specifically* correspond with job duties, according to statutory dictates and EEOC validation guidelines. This demonstration of "business necessity" serves to override the disparate impact claim for a discriminatory practice when the practice is job related.[123] Discrimination based on the applicant's inability to perform the demands of the job is, understandably, lawful. [124] If the employer can establish that "there is a legitimate business need for credit checks, then there is no Title VII problem,"[125] unless a less discriminatory, but equally effect, practice exists. The Civil Rights Act of 1991 allows plaintiffs to counter the business necessity defense by showing that an alternative employment practice would satisfy the employer's legitimate interests without having a disparate impact on a protected class.[126] Such alternative, less discriminatory practices, indeed may exist. For example, if an employer issued a company credit card as a term and condition of the employment relationship, other control mechanisms exist for monitoring the balance on that card, short of mandating a pre-employment credit report, which necessarily impacts minorities adversely as a protected class.

For many companies and businesses credit report checks have become routine for positions deemed financially sensitive and that involve handling money "[s]ighting [sic] a possible correlation between high debt and, for instance, the possibility of embezzlement."[127] Or, perhaps, credit history can assist an employer in determining whether an applicant's report "shows a debt load that may be too high for the proposed salary…"[128] Many are just concerned that potential employees are "carrying enormous debts or…living well beyond their means."[129] "There's an assumption that people with poor credit histories are more likely to steal…."[130] The fundamental belief in reviewing financial information regarding prospective employees is that "[t]he responsibility they exercise in running their personal financial affairs usually spills over to the workplace. Some employers also assume that people who have bad credit or money troubles might be more tempted to steal or commit other crimes involving the company."[131]

[123] Griggs v. Duke Power Company, 401 U.S 424 (1971).

[124] McDonnell Douglas Corp. v. Green, 411 U.S. 792 (1973).

[125] *EEOC Challenges Unnecessary Credit Checks*, HRM UPDATE, Apr. 2007, at 5.

[126] 42 U.S.C. § 2000e-2 (k)(1)(A)(ii) (2007).

[127] Klein & Richner, *supra* note 85.

[128] *Bad Behaviors by Workers: More Prevalent Than You Might Think*, HR FOCUS, Oct. 2007, at 9.

[129] Weston, *supra* note 51.

[130] *Use of credit Information by Insurers in Texas*, Tex. Dept. of Ins., Rep. to the 79th Legis. (Dec. 2004), http://www.tdi.state.tx.us/reports/documents/creditrpt04.pdf (last visited June 17, 2008).

[131] David W. Myers, *Credit Rating Could Hurt Job Prospects: Employers Prefer to Hire People Who Pay Their Bills*, N. O. TIMES PICAYUNE, Jan. 22, 2000, at R3.

Although readings on the topic often refer to "studies show that that people who handle their money wisely often make the best employees,"[132] extensive searches uncover no studies or evidence that link poor credit rating with poor performance or likelihood of theft. On the contrary, the only study on point, conducted by professors at Eastern Kentucky University, clearly disputes these assumptions. Two hundred bank employees were the subject of this study that specifically attempted to identify any such correlation. However, the results found no correlation between credit history and job performance. [133] Factors like divorce, medical illness, unemployment most often negatively impact credit reports and have nothing to do with character; "as a measure of conscientiousness or attention to detail, it is not very good."[134] Indeed, another study indicates that half of all bankruptcy filings, a major credit offender, are due to medical costs.[135] Even the notion that frivolous spending is the cause of a consumer's financial distress is debatably inaccurate. "There is no evidence of any "epidemic in overspending—certainly nothing that could explain a 255% increase in the foreclosure rate, a 430% increase in the bankruptcy rolls, and a 570% increase in credit card debt. A growing number of families are in terrible financial trouble, but no matter how many times the accusation is hurled, Prada and HBO are not the reason."[136] Yet, despite considerable evidence to the contrary, and without any empirical evidence to support the use of credit reports for employment purposes, the myth that financial troubles reflect character flaws and that paying all debts indicates personal responsibility continues to persist. [137]

The Supreme Court in *Connecticut v. Teal* acknowledged the importance of considering the employee or applicant individually and not in the abstract. In *Teal*, The Court rejected an employer's argument that a test used to determine promotions, which disproportionately excluded minorities and was not job-related, was not discriminatory because the overall result or "bottom line" percentage of candidates promoted favored minorities. "The suggestion that disparate impact should be measured only at the bottom line ignores the fact that Title VII guarantees these individual respondents the opportunity to compete

[132] *The Legal Obligations of Conducting a Background Check*, AllBusiness, http://www.allbusiness.com/government/employment-regulations/1483-1.html (last visited June 17, 2008).

[133] Teicher, *supra* note 12.

[134] *Id*.

[135] Leslie Eaton, *Bankruptcy, the American Morality Tale*, N. Y. TIMES, Mar. 12, 2005, at *Week in Review*.

[136] Elizabeth Warren, *The Over-Consumption Myth and Other Tales of Economics, Law and Morality*, 82 WASH. U. L. Q. 1485 (2004).

[137] Eaton, *supra* note 135.

equally with white workers on the basis of job-related criteria. Title VII strives to achieve equality of opportunity by rooting out 'artificial, arbitrary, and unnecessary' employer-created barriers to professional development that have a discriminatory impact upon individuals."[138] Unfortunately, the generic consideration of creditworthiness in the abstract as a condition of employment results in generalizations based on intuitive assumptions concerning personal solvency and fiscal responsibility, which may be neither accurate nor job related. Employers should resist this temptation to jump to unproven conclusions, which arbitrarily "limit, segregate or classify"[139] persons, and instead strive to develop predictive criteria for job performance in an effort to provide equality of opportunity to individuals, as well as to employ the most competent personnel for their enterprise.

CONCLUSION

Prospective employees, who have been eliminated from job opportunities based upon a poor credit score, must demonstrate under Title VII that such an employment practice has a disparate impact on members of a protected class. Employers then would be permitted to establish that such a policy is job related for the position in question and consistent with business necessity. Under federal law there must be a nexus between an applicant's credit score and the employee's particular job description or responsibilities. However, there is no comprehensive study available to suggest that one's credit score illuminates any particular personal quality upon which an employer could justify a hiring decision. There is no statistical proof that people who are poor managers of their own finances will necessarily be poor managers of an employer's funds, or alternatively, perform their job duties recklessly. Empirical studies establishing the predictive value of a low credit rating and job performance also are lacking. Moreover, current statistics support the argument that the use of credit records in business applications discriminates disproportionately against minorities.

Even if the employer was able to validate the selection criteria under EEOC Guidelines, prospective employees likely could establish that an alternative employment practice could accomplish the employer's objective without disadvantaging certain applicants. Admittedly, a balance should be struck between legitimate entrepreneurial interests in controlling the workforce and the societal goal of eliminating discriminatory employment practices.[140] Yet in reality, these goals share an even more desirable objective, that is, that the employer profits from

[138] Connecticut v. Teal, 457 U.S. 440, 451 (1982).
[139] The language is borrowed from Title VII's prohibitions. 42 U.S.C. § 2000e-2(a) (2007).
[140] Lye, *supra* note 28.

the most qualified workforce and employees enjoy their positions based upon merit. "Far from disparaging job qualifications as such, Congress has made such qualifications the controlling factor, so that race, religion, nationality, and sex become irrelevant. What Congress has commanded is that any tests used must measure the person for the job and not the person in the abstract."[141]

[141] Griggs v. Duke Power Co., 401 U.S 424, 436 (1971).

WHAT TO DO ABOUT "ME-TOO"? SUPREME COURT RULES IN *SPRINT/UNITED MANAGEMENT CO. v. MENDELSOHN* ON RECURRING EVIDENTIARY ISSUE IN EMPLOYMENT DISCRIMINATION CASES

by DEXTER R. WOODS, JR.[*]

INTRODUCTION

"Much Ado about Me-Too" and "Mystical Me-Tooistical Testimony" would fit in well with current legal headlines on what to do about me-too evidence in employment discrimination cases.[1] Broadly, me-too evidence in employment discrimination cases is testimony by non-parties to a lawsuit that they, too, have been victims of such discrimination.[2] When

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[1] Sample article headlines include the following: Paul M. Secunda, *Supremes Take "Me Too" Employment Discrimination Case*, WORKPLACE PROF LOG – A MEMBER OF THE LAW PROFESSOR BLOGS NETWORK, June 11, 2007, http://lawprofessors.typepad.com/laborprof_blog/2007/06/supremes_take_m.html; Ross Runkel, *Sprint/United Management Company v. Mendelsohn (06-1221): Employment Discrimination "Me Too" Testimony*, LAW MEMO.COM—FIRST IN EMPLOYMENT LAW, http://www.lawmemo.com/supreme/case/Sprint/ (last visited May 27, 2008). Despite the headlines, Me-Toosical, the Musical, seems unlikely.

[2] The term "me-too" evidence apparently first occurs in a book edited by Sprint's counsel, Paul W. Cane, Jr. of Paul, Hastings, Janofsky & Walker in San Francisco. Brief for Respondent against Certiorari at 9-10, Sprint/United Mgmt. Co. v. Mendelsohn, 128 S. Ct. 1140 (2008) (No. 06-1221), *available at* http://www.scotusblog.com/movabletype/archives/06-1221BIO.pdf; *see* BARBARA LINDEMANN & PAUL GROSSMAN, EMPLOYMENT DISCRIMINATION LAW 30 (3d ed. 1996).

the me-too evidence pertains to discrimination by someone other than the plaintiff's supervisor, courts and parties sometimes refer to the evidence as "other supervisor" evidence.[3] In the 2008 case of *Sprint/United Management Co. v. Mendelsohn*,[4] the United States Supreme Court considered whether courts should admit or exclude me-too/other-supervisor evidence.[5]

Ellen Mendelsohn (Mendelsohn) sued her employer, Sprint/United Management Company (Sprint), for age discrimination in violation of the Age Discrimination in Employment Act (ADEA).[6] Mendelsohn attempted to introduce evidence from other Sprint employees that Sprint had also discriminated against them based on their age.[7] However, because the other employees were not parties to the lawsuit and because their supervisors were not the same as Mendelsohn's supervisors, the United States District Court for Kansas (District Court) disallowed the evidence.[8] The District Court apparently relied on precedent by the United States Court of Appeals for the Tenth Circuit (Tenth Circuit) that testimony of other employees is admissible only if the other employees worked under the same supervisor as the plaintiff and were fired around the same time as the plaintiff.[9]

Mendelsohn appealed the District Court's exclusion of the proffered me-too or other-supervisor testimony.[10] The Tenth Circuit held that the same-supervisor rule applied in discriminatory discipline actions by individual supervisors, but not in reduction in force (RIF) cases that possibly involved company-wide discrimination.[11] The Tenth Circuit further held that the District Court should have included the proffered evidence and reversed and remanded the case to the District Court for a new trial that was to include the me-too evidence.[12]

Sprint petitioned the United States Supreme Court for a writ of certiorari to dispute the Tenth Circuit's inclusion of the proffered

[3] *See, e.g.,* Brief for the United States as Amicus Curiae, *Sprint* at 12, 128 S. Ct. 1140 (2008) (No. 06-1221), *available at* http://www.usdoj.gov/osg/briefs/2007/3mer/1ami/2006-1221.mer.ami.pdf. This paper will use me-too evidence and other-supervisor evidence interchangeably.

[4] Sprint/United Mgmt. Co. v. Mendelsohn, 128 S. Ct. 1140 (2008).

[5] *See* Order Granting Certiorari, *Sprint*, 128 S. Ct. 1140 (2008) (No. 06-1221), *available at* http://www.supremecourtus.gov/qp/06-01221qp.pdf.

[6] *Sprint,* 128 S. Ct. at 1143.

[7] *Id.*

[8] *Id.* at 1144.

[9] *Id.*

[10] *See id.* at 1144.

[11] *Id.*

[12] *Id.*

testimony.[13] Sprint argued that four circuits had determined, under Federal Rules of Evidence 401 and 402, that me-too evidence about other supervisors was irrelevant and, therefore, inadmissible.[14] Moreover, Sprint argued that five circuits exercised their discretion under Federal Rule of Evidence 403 to hold that even relevant me-too that would cause unfair prejudice, confusion, or waste of time, was inadmissible.[15] Sprint argued that the Tenth Circuit, contrary to those circuits, found me-too evidence as admissible per se.[16]

When the Supreme Court granted certiorari, the case elicited much commentary from legal scholars and much concern from groups representing both employers and employees.[17] On behalf of employers who wanted to excluded me-too evidence, the Society for Human Resource Management (SHRM), the world's largest organization devoted to human resource management, followed the case from its inception[18] and joined with two other employer groups (Equal Employment Advisory Council (EEAC)[19] and National Federation of Independent Business (NFIB)[20] to file two amici curiae briefs with the Supreme Court (one on certiorari and one on the merits).[21] Similarly, on behalf of employers, AT&T, Honeywell, and Lockheed joined to file an amici curiae brief on

[13] Brief for Petitioner for Certiorari at 1, *Sprint*, 128 S. Ct. 1140 (2008) (No. 06-1221), *available at* http://www.scotusblog.com/movabletype/archives/06-1221.pdf.

[14] *Id.* at 5.

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

[16] *Id.* at 6. *See also* Deepa Sarkar & Joe Hashmall, *Sprint/United Management v. Mendelsohn (06-1221)*, CORNELL UNIVERSITY LAW SCHOOL LEGAL INFORMATION INSTITUTE BULLETIN, www.law.cornell.edu/supct/cert/06-1221.html (last visited July 7, 2008) (preview of the case).

[17] *See* David G. Savage, *Taking on the Job: The Court Weighs Worker Rights in Age Bias, Benefits Suits*, ABA JOURNAL - LAW NEWS NOW, Nov. 2007, http://www.abajournal.com/magazine/taking_on_the_job; Greg Stohr, *Workplace Bias Evidence Draws U.S. Supreme Court Scrutiny,* BLOOMBERG NEWS, June 11 2007, http://www.bloomberg.com/apps/news?pid=20601103&sid=aIcj7hSplDb8&refer=us; Runkel, *supra* note 1.

[18] *See* Maria Greco Danaher, *10th Circuit: Extension of Same-Supervisor Rule Rejected*, SOCIETY FOR HUMAN RESOURCE MANAGEMENT—HR NEWS, Nov. 24, 2006, http://www.shrm.org/hrnews_published/ archives/ CMS_019289.asp.

[19] The EEAC stated that it was a nationwide association of employers dedicated to finding ways to eliminate employment discrimination. Brief for EEAC & SHRM as Amici Curiae In Support of Petitioner at 1, *Sprint*, 128 S. Ct. 1140 (2008) (No. 06-1221), *available at* http://www. scotusblog.com/movabletype/archives/06-1221EEAC.pdf.

[20] The NFIB stated that it was the nation's leading small-business advocacy association. Brief for EEAC *et al.* as Amici Curiae in Support of Petitioner at 2, *Sprint*, 128 S. Ct. 1140 (2008) (No. 06-1221), *available at* http://www.nfib.com/object/ IO_34559.html.

[21] *See* Brief for EEAC & SHRM in Support of Petitioner, *supra* note 19; Brief for EEAC *et al*. in Support of Petitioner, *supra* note 20.

certiorari,[22] and the U.S. Chamber of Commerce filed an amicus curiae brief on the merits.[23] On behalf of employees who wanted to include me-too evidence, AARP[24] and the Lawyers' Committee for Civil Rights under Law (Lawyers' Committee), joined by eleven other civil rights and employee organizations, also filed briefs on the case.[25] The United States, on behalf of both sides as an employer and as a defender of employees, likewise filed an amicus curiae brief.[26]

In general, the employer-sided briefs argued that permitting me-too evidence pertaining to other supervisors would unduly prejudice employers who would have to defend not only the case at issue, but would also have to defend other, unrelated claims of discrimination.[27] The employee-sided briefs argued that such me-too testimony was especially needed because direct evidence of discrimination is rare and because other types of circumstantial evidence such as statistical evidence and expert witness testimony are deterrently expensive.[28]

Employers and employees both felt substantially at risk with respect to this very important issue pertaining to the admissibility of evidence

[22] *See* Brief of AT&T *et al.* as Amici Curiae in Support of Petitioner, *Sprint*, 128 S. Ct. 1140 (2008) (No. 06-1221), *available at* http://www.appellate.net/briefs/Mendelson_amicusbrief.pdf. The brief noted that "[t]his case presents issues of great concern to businesses around the country, including *amici*, which are three of the largest employers in the Nation." *Id.* at 1. The three employers referred to are AT&T, Honeywell International, Inc. and Lockheed Martin Corp.).

[23] *See* Brief of the Chamber of Commerce as Amicus Curiae Supporting Petitioner, *Sprint*, 128 S. Ct. 1140 (2008) (No. 06-1221), *available at* http://www.uschamber.com/nclc/caselist/adea_082806.htm (then follow *Sprint* "View brief" hyperlink). The Chamber of Commerce represented itself as the "world's largest business federation." *Id.* at 1.

[24] AARP represented the interests of people age fifty or older, includind more than 39 million members of whom half were still working and protected by the ADEA. Brief of AARP *Amicus Curiae* In Support of Respondent at 1, *Sprint*, 128 S. Ct. 1140 (2008) (No. 06-1221), *available at* http://www.abanet.org/ publiced/preview/briefs/pdfs/07-08/06-1221_RespondentAmCuAARP.pdf.

[25] Brief of Lawyers' Committee *et al.* as Amici Curiae In Support of Respondent, *Sprint*, 128 S. Ct. 1140 (2008) (No. 06-1221), *available at* http://www.abanet.org/publiced/preview/briefs/pdfs/07-08/06-1221_ RespondentAmCu12CivilOrgs.pdf. Joining with the Lawyers' Committee were the Asian American Justice Center, the Mexican Legal Defense and Educational Fund, the National Association for the Advancement of Colored People, the NAACP Legal Defense and Educational Fund, the National Association of Social Workers, the National Employment Lawyers Association, the National Partnership for Women & Families, the National Women's Law Center, the People for the American Way Foundation, the Puerto Rican Legal Defense and Education Fund, and Women Employed. *Id* at 1.

[26] *See* Brief for the United States, *supra* note 3.

[27] *See* Allen Smith, *Supreme Court Will Review Exclusion of Co-worker Testimony*, SOCIETY FOR HUMAN RESOURCE MANAGEMENT—HR NEWS, July 20, 2007, http://www.shrm.org/law/library/CMS_022397.asp.

[28] *See* Sarkar & Hashmall, *supra* note 16.

in employment discrimination cases.[29] The Supreme Court's ruling on this common evidentiary issue would impact very large numbers of ADEA claims (16,548 filed in 2006 alone) and even larger numbers of other types of federal discrimination claims (59,220 filed in 2006).[30] Moreover, the ruling had the potential to either make all such me-too testimony admissible if the Tenth Circuit was affirmed or to make all such me-too testimony inadmissible if the Tenth Circuit was reversed.[31]

As it turned out, the Supreme Court neither affirmed not reversed the Tenth Circuit. One writer for the Los Angeles Times reported, "The Supreme Court . . . decided not to decide one of its most closely watched job discrimination cases. The non-decision was unanimous."[32] Instead, the Court vacated the judgment of the Tenth Circuit and remanded the case to the District Court.[33] The Supreme Court concluded that the District Court should not apply a per se rule excluding me-too/other supervisor testimony and the Circuit Court should not apply a per se rule including such testimony.[34] Rather, the Supreme Court decided that questions of "relevance and prejudice under Rules 401 and 403 are determined in the context of the facts and arguments in a particular case, and, thus, are generally not amenable to broad per se rules."[35]

The remainder of this paper will more closely examine the facts and the arguments in *Sprint v. Mendelsohn* and in similar prior cases. In doing so, the paper will attempt to draw some conclusions as to how *Sprint v. Mendelsohn* will impact not only the admissibility or exclusion of me-too testimony in future employment discrimination cases, but also the actions of the participants in such cases, including the courts and the parties.

THE DISTRICT COURT DECISION

The District Court first reported the facts of the case in ruling on Sprint's motion for summary judgment.[36] Mendelsohn worked as a

[29] *See* Woodley Osborne, *Sprint/United Management v. Mendelsohn Has Important Implications for the Effort to Combat Employment Discrimination*, ACSBLOG: THE BLOG OF THE AMERICAN CONSTITUTION SOCIETY, Dec. 3, 2007, http://www.acsblog.org/guest-bloggers-guest-blogger-sprintunited-management-v-mendelsohn-has-important-implications-for-the-effort-to-combant-employment-discrimination.html/.

[30] Sarkar & Hashmall, *supra* note 16.

[31] *Id*.

[32] David G. Savage, *No Ruling from Justices in Age-Bias Case: The Supreme Court Fails to Say Whether Co-Worker Testimony Should Be Allowed and Returns the Matter to the Trial Judge*, LOS ANGELES TIMES, February 27, 2008, at A10.

[33] *Sprint/United Management v. Mendelsohn*, 128 S. Ct. at 1140, 1147 (2008).

[34] Savage, *supra* note 32.

[35] *Sprint*, 128 S. Ct. at 1147.

[36] Mendelsohn v. Sprint/United Mgmt. Co., No. 03-2429-KHV, 2004 U.S. Dist. LEXIS 30629 (D. Kan. Nov. 29, 2004).

manager for Sprint for thirteen years prior to her termination at age fifty-one in 2002.[37] Except for immediately prior to her termination, she always received good evaluations.[38] In February 2002, her supervisor rated her as "Effective" and her 38-year-old co-worker as "Improvement Needed."[39] In late July or early August 2002, the supervisor reversed that evaluation and rated the younger co-worker as "Effective" and Mendelsohn as "Improvement Needed."[40] Also in late July 2002, the supervisor added a thirty-six year old manager to the group and in September gave the new manager some of Mendelsohn's responsibilities.[41]

Based on input from her supervisor and pursuant to an ongoing company-wide RIF, Sprint terminated Mendelsohn on November 22, 2002.[42] Although Sprint terminated six employees from Mendelsohn's work group (including four over age forty), her work group actually increased in size by one employee, including five managers under age forty.[43] Sprint did not follow its Displacement Guidelines which stated that management should favorably consider length of service when making termination decisions.[44] In August 2003, Mendelsohn sued Sprint for age discrimination.[45]

In its summary judgment ruling on November 29, 2004, the District Court discussed whether Mendelsohn could establish that age was a determining factor in terminating her employment.[46] The Court analyzed the case pursuant to the burden-shifting framework of *McDonnell Douglas*.[47] First, Sprint conceded for purposes of summary judgment that Mendelsohn could establish a prima facie case that: "(1) she was a member of the protected age group, over age 40; (2) she was performing satisfactorily; (3) defendant terminated her employment; and (4) defendant replaced her with a younger person."[48] Next, Sprint met its burden to show its nondiscriminatory reason for terminating

[37] *Id*. at *4.
[38] *Id*. at *5.
[39] *Id*. at *6.
[40] *Id*. at *7.
[41] *Id*. at *7-8.
[42] *Id*. at *8.
[43] Mendelsohn v. Sprint/United Mgmt. Co., No. 03-2429-KHV, 2004 U.S. Dist. LEXIS 30629 at *8-9 (D. Kan. Nov. 29, 2004).
[44] *Id* at *9.
[45] *Id*.
[46] *Id*. (citing Greene v. Safeway Stores, Inc., 98 F.3d 554, 557 (10th Cir. 1996)); s*ee also* 29 U.S.C. § 623(a)(1) (unlawful under ADEA to "discharge any individual…because of such individual's age.").
[47] *Id*. at *10-12 (citing McDonnell Douglas Corp. v. Green, 411 U.S. 792, 802-05 (1973)).
[48] *Id*. at *11n.5.

Mendelsohn was to implement a RIF to meet budget cuts.[49] Mendelsohn then had the burden to show the reason as pretextual.[50] The District Court said that she could do so by showing by direct or circumstantial evidence that Sprint terminated her in a manner inconsistent with the RIF criteria, that Sprint falsified or manipulated her evaluation under the RIF criteria, and/or that the RIF was a sham.[51] Mendelsohn argued both that Sprint did not follow its RIF criteria and that it deliberately manipulated her and her co-workers' evaluations so that she would be terminated pursuant to the RIF.[52] Moreover, she argued that two thirds of the employees who were eliminated from her group were over age forty, and that her responsibilities were given to employees under age forty.[53]

The District Court concluded that upon viewing the facts as a whole and in a light most favorable to the plaintiff, Sprint's reason for termination could be considered pretextual.[54] Therefore, the Court denied Sprint's motion for a summary judgment, and the parties prepared for trial.[55]

Prior to trial, Sprint filed a motion in limine seeking to exclude me-too testimony of Sprint's allegedly discriminatory treatment of other employees who were not supervised by plaintiff's supervisor because such evidence would not be relevant.[56] The motion relied exclusively on *Aramburu v. Boeing, Co.*,[57] in which the Tenth Circuit affirmed summary judgment for the defendant because the plaintiff could produce no evidence that the defendant was treated differently than "similarly situated" non-minorities.[58] The District Court apparently followed *Aramburu's* philosophy and language when it noted in a two-sentence minute entry on the docket sheet, "Plaintiff may offer evidence of discrimination against Sprint employees who are similarly situated to her. 'Similarly situated employees,' for purposes of this ruling, requires proof that (1) [Mendelsohn's supervisor] was the decision-maker in any adverse employment action; and (2) temporal proximity."[59] Accordingly, Mendelsohn could not use witnesses who claimed that Sprint discriminated based on age unless the witnesses testified that

[49] *Id.*
[50] *Id.* at *12.
[51] *Id.* at *12-13.
[52] *Id.* at *14.
[53] *Id.* at *13-14.
[54] *Id.* at *14.
[55] *Id.*
[56] Mendelsohn v. Sprint/United Mgmt. Co., 466 F.3d 1223, 1225 (10th Cir. 2006).
[57] 112 F.3d 1398 (10th Cir. 1997).
[58] *See id.* at 1404; *Mendelsohn,* 466 F.3d at 1225.
[59] *Mendelsohn*, 466 F.3d at 1225.

Mendelsohn's supervisor was the one who discriminated and that he did it at about the same time as the Mendelsohn case.[60] Mendelsohn had no such same-supervisor/same-time witnesses.[61]

Following the ruling on the motion in limine, she submitted an offer of proof summarizing deposition testimony of five other Sprint employees over age forty who were terminated in the same RIF by supervisors other than Mendelsohn's.[62] One witness would have testified that her supervisor told her she was too old for the job and sent her and four other Sprint employees an e-mail reciting Jack Welch's philosophy that top employees are those who "are blessed with lots of runway ahead of them."[63] A second witness would have testified that she accidentally received from a supervisor a copy of a spreadsheet entitled "layoffs" or "RIFs" that had everyone's age on it.[64] A third witness would have testified that a manager told her and others that he had too many older people in his department and that he would clean up his department when Sprint had layoffs.[65] A fourth witness would have testified that his supervisor said that he had been terminated because his position was eliminated, but that Sprint hired another person to fill his position.[66] A fifth witness would have testified that he had to get his Vice President's approval when he wanted to hire someone over forty years old, and that most of the former Sprint employees who used Sprint's outplacement service were over forty years old.[67]

At trial, Sprint took full advantage of Mendelsohn's inability to use me-too testimony that pertained to other supervisors and portrayed Mendelsohn as an isolated case, "the only person over 40 without a job because of this reduction in force."[68] After eight days of trial, the jury found for Sprint.[69] Mendelsohn filed a motion for a new trial based on her objections to the motion in limine.[70] The district court denied the motion for a new trial, and Mendelsohn appealed to the Tenth Circuit.[71]

[60] *See id.*
[61] *See id.*
[62] Brief for the United States, *supra* note 3, at 3.
[63] *Id.*
[64] *Id.* at 3-4.
[65] *Id.* at 4.
[66] *Id.*
[67] *Id.* at 5.
[68] Brief for Respondent against Certiorari, *supra* note 2, at 6.
[69] Mendelsohn v. Sprint/United Mgmt. Co., 466 F.3d 1223, 1225 (10th Cir. 2006).
[70] *Id.*
[71] *Id.*

THE TENTH CIRCUIT DECISION

On appeal, Mendelsohn argued that the me-too, other-supervisor testimony from the five witnesses was relevant because Mendelsohn and each of the employees were over forty and terminated under the same RIF.[72] Sprint, however, continued to argue that the same-supervisor rule should apply and that evidence about discriminatory intent of other supervisors was irrelevant in considering the discriminatory intent of the decision-making supervisor.[73]

Although the *Aramburu* decision and the District Court ruling considered certain evidence irrelevant, neither decision specifically discussed (nor even mentioned) such irrelevance in conjunction with Federal Rules of Evidence 401-403. Rule 401 defines relevant evidence as "evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence."[74] Rule 402 states that "[a]ll relevant evidence is admissible, except as otherwise provided . . . [and] [e]vidence which is not relevant is not admissible."[75] Rule 403 states that even relevant evidence "may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence."[76]

In *Sprint,* the Tenth Circuit majority similarly did not specifically mention Rules 401-402 in discussing relevance.[77] To explain how the same-supervisor rule can properly exclude irrelevant evidence, the court set forth the following hypothetical:

> If X fires A, an Hispanic, for particular misconduct, but gives only a warning to B, a non-Hispanic, for identical misconduct, one might infer that something beyond the misconduct (such as a bias by X against Hispanics) motivated the disciplinary action. But if it was Y, not X, who decided not to impose a harsher sanction against B, one cannot infer that X's decision to fire A must have been motivated by something other than A's misconduct. X may simply have a less tolerant view toward misconduct than Y does.[78]

[72] *Id.* at 1226.
[73] *Id.* at 1226-27.
[74] FED. R. EVID. 401.
[75] FED. R. EVID. 402.
[76] FED. R. EVID. 403.
[77] *See Mendelsohn*, 466 F.3d at 1226-31. The majority implicated Rule 401 when it discussed Rule 403, which courts consider only if evidence is first found relevant under Rule 401. *Id.* at 1231. The dissent specifically mentioned Rule 401. *Id.* at 1233 (Tymkovich, J., dissenting).
[78] *Id.* at 1227.

The Tenth Circuit went on to state that it did not apply the same-supervisor rule in cases involving company-wide policies such as Sprint's company-wide RIF.[79] Application of the rule against a plaintiff such as Mendelsohn would prevent the plaintiff from proving a discriminatory RIF if the plaintiff was the only person selected for the RIF by a particular supervisor.[80] The court noted that "scores of other employees within the protected group also selected for the RIF might work for different supervisors."[81] The court warned against "blanket pretrial evidentiary exclusions" against evidence that, although not conclusive evidence of discrimination, could cause a reasonable trier of fact "to raise an eyebrow."[82]

Having concluded that such me-too, other-supervisor evidence should not be excluded as irrelevant (presumably under Rules 401 and 402), the Tenth Circuit went on to caution against excluding such evidence under the "extraordinary remedy" of Rule 403 because of the possibility of unfair prejudice, confusion, or waste of time.[83] In balancing the probative weight of the evidence against the prejudicial weight of the evidence, courts should "give the evidence its maximum reasonable probative force and its minimum reasonable prejudicial value."[84]

The Court determined the me-too evidence from the five witnesses was not unduly prejudicial and that Sprint would have the opportunity to rebut it.[85] According to the Tenth Circuit, the District Court applied the same-supervisor rule improperly to exclude me-too/other-supervisor evidence in this RIF case. Consequently, the majority reversed the District Court and remanded the case for a new trial in which the evidence would be allowed.[86]

The dissenting justice would not have reversed the District Court for several reasons. First, the dissent viewed the case as a "classic judgment call.'[87] Second, the dissent maintained that the majority's opinion could be read as a per se rule that required admission of "anecdotal" evidence (the dissent's term for me-too evidence or other-

[79] *Id.* at 1227-28 (citing Gossett v. Oklahoma *ex rel.* Bd. of Regents for Langston Univ., 245 F.3d 1172, 1177-78 (10th Cir. 2001) & Equal Employment Opportunity Comm'n v. Horizon/CMS Healthcare, 220 F.3d 1184, 1198 n.10 (10th Cir. 2000)).

[80] *Id.* at 1228.

[81] *Id.*

[82] *Id*. at 1230.

[83] *Id*. at 1230-31.

[84] *Id*. at 1231.

[85] *Id.*

[86] *Id*.

[87] *Id*. at 1232.

supervisor evidence).[88] Third, the dissent would have admitted anecdotal evidence of company-wide discrimination only if there was independent evidence to establish a foundation for admissibility.[89] Fourth, the dissent reasoned that even if the majority's rule of law was correct, it should have remanded the case for the District Court to apply rather than applying the rule of law itself.[90]

The three-judge panel denied Sprint's petition for a rehearing (again by a 2-1 vote) and the full Tenth Circuit likewise denied Sprint's petitioned for rehearing *en banc* (by a 7-5 vote).[91] On March 5, 2007, Sprint petitioned the Supreme Court for a writ of certiorari.[92]

THE SUPREME COURT DECISION

Upon reviewing the petition for certiorari and related briefs and materials, the Supreme Court granted certiorari as follows:

> This case presents a recurring question of proof in employment discrimination cases: whether a district court must admit "me, too" evidence—testimony, by nonparties, alleging discrimination at the hands of persons who played no role in the adverse employment decision challenged by the plaintiff. The Tenth Circuit panel majority held that a court commits reversible error by excluding "me, too" evidence. This decision conflicts with those of other circuits. Specifically, four circuits have held "me, too" evidence wholly irrelevant. Five circuits have held that "me, too" evidence may be excluded under Federal Rule of Evidence 403. Granting certiorari will resolve the conflict between the circuit courts of appeals on this important question of law.[93]

Petitioner Sprint and respondent Mendelsohn focused much of their arguments on existing case law from the Second, Third, Fifth, and Sixth Circuits. In a Second Circuit age discrimination case, the trial court judge permitted six former employees to testify that, they too, were discharged (by other supervisors) because of age.[94] The jury found for the plaintiff, but the Second Circuit Court reversed and said the trial

[88] *Id*. at 1232, 1234. Although the Tenth Circuit likely did not formulate a rule of law per se requiring anecdotal evidence to be admitted, it is perhaps poetic justice that the dissent raised the issue. After all, the majority justices similarly attributed a per se rule (except one of exclusion) to the District Court. *See id.* at 1230 (majority cautioned courts against usage of blanket exclusions).

[89] *Id*. at 1232-33.

[90] *Id*. at 1233 n.3.

[91] Brief for Petitioner for Certiorari, *supra* note 13, at 1.

[92] Docket, *Sprint*, 128 S. Ct. 1140 (2008) (No. 06-1221), *available at* http://www.supremecourtus.gov/ docket/06-1221.htm.

[93] Order Granting Certiorari, *supra* note 5.

[94] Brief for Petitioner for Certiorari, *supra* note 13, at 8 (citing Haskell v. Kaman Corp., 743 F.2d 113 (2d Cir. 1984)).

court should have excluded the testimony that "aside from presenting unnecessary collateral issues, provided no basis for an inference of discrimination."[95]

The Fifth Circuit similarly held that a district court should not have permitted testimony from three "me, too" witnesses.[96] The Fifth Circuit noted that the proffered witnesses were not in a position to testify as to the company's motive, intent, or purposefulness in failing to promote the plaintiff because none of them had worked with the plaintiff or had any knowledge of plaintiff's relationship with the company.[97] The witnesses could testify only as to their own dealings with the company and their testimony, therefore, would be irrelevant.[98]

In the Sixth Circuit case, the district court permitted plaintiff to call two older workers who testified that they were laid off within a year of the plaintiff and that they had heard their supervisors make discriminatory, ageist comments.[99] The jury found for plaintiffs, but the Sixth Circuit reversed and granted a new trial without the me-too testimony.[100] The Court stated: "The fact that two employees of a national concern, working in places far from the plaintiff's place of employment, under different supervisors, were allegedly told they were being terminated because they were too old, is simply not relevant to the issue in this case."[101]

Similarly, the Third Circuit summarily affirmed the district court's exclusion of testimony from five other employees laid off at the same time as the plaintiff who claimed they were also laid off based on age.[102] The district court explained that witnesses' testimony about their own layoffs was not relevant to the plaintiff's layoff.[103]

In reviewing these cases, Sprint argued that "[s]everal circuits have held that 'me, too' evidence *never may be admitted* as it is irrelevant . . . ."[104] Sprint contended that the only relevant evidence of discriminatory intent is evidence on the thought processes and the biases of the plaintiff's decisionmaker (not other decisionmakers).[105] In

[95] *Id.* (quoting *Haskell, 743* F.2d at 121).
[96] *Id.* at 8-9 (citing Goff v. Cont'l Oil, 678 F.2d 593 (5th Cir. 1982)).
[97] *Id.*
[98] *Id.*
[99] *Id.* at 10-11 (citing Schrand v. Fed. Pac. Elec. Co., 851 F.2d 152 (6th Cir. 1988)).
[100] *Id.* at 11.
[101] *Id.* at 11 (quoting *Schrand,* 851 F.2d at 156).
[102] *Id.* at 11-12 (citing Moorhouse v. Boeing Co., 501 F. Supp. 390 (E.D. Pa.), *aff'd*, 639 F.2d 774 (3d Cir. 1980)).
[103] *Id.*
[104] Brief for Petitioner's Reply for Petition for Certiorari at 1, *Sprint*, 128 S. Ct. 1140 (2008) (No. 06-1221), *available at* http://www.scotusblog.com/movabletype/archives/06-1221Reply.pdf.20/1 (emphasis in the original).
[105] *Id.*

addition to arguing that four circuits held me-too evidence as irrelevant and excludible under Rules 401 and 402, Sprint also argued that such circuits (and the Seventh Circuit) would exclude even relevant me-too evidence under the balancing aspects of Rule 403.[106]

With respect to Rule 403's "undue delay and waste of time," Sprint noted that for every piece of me-too evidence the plaintiff presented, the defendant would have to present not-you-either evidence, thus requiring multiple trials within a trial.[107] Moreover, if the plaintiff presented inculpatory me-too evidence, the defendant would have to present exculpatory me-too evidence of all the employees who did not allege discrimination.[108] Hence, Sprint's eight-day trial could have become a four, five, or six-week trial.[109]

With respect to Rule 403's "confusion of the issues or misleading the jury," Sprint argued that me-too testimony would distract the jury from focusing on the plaintiff's case because of the possibility that the jury would assume a connection between the witnesses and the plaintiff.[110] With respect to "unfair prejudice," Sprint claimed that marginally relevant me-too testimony would add an emotional element to the case that jury instructions would not be able to overcome and quoted *Moorhouse*: "[E]ven the strongest jury instructions could not have dulled the impact of a parade of witnesses, each recounting his contention that defendant had laid him off because of his age."[111]

Mendelsohn viewed the cases differently and argued that existing case law did not represent a blanket exclusion or inclusion of me-too testimony, but that each decision was case specific – based on its own unique facts.[112] With respect to the instant case, she argued that the Tenth Circuit did not create a per se rule requiring inclusion of me-too evidence, but rather held that the District Court had abused its discretion in excluding the evidence based on all the circumstances of the case.[113] Moreover, she argued that the link between the testimony and the case need not be strong and evidence is relevant under Rule 401 if it "only slightly affects the trier's assessment of the probability of the matter to be proved."[114]

[106] Brief for Petitioner for Certiorari, *supra* note 13, at 15-21.
[107] *Id.* at 16-17.
[108] *Id* at 16.
[109] *Id.*
[110] *Id.* at 18.
[111] *Id.* at 19-21 (quoting Moorhouse v. Boeing Co., 501 F. Supp. 390, 393 n.4 (E.D. Pa.), *aff'd*, 639 F.2d 774 (3d Cir. 1980)).
[112] Brief for Respondent against Certiorari, *supra* note 2, at 15-26.
[113] *Id.* at 10-14.
[114] Brief for Respondent at 16, *Sprint*, 128 S. Ct. 1140 (2008) (No. 06-1221), *available at* http://www. abanet.org/publiced/preview/briefs/pdfs/07-08/06-1221_Respondent.pdf.

Mendelsohn also cited additional case law that found me-too evidence relevant under Rule 401 to show a pattern and practice of discrimination and/or a culture of discrimination.[115] Mendelsohn's "quintessential" example of the former involved a minority claimant who relied on over forty instances of me-too discrimination to establish a pattern and practice of widespread discrimination against others that the court found sufficient to establish a presumption of discrimination against the claimant.[116] Mendelsohn also argued that eleven circuits found evidence regarding a culture of discrimination to be relevant toward determining whether discrimination existed with respect to individual claimants.[117]

Mendelsohn further argued that evidence found relevant under Rule 401 should not be excluded under Rule 403 because more weight is given to the evidence's probative value than to its prejudicial effect.[118] Even marginally relevant evidence should not be excluded, but rather attacked by "vigorous cross-examination, presentation of contrary evidence, and careful instruction on the burden of proof."[119]

In applying her legal view to the facts at hand, Mendelsohn noted a nexus between the me-too testimony and the plaintiff's case. The proposed witnesses were all dismissed pursuant to Sprint's company-wide RIF, all were dismissed within the same year, and all worked at the same company headquarters.[120] She explained how me-too, other-supervisor, or anecdotal evidence could be relevant to show discriminatory intent by the plaintiff's supervisor:

> Fellow supervisors typically have for years worked under the same leadership, been guided by and interpreted the same memos, e-mails, speeches and comments from the same managers, had access to the same computer files, attended the same or similar meetings, and talked in overlapping circles at the same lunches or around the same water coolers. That is why a reasonable trier of fact in the instant case could care about age discrimination by other Sprint supervisors in the 2001-03 RIF.[121]

Sprint countered that "anecdotes do not make an atmosphere" and that Mendelsohn's hypothesis about "a rogue employer, with odious and rampant discriminatory practices, in which one supervisor infers a license or instruction to discriminate based on the words or conduct of

[115] *Id.* at 18-44.
[116] *Id.* at 21-22 (citing Int'l Bhd. of Teamsters v. United States, 431 U.S. 324 (1977)).
[117] *Id.* at 33-44.
[118] *Id.* at 14 (quoting WEINSTEIN'S FEDERAL EVIDENCE ¶403(3)).
[119] *Id.* at 17 (quoting Daubert v. Merrell Dow Pharmaceuticals, 509 U.S. 579, 596 (1993)).
[120] Brief for Respondent against Certiorari, *supra* note 2, at 1.
[121] Brief for Respondent, *supra* note 114, at 29.

others" did not make sense considering that Mendelsohn was able to assail "just a handful of supervisors in a 70,000-employee organization… [a]midst layoffs affecting some 15,000 persons,"[122]

In considering the legal issues and facts of the case during oral arguments, the Supreme Court Justices spent much time presenting hypothetical situations that required the attorneys to consider how much nexus was required for me-too testimony to be considered relevant under Rule 401.[123] The Court also spent much time speculating with the attorneys as to whether the District Court excluded the me-too testimony of the five witnesses based on Rule 401 or on Rule 403.[124]

Although some commentators predicted a close Sprint victory based on the Supreme Court's past employment law decisions and upon the oral arguments,[125] Judge Thomas delivered the opinion for a unanimous Court.[126] The Court concluded that the me-too evidence in this case was neither per se admissible nor per se inadmissible.[127] Because the Court could not determine that the District Court had applied a per se rule, it vacated the Tenth Circuit decision and remanded the case to the District Court to determine the admissibility of the evidence under the appropriate standard.[128]

Regarding the appropriate standard, the Court noted that relevance under Rule 401 and prejudice under Rule 403 "are determined in the

[122] Brief for Petitioner's Reply at 16-17, *Sprint*, 128 S. Ct. 1140 (2008) (No. 06-1221), *available at* http://www.abanet.org/publiced/preview/briefs/pdfs/07-08/06-1221_PetitionerReply.pdf.

[123] Transcript of Oral Argument, *Sprint*, 128 S. Ct. 1140 (2008) (No. 06-1221), *available at* http://www.supremecourtus.gov/oral_arguments/argument_transcripts/06-1221.pdf. Justice Souter asked whether company-wide discrimination existed if two of three or nineteen of twenty supervisors discriminated. *Id.* at 5-6. Justice Kennedy and Justice Scalia asked similar questions with respect to one or three supervisors, respectively, in a company with 2,000 employees. *Id.* at 25, 27. Chief Justice Roberts questioned the relevance of four discriminatory supervisors in Los Angeles in connection with a defendant supervisor in Fresno. *Id.* at 33.

[124] For example, Justice Scalia asked the following questions: "We don't really know, do we, what the district court's order was based on? Whether it was based on 401 or 403? Did the district court explain its order at all? It didn't, did it?" *Id.* at 4.

[125] Kevin Russell, *Sprint/United Management v. Mendelsohn*, SUPREME COURT OF THE UNITED STATES WIKI (SCOTUSWIKI), http://www.scotuswiki.com/index.php?title=Sprint/United_Management_v._Mendelsohn#Amici_filings (last visited May 27, 2008) (predicting a 5-4 verdict in favor of usually excluding other-supervisor evidence with a majority opinion written by Justice Scalia and joined in by Justices Kennedy, Alito, Thomas, and Roberts and a dissenting opinion written by Souter and joined in by Breyer, Ginsberg, and Stevens); Runkel, *supra* note 1 (predicting a majority of the court in favor of excluding other-supervisor evidence in the absence of an independent showing of company-wide discrimination).

[126] Sprint/United Mgmt. Co. v. Mendelsohn, 128 S. Ct. 1140, 1142 (2008).

[127] *See id.* at 1147.

[128] *Id.*

context of the facts and arguments in a particular case, and thus are generally not amenable to broad per se rules."[129] The Court also noted that a district court is accorded wide discretion in determining the admissibility of evidence, particularly with respect to Rule 403, which requires "on-the-spot balancing."[130] Accordingly, circuit courts should uphold Rule 403 rulings unless the district court has abused its discretion.[131] In the absence of unambiguous evidence as to how the district court ruled, circuit courts should not presume that the district court ruled incorrectly, but should remand the case so that the district court can explain its ruling "explicitly and on the record."[132]

IMPACT OF THE SUPREME COURT DECISION

Although the Supreme Court opinion is relatively brief and does not give detailed guidance regarding the admissibility of me-too evidence, it does provide some guidance and will likely have an impact upon future litigation in this and other areas. The rest of this paper discusses the teachings of the opinion with respect to the instant case, district courts, circuit courts, employers, employees, and juries.

With respect to the instant case, Mendelsohn's attorney said that because the District Court did not conduct a fact-specific inquiry, the case was headed back to retrial where the court would consider why the witnesses had relevant testimony to offer.[133] Sprint's attorney stated that he expected the District Court would invite the parties to file briefs on the issue and again exclude the evidence with a more detailed explanation as to its rationale.[134]

What should the District Court do based on all the facts and circumstances with the me-too evidence indicating some possible ageist discrimination by approximately five of Sprint's supervisors out of perhaps 1,000 total Sprint supervisors involved in nearly 15,000 layoffs?[135] The District Court judge remarked, "[I]t was my view that [the disputed] testimony would not have affected the outcome of the case in any way . . . . I visited with the jury afterwards and they did not believe this was a close case."[136] Based on that comment and the case's factual record, the District Court would likely exclude the evidence and

[129] *Id.*
[130] *Id.* at 1145.
[131] *Id.*
[132] *Id.* at 1146.
[133] Allen Smith, *Supreme Court: Admissibility of 'Me, Too' Testimony Depends on the Facts*, SOCIETY FOR HUMAN RESOURCE MANAGEMENT – HR NEWS, Feb. 26, 2008, http://www.shrm.org/hrnews_published/ ARCHIVES/CMS_024756.asp.
[134] *Id.*
[135] Brief for Petitioner's Reply, *supra* note 122, at 17.
[136] *Id.* at 20.

explain why under Rules 401 and/or 403. The Tenth Circuit would likely defer to such ruling.

Such ruling, however, might appear anomalous in light of another case against Sprint that the decisions, briefs, and articles pertaining to the instant case mention only once and only tangentially.[137] During much of the time of the instant case's court proceedings, lasting from August 2003 through February 2008, former Sprint employees were seeking class action remedies for age discrimination in connection with Sprint's RIF.[138] In May 2006, Sprint settled one suit with 462 employees for $5.5 million[139] and in September 2007, it settled an even larger suit with 1,697 employees for $57 million.[140] Mendelsohn could argue that these settlements indicated Sprint was engaged in systematic and significant age discrimination.[141] Sprint could argue that it was simply avoiding litigation costs that were particularly imminent considering the possible per se admission of all me-too testimony.[142]

Because the Supreme Court did not provide definitive guidelines regarding admission of me-too evidence, the battle over such evidence will continue to be heavily litigated at the district court level.[143] Though the decision did not make the job any easier for district courts, it did remind all participants of the district court's role as the primary arbiter whose evidentiary decisions should be given great deference.[144] The Supreme Court noted, "with respect to evidentiary questions in general and Rule 403 in particular, a district court *virtually always* is in the better position to assess the admissibility of the evidence in the context of the particular case before it."[145] The decision also reminded district

[137] In a footnote, Mendelsohn stated that Sprint's current argument that five me-too witnesses did not establish enough of a foundation for discrimination could have been answered at the time of trial when over 2,000 of Sprint's employees were alleging that age discrimination permeated the RIF. Brief for Respondent, *supra* note 114, at 31 n.46.

[138] Associated Press, *U.S. Judge Approves $57 Million Sprint Settlement over Age Discrimination,* Sept. 11, 2007, http://hosted-communications.tmcnet.com/news/ 2007/ 09/ 11/2929508.htm.

[139] *Id.*

[140] Brian White, *Sprint (S) Settles Age Discrimination Lawsuits for $57 Million, Sept. 12, 2007,* http://www. bloggingstocks.com/2007/09/12/sprint-s-settles-age-discrimination-lawsuits-for-57-million/; *see* Williams v. Sprint/United Mgmt. Co., No. 03-2200-JWL, 2007 U.S. Dist. LEXIS 67368 (D. Kan. Sept. 11, 2007) (court approval).

[141] *See* White, *supra* note 140.

[142] *See id.*

[143] Smith, *supra* note 133. Mendelsohn's lawyer stated: "That is the frustrating part here. We thought the court would provide more guidance." Savage, *supra* note 32. Sprint's lawyers agreed, stating: "The court could have helped by laying out more precise markers. This means there will be future fights over whether this kind of evidence can be admitted." *Id.*

[144] Sprint/United Mgmt. Co. v. Mendelsohn, 128 S. Ct. 1140, 1144-45 (2008).

[145] *Id.* at 1146 (emphasis added).

courts, however, that they need to explain their decisions adequately so that appellate courts can determine whether district courts have abused their discretion.[146]

In light of the Supreme Court decision, district courts should feel more empowered to decide each case on its merits and not feel obligated to use some of the blanket rules (usually of exclusion) that have been developed. For example, the "stray remarks" rule holds that remarks reflecting bias are not admissible unless closely related to the alleged discrimination against the plaintiff and the "temporal proximity" rule holds that the time between evidence of discriminatory intent and a discriminatory act against plaintiff must be very short in order to be admissible.[147] District courts should find such rules helpful, but not overly restrictive.

The impact of *Sprint v. Mendelsohn* on circuit courts seems clear. Circuit courts should not impose their judgment upon the evidentiary decisions of the district courts absent an abuse of discretion.[148] Circuit courts, however, should feel free to require from district courts adequate explanation of their evidentiary rulings.[149]

The impact of the decision upon employers and employees is not as clear. Both sides were much more concerned about averting evidentiary disaster, rather than seeking evidentiary triumph. The employer groups generally argued against a per se rule of admission, rather than arguing for a per se rule of exclusion.[150] The employee groups argued against a per se rule of exclusion, rather than arguing for a per se rule of admission.[151] Because the Supreme Court disavowed per se rules either way, both employers and employees claimed victory. Sprint's counsel said: "We won. The court unanimously rejected the 10th Circuit's rule that would have included all such testimony from co-workers. And that's a win in anybody's book."[152] Similarly, general counsel for the EEAC said, "We're pleased with the outcome and the court's categorical rejection of any evidentiary per se rule of admissibility."[153] On the other side, Mendelsohn's counsel said, "This is a victory for plaintiffs' attorneys across the country . . . . Sprint and the business community

[146] *Id.* at 1144-46.
[147] Osborne, *supra* note 29.
[148] *Sprint,* 128 S. Ct. at 1146-47.
[149] *Id.*
[150] *See, e.g.,* Brief of EEAC *et al., supra* note 20, *passim;* Brief of AT&T *et al., supra* note 22, *passim*.
[151] *See, e.g.,* Brief of AARP*, supra* note 24, *passim;* Brief of Lawyers' Committee *et al., supra* note 25, *passim*.
[152] Savage, *supra* note 32.
[153] Smith, *supra* note 133.

had urged the court to say this evidence is never admissible, and the court said no to that."[154]

From a public policy perspective, the Supreme Court's decision seems wise. A per se rule admitting me-too evidence would have altered the scope of employers' liability under the federal discrimination laws because employers would end up being liable not only for actions against individual plaintiffs, but also for actions against non-party me-too testifiers.[155] Somewhat similarly, employer defendants would have been liable not to individual plaintiffs, but to a "fictional composite" plaintiff who could bundle weak individual claims into a single, stronger claim.[156] Even so, in light of Sprint's class action settlements, employers' fears that "creative litigants could easily string together unrelated personnel practices and decisions to form nationwide class [actions] of thousands or millions of employees" perhaps have been realized.[157] Such lawsuits will likely continue even with the Supreme Court's refusal to admit all me-too evidence.

Some employer groups argued that the possible admission of me-too evidence would cause employers to engage in the poor management practice of centralizing their employment decision-making to avoid the risk of a rogue supervisor's misconduct being used to taint the entire company.[158] Others suggested that employers who have decentralized decision-making would face less me-too evidence than employers with centralized decision-making because a nexus between the me-too evidence and the plaintiff's discrimination would be more difficult to establish in decentralized workplaces.[159]

Sprint's argument that it engaged in decentralized decision-making helped exclude the me-too evidence at the trial court level in the instant case.[160] However, in the class action lawsuits that Sprint agreed to settle, evidence indicated systematic company-wide activities whereby younger employees were transferred into safe positions and older employees were then adversely affected by a new evaluation scheme.[161] From a company policy perspective, Sprint should have conducted its

[154] Savage, *supra* note 32; Smith, *supra* note 133.

[155] Brief of AT&T *et al*, *supra* note 22, at 2-3.

[156] *Id.* at 5.

[157] *Id.* at 8.

[158] Brief of Chamber of Commerce, *supra* note 23, at 8.

[159] Smith, *supra* note 133.

[160] *See* Brief for Petitioner at 34, *Sprint*, 128 S. Ct. 1140 (2008) (No. 06-1221), *available at* http://www.abanet.org/publiced/preview/briefs/pdfs/07-08/06-1221_Petitioner.pdf.

[161] *See* Mindy Chapman, *Playing It "Safe" During RIF Costs Sprint $57 Million,* HR SPECIALIST: CASE IN POINT: REAL-LIFE EMPLOYMENT LAW LESSONS, June 6, 2007, http://blog.thehrspecialist.com/archives/137-Playing-it-Safe-During-RIF-Costs-Sprint-57-Million.html.

RIF based on honest and longstanding documented employee rankings.[162]

With respect to the public policy ramifications of the instant case, employee groups were pleased that the Supreme Court ruled against a per se rule of excluding me-too evidence. Such a rule would have represented "a dramatic retrenchment in employment discrimination law that would [have resulted] in a severe contraction of . . . rights and protections."[163] Categorically excluding me-too evidence would have substantially undermined the continued efficacy of the anti-discrimination laws.[164] Even though the Supreme Court did not so restrict plaintiffs, some commentators still believe that the decision might be hailed as an employer victory because most of the evidentiary balancing under the status quo seems to come out in favor of defendants.[165]

The case underlined the difficult problems employees have in proving discrimination because employers generally do not leave overt traces of their discriminatory decisions.[166] Because "proof of discrimination in today's workplace requires the gathering of many bits of evidence no one of which may be conclusive," plaintiffs should be "afforded the full benefit of the purposefully liberal relevancy standards established by the Federal Rules of Evidence."[167] Currently, employment discrimination plaintiffs are less successful at trial court level than most other plaintiffs.[168] Moreover, even when plaintiffs prevail at trial, they are reversed forty-two percent of the time upon appeal; conversely, when defendants prevail at trial, they are reversed eight percent of the time.[169]

Although the Supreme Court's decision has no direct impact on juries, the above statistics indicate that evidentiary decisions by courts will obviously and often impact jury decisions. Moreover, Mendelsohn argued in her brief that less liberal interpretations of relevance would essentially turn trials by jury into trials by motion in limine.[170] Similarly, amici curiae briefs stated that courts should not assume that juries are incapable of understanding the distinction between same-supervisor evidence and other-supervisor evidence and noted that studies have shown that decisions of trial judges and juries are

[162] *See id.*
[163] Brief of AARP, *supra* note 24, at 4.
[164] Brief of Lawyers' Committee, *supra* note 25, at 12.
[165] Russell, *supra* note 125.
[166] Osborne, *supra* note 29.
[167] Brief for Lawyers' Committee, *supra* note 25, at 12.
[168] *Id.* at n.13.
[169] *Id.*
[170] Brief for Respondent, *supra* note 114, at 53.

remarkably similar.[171] Of course, if that is true, one might argue that it does not really matter that the judges are assuming some of the duties of the jury. However, in our notion of jurisprudence, the judge is to decide the law, and the jury is to decide the facts. In those close evidentiary cases that are "judgment calls," for which there seems no clear legal basis to decide, the courts should defer to the juries.

Judges who wish to admit and permit juries to determine the weight of me-too evidence should certainly feel empowered to do so after *Sprint v. Mendelsohn*, which strongly reinforced trial judges' discretion. Judges should also feel inclined to do so after *Sprint v. Mendelsohn* and the class action cases, which showed the danger of the district court excluding evidence that, in retrospect, appeared relevant.

CONCLUSION

The Supreme Court's decision in *Sprint v. Mendelsohn* seems appropriate. Although it did not set forth sweeping new evidentiary rules with respect to me-too evidence in employment discrimination cases, it reinforced the applicability and usage of Federal Rules of Evidence 401 and 403 in order to make evidentiary decisions. It also reinforced the roles that the courts and other participants need to fulfill in these evidentiary contests. *Sprint v. Mendelsohn* will likely be oft cited in both employment law cases and in other cases with evidentiary issues.

[171] Brief for Lawyers' Committee, *supra* note 25, at 19-20. One study of trial judges and juries in 3,576 criminal and civil trials found that the judges and juries made identical decisions in the same case seventy-eight per cent of the time and were evenly split on the remaining twenty-two percent of cases. *Id.* at 20.