Published by
Husson University
Bangor, Maine

For the

NORTH ATLANTIC REGIONAL BUSINESS LAW ASSOCIATION

GUIDELINES FOR 2011

Papers presented at the 2011 Annual Meeting and Conference will be considered for publication in the Business Law Review. In order to permit blind refereeing of manuscripts, papers must ***not*** identify the author or the author's institutional affiliation. A removable cover page should contain the title, the author's name, affiliation, and address. If you are presenting a paper and would like to have it considered for publication, you must submit *two* clean copies, no later than March 29, 2011 to:

Professor William B. Read
Husson University
1 College Circle
Bangor, Maine 04401

The Board of Editors of the Business Law Review will judge each paper on its scholarly contribution, research quality, topic interest (related to business law or the legal environment of business) writing quality, and readiness for publication. Please note that, although you are welcome to present papers relating to teaching business law, those papers will not be eligible for publication in the Business Law Review. This subject matter should be submitted to the Journal of Legal Studies Education. Also note that the Board of Editors will consider only one paper per person, including co-authored papers. Only papers presented at the Annual Meeting will be considered for publication.

FORMAT

1. Papers should be no more than 20 single-spaced pages, including endnotes. For fonts, use 12 point, Times New Roman. Skip lines between paragraphs and between section titles and paragraphs. Indent paragraphs 5 spaces. Right-hand justification is desirable, but not necessary.
2. Number pages in pencil on the back in the lower right corner. Do not number the front of the page. Please do not fold or staple your paper.
3. Margins: left—1-1/2 inches, right, top, bottom (except first page)—1 inch.
4. Upon acceptance, the first page must have the following format:
   a. The title should be centered, in CAPITAL LETTERS, on line 10.
   b. Following the title, center the word "by" and the author's name, followed by an asterisk (*).
   c. Space down 3 lines and begin your text.
   d. Please add a solid line (18 spaces in length) beginning from the left margin, toward the bottom of the first page, leaving enough room under the line to type on the next line an asterisk and the author's position or title and affiliation. This information should appear as the last line on the page.
5. Headings:
   FIRST LEVEL (caps, flush with left margin)
   Second Level (center, italics)
   Third Level: (flush with left margin, italics, followed by a colon [:])
   Fourth Level: (flush with left margin, italics, followed by a colon [:], with text immediately following).
6. Endnotes should conform to the *Uniform System of Citation*, 19th edition and should begin 3 lines after the end of the text.
7. E-mail a copy of the final version of your paper in Microsoft Word to readw@husson.edu.

The Business Law Review is published once each year. Its purpose is to encourage scholarly research in Business Law and the Legal Environment of Business. Publication is made possible by gifts and grants from:

Andover IP Law, Andover, MA.
Bentley University, Waltham, MA.
Husson University, Bangor, ME.
North Atlantic Regional Business Law Association
Suffolk University, Boston, MA.
University of Bridgeport, Bridgeport, CT.
West Educational Publishing

THANK YOU

Next Annual NARBLA Meeting
April 2, 2011

Bentley University
Waltham, MA

Please contact:

Professor Elizabeth A. Brown
Law, Taxation and Financial Planning Department
Bentley University
175 Forest Street
Waltham, MA 02452

Mobile Phone: 415-260-6077
Office Fax: 781-788-6413
ebrown1@bentley.edu

TABLE OF CONTENTS

CONTRACT ISSUES AND SPECIALIZED COURTS: THE PRICE OF ADMISSION

by ERIC T. BELLONE J.D.* AND
GRAHAM KELDER, J.D.**

INTRODUCTION

Business law is the foundation of many legal concepts and principles used in other fields of learning. More and more disciplines are using basic business law principles in their daily matters. Health care providers use proxies for health care decisions; land developers employ the business law principle of the Statute of Frauds to transfer an interest in land; family law employs the business concept of agency in deciding how parents must care for their children; and the criminal justice system utilizes contract law for agreements between the State and a defendant where the defendant pleads guilty to a crime in exchange for a reduced sentence or charge. Unfortunately, business law principles are often misunderstood and misused by these other areas creating negative outcomes.

In recent years, the criminal justice system has begun using specialized courts to deal with specific issues. The main type of specialized court is the drug court. Drug courts push basic business law concepts to new heights. Proponents maintain that while drug courts bend these legal concepts, they do not break them. Critics charge that drug courts not only break these legal concepts, but use their trappings

* Eric T. Bellone is an Assistant Professor of Legal Studies at Suffolk University and a Ph.D. Candidate in Law, Policy & Society at Northeastern University.
** Graham Kelder is an Assistant Professor of Legal Studies at Suffolk University.

to highjack the legitimacy that these legal concepts have attained through centuries of pedigree.

Drug courts, like many specialized courts, press the judiciary and judges beyond their traditional roles. Drug courts hope to combine law and drug treatment as an effective and efficient means of drug therapy. Critics maintain that mixing therapy and law, dubbed "therapeutic jurisprudence," creates a paradox that cannot be rationalized. Therapy presupposes that the offender is the victim of an illness and does not exercise free will, and therefore should be treated and not punished for the illness. Alternatively, criminal law presupposes free will. Punishment is based on altering individual choice through deterrence. These two concepts are diametrically opposed. In the drug court, when an offender cannot be "cured," the law mandates that he or she be punished.[1]

This paper examines the allegation that drug court plea agreements/drug court contracts violate the basic legal principles of plea-bargaining and contract law and can only be aligned with such principles under limited circumstances. It presents an analysis of drug court post-plea entry through a framework of contract. Specifically, this paper will explore the allegation that when the State, as a drug court, enters into a contract with a defendant through the plea bargaining process, the arrangement creates a situation where one party to the contract (in particular the drug court judge) interprets the terms of the contract and also has the power to enforce its interpretation, leading to a lack or failure of consideration under contract law. A second concern involves the "point of failure" for drug court defendants when the drug court judge acts as both a participant in the drug court process and a fact-finder of a defendant's breach of plea agreement/drug court contract. The paper concludes with a discussion of how these violations can be avoided and remedied.

Drug courts generally channel offenders through the criminal justice process in two ways: deferred prosecution and post adjudication.[2] One author maintains that "[d]eferred prosecution drug courts require a defendant to waive his rights to a speedy trial and enter treatment as soon after being charged as possible" generally without a plea.[3] This paper focuses on the post-adjudicative, post plea model of drug court

[1] Morris S. Hoffman, *Therapeutic Jurisprudence, Neo-Rehabilitationism, and Judicial Collectivism: The Least Dangerous Branch Becomes Most Dangerous*, 29 FORDHAM URB. L.J. 2063, 2088 (2002). Not punishing behavior that has been criminalized by the legislative branch of government by the judiciary is another issue highlighted by Judge Hoffman.

[2] Eric J. Miller, *Embracing Addiction: Drug Courts and the False Promise of Judicial Intervention,* 65 OHIO ST. L.J. 1479, 1489 (2004).

[3] *Id.*

entry. Many view the reaching of a plea agreement as a condition of gaining entry into a drug court program as problematic, in light of the plea bargaining principles as explained and clarified through the bargained for exchange rules contract law. A majority of offenders, and the number is rising, are gaining entry into drug courts using this process.[4] It begins when an offender enters a guilty plea, in some jurisdictions to the highest offense alleged, at an early stage in the proceedings.[5] Offenders waive the right to be prosecuted under the traditional court system and "voluntarily" enter the drug court system.[6] Casey notes,

An early plea is a critical component of most drug court models. A rapid progression from arrest to treatment facilitates the treatment process, as it stresses the causal connection between drug activity and the consequences of that behavior. In addition, the early plea eases court congestion and satisfies prosecution concerns about conviction rates and cases loads.[7]

HOW DRUG COURTS OPERATE

Unlike a traditional drug rehabilitation programs, drug courts do not relinquish control over their case by outside referral. Rather, drug courts use the coercive effect of the criminal justice system as a central element of handling an offender. The primary players are traditional criminal justice professionals (judge, prosecutor, defense counsel, etc.) in non-traditional roles as part of a treatment team.[8] The non-traditional roles assumed by the treatment team are designed to help rehabilitate rather than punish the offender. The structure of the drug court is also designed to move offenders into treatment quickly. Critics of the speed of the transfer of the offender into the drug court arena maintain that it

[4] *Id.* at 1490. The post adjudication model is preferred by many drug court proponents because it has a greater coercive effect on the defendant. This coercive effect is necessary for leverage during the rehabilitation process.

[5] Mae C. Quinn, *Whose Team Am I On Anyway? Musings Of A Public Defender About Drug Treatment*, 26 N.Y.U. REV. L. & SOC. CHANGE 3, 42 (2001). Not just pleading guilty, but pleading guilty to the highest alleged crime enhances the coercive effect on the defendant during the rehabilitation process.

[6] Timothy Casey, *When Good Intentions are not Enough: Problem Solving Courts and the Impending Crisis of Legitimacy,* 57 SMU L. REV. 1459, 1482 (2004).

[7] *Id.* at 1483. The rapid succession that is favored by proponents of the drug court model is often criticized by its opponents. The speed at which the defendant enters the system is often seen as a red flag with concern to constitutional issues.

[8] Douglas B. Marlowe, *New Voices in the War on Drugs: Effective Strategies for Intervening with Drug Abusing Offenders*, 47 VILL. L. REV. 989, 991 (2002). The non-traditional roles of the judge and defense attorney are often cited as examples of problems. These non-traditional roles can cause confusion for the defendant as to what can be expected from the key players in this "court" system.

violates the basic legal axioms of fairness in plea bargaining and due process. Drug court advocates maintain that the time delays involved in drug cases have severe consequences for improving an offender's chances of rehabilitation. Although such delays may protect legal rights, they may have terrible repercussions on behavior modification.[9]

Often a plea agreement is the basis of a "drug court contract" that explains the terms and responsibilities of the parties.[10] This contract specifies the rights and duties of each party and the penalties for breach. Drug court advocates argue that a behavioral contract is the basis for the protection of constitutional rights.[11] Advocates argue the defendant's signing of the contract is a proper waiving of rights. If the offender successfully completes the treatment program, the court will allow his/her record to be expunged or allow the offender to "re-plea" to an already specified lesser offense.[12]

Waiving an offender's rights should not be minimized. Constitutional rights to counsel, trial, self-incrimination, and unreasonable searches and seizures are all waived.[13] Mae Quinn, a staff attorney at the Bronx Defenders Office (NY), writes specifically about the difficulties of providing counsel to defendants in post-plea jurisdictions. Quinn considers a scenario in which a drug court judge calls aside a defense attorney for arguing too vehemently against a sanction for a client who failed to comply with a drug court program. Does the drug court team approach permit a defense attorney to abandon strong advocacy efforts? When does zealous representation create a situation where the defense attorney is no longer a "therapeutic team member?" Such a situation highlights the defense attorney's paradox of protecting a defendant's liberty interests while protecting a defendant's sobriety.[14]

Along with constitutional rights, the rights under the Rules of Evidence and the Rules of Criminal Procedure are waived. For therapeutic jurisprudence advocates, the exchange of rights for

[9] *Id.* at 990.

[10] Faye S. Taxman, *Graduated Sanctions: Stepping into Accountable Systems and Offenders*, PRISON J. 79(2): 182, 205. (1999). The plea agreement is often the drug court contract. The drug court contract is signed by the defendant, the prosecutor, and the drug court judge (among others) as parties to the contract and subject to its terms.

[11] *Id.* at 187. The use of a "contract" is used to bind the defendant as well as to detail the rights the defendant is forgoing.

[12] Casey, *supra* note 6, at 1481. Opponents of drug courts take issue with the judicial branch of government taking a defendant, who has pled guilty to conduct criminalized by the legislative branch of government, and expunging his record after completion of treatment.

[13] Quinn, *supra* note 5, at 55.

[14] *Id.* at 155. The occasion for such conflicts of interest can arise all too often, placing the defense attorney in the position of having to choose between safeguarding a defendant's rights or health.

treatment seems not only rational and justified but ideal.[15] The problems start when the offender "fails" treatment. "If the defendant fails to complete the treatment process, the original plea of guilty is enforced, and the defendant is, in most cases, sentenced to a long period of incarceration."[16] Under traditional contract law, a situation where one party has the power to interpret and enforce its interpretation of an agreement is unlikely to exist. Further, if such a situation arose, the claiming party would have an unbiased forum (in which a neutral, detached fact-finder is not a party to the agreement), and could review the properly recorded facts and evidence. Moreover, if the claiming party were not satisfied with procedures of the forum that reviewed the facts and evidence, the claiming party could have such procedures reviewed by an appellate court.

The next part of this article examines in more detail how offenders enter the drug court process. Specifically, it investigates the plea bargaining process, where more than fifty percent of offenders may be subject to a mandatory plea before gaining entry into a drug court program.[17] Further, this paper explores the allegation that when the State, represented by the drug court judge, enters into a contract with a defendant through the plea bargaining process, this arrangement creates a situation where one party to the contract (as before) interprets the terms of the contract and also has the power to enforce its interpretation, leading to a lack or failure of consideration under contract law.

DRUG COURT PLEA AGREEMENTS AND TRADITIONAL PLEA AGREEMENTS

There are two main differences between a drug court plea agreement and a traditional plea agreement. In a traditional plea agreement, the defendant always obtains the "benefit of the bargain"; in a drug court plea agreement, the defendant may or may not obtain such benefit depending on subjective interpretation of the defendant's conduct by the drug court judge.

In *United States v. Moscahlaidis*, the court held that a plea bargain is a contract with the State and therefore is to be analyzed under contract law.[18] This position was reinforced in *United States v. Bernard* where

[15] Casey, *supra* note 6, at 1483.

[16] *Id.* at 1484.

[17] *Id.* at 1483.

[18] *United States v. Moscahlaidis*, 868 F.2d 1357, 1361 (3d Cir. 1989). The court held that if the government breaches a plea agreement, under the standards of contract law, the agreement is void and the guilty plea withdrawn. In the drug court context, applying this standard would necessitate that the drug court contract be void and any guilty plea withdrawn.

the court found that although a plea agreement occurs in the criminal context, it remains contractual in nature and is to be analyzed under contract law standards.[19] The United States Supreme Court stated that when "[p]roperly administered, they [plea bargains] can benefit all concerned."[20] Experts also emphasize that "[s]ince plea agreements are viewed as contracts, the precise wording of an agreement is critical to its enforceability."[21] Thus, drug court contracts (through plea bargains) are subject to the basic tenets of contract law.

In general, contract law requires a showing of mutual assent by both of the parties as the first prerequisite of a contract. This manifestation of such mutual assent is often called the "meeting of the minds".[22] Such assent can be written, spoken, or inferred by acts or failure to act. For a meeting of the minds to be effective, it must be shown that: (1) the parties intended to engage in the conduct showing assent, and (2) knew or had reason to know that the other party might infer such assent from the conduct.[23] In the typical plea bargaining process, the assent is manifested in a spoken, straightforward statement from either party of the intent to begin plea bargaining negotiations.[24]

There is a body of law that allows the prosecutor far-flung discretion to determine whether a defendant has sufficiently cooperated with the State and has fulfilled his/her obligations under a plea agreement. When a defendant states that as part of the duties under a plea agreement he/she is cooperating in the prosecution of another defendant/case, the prosecutor has great latitude in determining whether such cooperation was sufficient to satisfy the defendant's duty under the plea agreement. Courts rarely find that the government's non-performance for lowering a sentence or reduction in charges constitutes a breach of the plea agreement.[25] In *In Re Sealed Case,* the defendant entered into a plea agreement containing language that stated the defendant was to "cooperate truthfully, completely and forthrightly."[26] "After the plea was signed and the defendant pled guilty, the government asked the defendant to cooperate on two cases;

[19] *United States v. Bernard,* 373 F.3d 339, 345 (3d Cir. 2004).

[20] *Blackledge v. Allison*, 431 U.S. 63, 71 (1977). Here representations by the defendant that the plea agreement was possibly made through such factors of misunderstanding, duress, or misrepresentation rendered the plea agreement constitutionally inadequate as a basis for imprisonment. A defendant operating under a drug court contract might employ these factors to void an agreement.

[21] Bender *Plea Agreements and Procedure* § 6.05 (2002).

[22] RESTATEMENT (SECOND) OF CONTRACTS § 24 (1981).

[23] *Id.*

[24] *Id.*

[25] Bender, *supra* note 21, § 6:08[2] (2002).

[26] *Id.* at § 6:08[2] (2002), citing 244 F.3d 961 (D.C. 2001).

the defendant cooperated fully on one of the two cases and partially on the second."[27] The prosecutor stated that the defendant violated the plea agreement because of the partial cooperation on the second case. The Court concluded that since the plea agreement gave sole and complete discretion to the prosecutor to decide the definition of "cooperation," and there was no objective way to determine whether the defendant's cooperation was sufficient, the prosecutor's interpretation of the plea had to be followed.[28]

Applying this reasoning and this body of law to a defendant's plea agreement in a drug court situation suggests that the State, either through the drug court judge or other State actor, has the ability to terminate a plea agreement with no review. Drug court plea agreements, as well as drug court behavioral contracts, tend to be written in such a manner that the State has broad discretion in defining "cooperation" or "compliance." Such language can be considered "boiler-plate."

The drug court defendant's situation, however, can be distinguished from the more traditional plea bargaining defendant. The above detailed case involves a defendant cooperating in other cases the prosecutor is pursuing, not in the defendant's own case. This distinction brings it more in line with the traditional drug court scenario where the defendant's cooperation is mandated in his own case and not on the prosecution of others. In *United States v. Truman,*[29] the United States Court of Appeals for the Sixth Circuit held that because the "cooperation" the defendant was to render did not involve the investigation or prosecution of another person, the authority for determining whether the defendant "cooperated" was subject to review before a neutral judge. In this case, the prosecutor's discretion was limited and an independent judge ruled on whether the defendant did breach the agreement and could be discharged from the program. Only after such an independent review can a determination be made whether the State breached the agreement by no performance and (1) the defendant can return to the program or (2) whether the agreement fails due to failure of consideration and the plea agreement is vacated.

CONSIDERATION

Critics of the plea-bargaining process as a prerequisite to entering into a drug court contract present two arguments: (1) that the plea bargain contract is flawed and creates no enforceable contract, or (2) in the alternative, that the plea bargain contract is void. If no contract

[27] *In Re Sealed Case*, 244 F.3d 961, 964 (2001).
[28] *Id.* at 964 – 966.
[29] *United States v. Truman*, 304 F.3d 586 (6th Cir. 2002).

exists, then the plea bargain contract is said to have never been formed for "lack of consideration." If the plea bargain contract *does* exist, then the agreement is said to be void for failure of consideration. Either way, critics maintain that reliance on a plea bargain as the vehicle for entry into a drug court does not pass legal muster and, in its present form, cannot be used for such a purpose.

Lack of Consideration: When there is a "lack of consideration" no contract is formed.[30] When this occurs, neither party may rely on the contract or enforce any rights derived from the contract. There are several circumstances that result in a proposed contact not being formed for lack of consideration. These include, but are not limited to: (1) an illusory promise, (2) a unilateral right to terminate, and (3) a unilateral option to cancel.

Barron's Law Dictionary defines an illusory promise as "a promise so indefinite that it cannot be enforced or which, by virtue of provisions or conditions contained in the promise itself, is one whose fulfillment is optional or entirely discretionary on the part of the promisor.[31] Since such a promise does not constitute legal consideration, it is not sufficient as consideration for a reciprocal promise and thus cannot be a valid contract.[32] In the drug court situation, it can be argued that post-plea form of entry can be viewed as illusory. In such a situation, the State is both a party to a plea agreement/drug court contract and the interpreter of the agreement with the power to enforce its interpretation. An agreement that grants such overwhelming power to one side of an agreement, including the power of interpretation as to what promise is given or whether a promise is given at all, might invalidate the promise as consideration. In the post-plea drug court situation, the power to impose a one sided interpretation of an agreement by the State may render the contract void for lack of consideration.

If the contract allows one or both parties the "Right to Terminate" the agreement, this right might make the promise illusory and the contract unenforceable. If the agreement allows one party to terminate by merely giving notice, the traditional common law view is that the party with the termination right has not furnished consideration. The modern

[30] *See McCraw v. Llewellyn*, 123 S.E.2d 575 (N.C. 1962) (reinforcing the basics of the definition of consideration). *See generally* 17A AM. JUR.2D *Contracts* §§ 1-5, 11-13, 102-167 (1991) (concerning consideration in general).

[31] *Spooner v. Reserve Life Insurance Company*, 287 P.2d 735 (Wash. 1955). The court held that a promise by the insurance company to pay respondent a renewal bonus that was voluntary and could be withheld with or without notice rendered the promise to pay illusory and unenforceable. In the drug court contract situation, the promise by the judge (who is also a party and signatory to the drug court contract) is similarly illusory where the judge is a party to the contract **and** the sole arbiter of the contract's meaning and enforcement.

[32] *See supra* note 30, 17A AM. JUR.2D *Contracts* §§ 1-5, 11-13 (1991).

trend holds that as long as the terminating party has the obligation to give notice, this duty of notice itself furnishes consideration.[33] In the drug court situation, it may be argued that the more traditional, common law view of a right to terminate is more applicable. In the drug court situation, often different defendants enter into plea agreement/drug court contracts with the same terms. Yet, even with identical agreements, different drug court defendants can be treated differently by the drug court judge in the imposition of sanctions. Such sanctions can include being terminated from the program. One of the main goals of written contracts is to give consistency of terms and expectations to each contracting party. The drug court defendant may not be provided with such consistency because the State has such overwhelming power of interpretation. Since the written terms are more fluid in the drug court situation, it may be argued that such terms do not give proper notice under the agreement as they would under the traditional situation, where neither party has the absolute power to impose its interpretation of an agreement on the other party. The fact that different defendants, with identical plea agreement/drug court contracts, can be treated differently for the same infraction may negate the more contemporary view which holds that notice may furnish consideration for a right to terminate.

An "Option-to-Cancel" Clause reserves the right of a party to cancel or withdraw at any time, but can be an illusory promise. However, like the right to terminate clause mentioned above, if the right is restricted (such as by requiring thirty days' notice), that may be construed as consideration.[34] In the post-plea drug court context, a similar argument may apply, as in the right to terminate situation. Granting the State the option to cancel the plea agreement/drug court contract may create a situation where the state can treat different drug court defendants differently even though each defendant has signed identical plea agreement/drug court contracts with the State.

FAILURE OF CONSIDERATION

When there is a failure of consideration, a valid contract becomes unenforceable because the performance bargained for has not been rendered.[35] A breach of contract is defined by *Barron's Law Dictionary*

[33] *Id.* at § 11-13.

[34] *Id.*

[35] *Franklin v. Carpenter*, 244 N.W.2d. 492 (Minn. 1976). The Court held that where there is a "lack of consideration," no valid contract is ever formed; when there is "failure if consideration," a contract valid when formed becomes unenforceable because the performance bargained for has not been rendered. In the drug court instance, the performance bargained for (an objective review performance by the defendant) may not have been rendered due to an arbitrary or ill-conceived interpretation of the actions of the

as "a party's failure to perform some contracted –for or agreed-upon act, or failure to comply with a duty imposed by law which is owed to another or society."[36]

The term "failure of consideration" covers all cases where an obligation under a contract has not been performed regardless of the circumstances or fault of the breaching party. All failures of consideration are not breaches of contract. A failure to render performance of a promise may not be a breach because of impossibility or destruction of the subject matter, but such a failure of consideration does discharge the other party from its duties under the contact and creates an obligation to make that party whole.[37] There is a breach of contract when a contract fails for failure of consideration when a party refuses to perform its part of the bargain. This defeats the very goal of the contract and releases the non-breaching party from its duties and obligations under the contract.

A plea agreement/drug court contract can be said to fail for failure of consideration in that the State is refusing to perform its part of the agreement. In the drug court situation, the failure to perform on the part of the State is not due to impossibility or due to destruction of the subject matter, but because the State is enforcing its view of the agreement and is now free not to perform (hence not provide the defendant with the benefit of the bargain), with no adverse consequences. Plea agreement/drug court contracts detailed earlier maintain that sanction/termination can result from relapse, failure to show up for treatment, failure to show up for drug court, or failure to follow drug court rules, which may include amorphous concepts like "treating others with respect" or following a dress code. The judge's discretion to interpret these plea agreement/drug court contract terms is vast. It can be argued that the defendant did not fail the program so much as the drug court judge failed the defendant from the program.

The potential failure of consideration issue is an "argument in the alternative" approach to the post-plea drug court situation, where it might be said that a lack of consideration argument falls short. If the defendant shows that the State breached the plea agreement, relief may

defendant with relation to the drug court contract by the drug court judge (a party and signatory to the drug court contract).

[36] This definition distinguishes between the lack of consideration and failure of consideration in a contract. In either event, in the drug court situation, there may not be a valid contract from the beginning or later when the promised performance by the drug court judge has failed.

[37] *Inches v. Butcher*, 104 N.W.2d 556 (N.D. 1960). Here, the defendants promise to render services to the plaintiff were rendered unnecessary because of a death; there was a failure of consideration for the plaintiff's conveyance. In the drug court context, it is not the mere promise of aiding the defendant under the drug court contract, but the actual help.

be: (1) to allow withdrawal of the plea, (2) to alter the sentence, or (3) to order specific performance of the agreement.[38] The remedy for the State's breaching of an agreement is dependent upon the specifics of the case.

> Whether the court will order "specific performance" of a plea agreement depends entirely on the nature of the alleged breach or failure to satisfy the terms of the agreement, the specific language of the plea agreement, and the facts surrounding the government's determination that the defendant is not entitled to the benefits of the plea agreement.[39]

The *Velez Carrero* case reiterates the case specific nature of the review of plea agreement breach cases. The main point that can be concluded from case law is that the courts will hear these cases, and not leave decisions regarding breach or review up to the State. In *United States v. Gomez*,[40] the court held that the government should have withdrawn from the agreement rather than breach at sentencing. In *United States v. Saling*,[41] the court remanded the case so that the defendant could be resentenced, or allowed the defendant to withdraw his plea or if government breaches, the court has the option of ordering specific performance or withdrawal as a remedy for the defendant.[42]

In the drug court context, it is likely that ordering specific performance or altering the sentence are not viable options. Ordering continuation of treatment in drug court, where the service rendered (treatment) is so specialized, is likely to help provide the defendant

[38] Bender, *supra* note 21, § 6.08[1] (2002).

[39] *United States v. Velez Carrero*, 77 F.3d 11 (1st Cir. 1996). The Court held that because plea bargaining requires defendants to waive fundamental constitutional rights, prosecutors engaging in plea bargaining are to be held to the most meticulous standards of both promise and performance. As a drug court contract (signed by the defendant, the prosecutor and the drug court judge) is the result of a plea bargain where the defendant gives up these same fundamental constitutional rights, drug court contracts must be held to the same standard.

[40] *United States v. Gomez*, 271 F.3d 779, 782 (8th Cir. 2001). The Court interpreted the plea agreement according to general contract principles and held that in the event of a breach by the defendant the government was required to withdraw from the agreement or keep its promise to the defendant. Under a drug court contract, the government would be required to release the defendant from the contract or move forward keeping its promises under the agreement.

[41] *United States v. Saling*, 205 F.3d 764, 768 (5th Cir. 2000). The Court opined that when any plea rests in any significant degree on a promise or agreement of the prosecutor, so that it can be said to be part of the inducement or consideration, such promise must be fulfilled. Under a drug court contract, the promise of help and an objective interpretation of the contract provisions are significant inducements to the defendant. After the defendant is involved in the drug court system, he or she may or may not receive their benefit of the bargain.

[42] *Id.* at 769.

beneficial treatment. Further, altering the drug court defendant's sentence does not seem to be a viable option. There have been no provisions for such an event under the plea agreement/drug court contract and the awarding of such a benefit to the defendant could be tantamount to allowing him/her to benefit from his/her own wrongdoing. The only viable option seems to be to allow the defendant to withdraw his/her plea and, outside of another option, let the traditional court system run its course.

Having a defendant's termination from a drug court program be subject to an independent judge's review is more likely to be addressed on due process grounds. In a reversal of recent trends, some courts have held that a defendant, alleging non-compliance and termination from a drug court program, must have a meaningful opportunity to be heard as in *Looney v. Oklahoma*,[43] *State v. Valentine*,[44] and *Hagar v. State*.[45] Further, to ensure a meaningful appeal, the drug court must give written reasons for terminating the defendant, including why the program's sanctions were inadequate or inappropriate. Many drug courts do not mandate such a written record for termination. Without such a record, there can be no meaningful review of the drug court proceedings or reasons for termination. Such written reasons give an appellant judge a proper foundation and record for review.

THE PROCESS OF THE PLEA BARGAIN

The plea bargaining process is designed to ensure that all guilty pleas are knowing and voluntary with an understanding of the consequences. In a post-plea drug court situation, the plea agreement is not concluded at the passage of sentencing; instead, the plea agreement is contingent upon the procedures of the drug court and the behavior of the defendant. The time to conclude if all parties have fulfilled their respective obligations under the plea agreement may not be known for over a year. This significant lag of time is not considered by "boilerplate" plea agreement questions. Further, these questions do not seem to recognize the dual role of the drug court judge as both party to the plea agreement/drug court contract and fact-finder of the agreement. The

[43] *Looney v. Oklahoma*, 49 P.3d 761 (Okla. Crim. App. 2002). A defendant has the right to appeal his termination from a drug court just as he has t he right to appeal the acceleration of his deferred sentence.

[44] *State v. Valentine*, 100 Wash App. Lexis 866 (2000). A defendant's due process rights were violated when she was terminated from a drug court program without being afforded a meaningful opportunity to respond to the allegations of non-compliance.

[45] *Hagar v. State*, 990 P.2d 894 (Okla. Crim. App. 1999). The defendant had the right to appeal from the decision terminating his participation in the drug court program and the defendant was entitled to written notice of the application to terminate his participation in the drug court program.

post-plea drug court situation is unique in the American criminal justice experience because of this concentration of power. The guidelines and questions asked for a traditional plea bargain may fall short of the necessary level of defendant understanding because they presuppose that a single entity cannot be both party and neutral, detached fact-finder. Further, such guidelines and questions presuppose that an objective and independent forum exists to hear any claims of breach of the agreement. The short-circuiting of the appellate process through the terms of the plea agreement/drug contract, along with the lack of a written record of drug court proceedings, may not be anticipated by the "boiler plate" plea agreement colloquies that regularly precede traditional plea agreements in criminal courts. In some jurisdictions, entry into a drug court requires that the defendant plead guilty to the highest alleged charge to gain entry to the drug court program, most notably in the Bronx (NY) Drug Court program.[46]

Based on these issues, it is likely that the traditional plea bargain procedures may have to be modified to account for the unique system that drug courts represent: namely, that the drug court as party to the plea agreement/drug court contract is the sole interpreter of the terms of the plea agreement/drug court contract, and has the power to enforce its interpretation.

INTERPRETATION OF PLEA AGREEMENT/DRUG COURT CONTRACT TERMS

Proponents argue that drug court contract clauses must be open to interpretation by the drug court judge to foster treatment.[47] Critics charge that granting the drug court judge (a party and signatory to the drug court contract) the ability to interpret and enforce the plea agreement/drug court contract renders the agreement invalid.[48] The city of Buffalo, New York uses a standard drug court contract that maintains, "I understand and agree that the Drug court Judge [sic] alone will determine whether or not I have complied with or failed any of the terms of this agreement."[49] It may seem to a defendant that complying with the terms of the plea agreement/drug court contract is dependent upon the subjective standards of assessment of the drug court judge. These clauses are standard in many plea agreement/drug court

[46] Quinn, *supra* note 5, at 55. Attorney Quinn cites many instances where the drug court process creates irregularities with a defendant's dues process rights and may create a legitimacy problem for courts of law in general.

[47] Taxman , *supra* note 10, at 187.

[48] Marlowe, *supra* note 8, at 991.

[49] Roger Washousky, City Court of Buffalo (New York) *Buffalo Drug Treatment Court Process Evaluation*. RECOVERY SOLUTIONS AND TRAINING INC. (2001).

contracts. In Rhode Island, the clause reads, "If the defendant fails to abide by the Drug Court conditions and orders, he she may be terminated from the program by the Drug Court judge and sentenced as he or she deems appropriate."[50] Again, the failure to comply is not fully articulated. These clauses that grant power to the drug court judge to terminate for non-compliance are generally predicated upon cooperation with drug program rules and procedures. Unfortunately, these rules and procedures are often left ambiguous in an effort to maintain flexibility in treatment. They may leave the defendant with little power to refute a drug court judge's interpretation of facts or events.

Definitions of expectations and requirements may not always be clear for drug court defendants. Clauses that maintain, "I agree to fully cooperate with all evaluation and all treatments as required by the court and by my case manager" are also ambiguous.[51] The definition of terms such as "full cooperation" for undefined "evaluations" and "treatments" that will be required by the court or case manager at some future date increase ambiguity in the plea agreement/drug court contract. For drug court advocates, these clauses allow for flexibility in treatment, which grant the drug court judge and treatment personnel the ability to change treatment tactics as the defendant's treatment evolves. For the defendant, these clauses may be viewed as ambiguities that grant the drug court judge the ability to interpret the terms of the agreement for compliance and sanction and/or termination from the program. In the Plattsburgh, New York program, the drug court handbook states that defendants must "respect the opinions and feelings of other people in Drug Court" and "are required to dress appropriately for all Court sessions, probation and treatment appointments."[52] With behaviors ranging from violent felony offenses to basic rudeness, the drug court judge has wide latitude to sanction different defendants in different ways for seemingly like offenses.

Further, compliance may be an evolving concept that drug court defendants may not clearly understand. In San Diego, California, a clause in the drug court contract states, "I agree to cooperate in an assessment/evaluation for planning an individualized drug treatment program adequate to my needs. I understand that my treatment plan may be modified by the treatment provider or Drug Court Team as circumstances arise, and I agree to comply with the requirements of any

[50] http://www.courts.ri.gov/superior/pdfadministrativeorders/2001-4.pdf, Rhode Island Superior Court Administrative Order No. 2001-4 (2001).

[51] Washousky, *supra* note 49, at 86.

[52] CITY OF PLATTSBURGH, NY, *DRUG COURT HANDBOOK*. Available online at www.courts.state.ny.us/courts/4jd/plattsburgh_city/drugcourt handbook .pdf. p. 11. (2005).

such modifications."[53] The ever-changing landscape of treatment may leave some drug court defendants in doubt as to requirements and may allow drug court judges an overarching authority to interpret issues of compliance and/or cooperation.

In some jurisdictions, defendant behavior that merits sanctions and/or termination is reduced to writing in the form of guidelines. These guidelines are designed to lend predictability to the sanctioning process for defendants. Often, disclaimers that negate their authority accompany such guidelines. The Mecklenburg County drug court of Charlotte, North Carolina, states, "There is a sanctions/incentives guideline that is a guide to the court for its decisions. The court is not obligated by the guideline. The judge has discretion but usually follows the guideline."[54]

CONCLUSION

Drug courts offer an opportunity to rehabilitate drug offenders and lessen the strain of the criminal justice system's resources by providing offenders with intense supervision without the high costs of incarceration. Drug courts constitute a new and evolving institution that is changing and adapting as new issues and circumstances arise. Unfortunately, the legitimacy of drug courts and drug court procedures may be questioned on many levels. The plea agreement/drug court contract is treated as binding, but the contract may not satisfy the basic tenets of contract law and fail as a vehicle of drug court entry, rendering the plea agreement/drug court contract invalid. A drug court has all the trappings of a traditional courtroom, but constitutional protections often do not exist, the rules of criminal procedure do not apply, and the rules of evidence are not used. The drug court judge is employed like a traditional judge, but he or she is also an active party to the plea agreement/drug court contract and proceedings, creating a situation in which the judge's discretion is overarching. A defense attorney is not zealously representing the rights and liberties of the defendant, but is part of a "therapeutic treatment team" more concerned with the defendant's treatment than his or her constitutional rights. These issues raise concerns about drug courts and the possible consequences outside of the proper safeguards employed by traditional courts.

A possible solution to the predicament of the drug court judge being both party and fact-finder of the plea agreement/drug court contract

[53] SAN DIEGO, CA SUPERIOR COURT ADULT DRUG COURT PROGRAM. *PARTICIPANT CONTRACT*. Available online at http://dcpi.ncjrs.orgt/pdf/Participant% 20Contract%20-%20San%Diego,%20CAA.doc p. 1-2 (2005).

[54] COUNTY OF MECKLENBURG, NC, *DRUG COURT OVERVIEW: SUPERVISION, TREATMENT, EDUCATION, AND PREVENTION (S.T.E.P.) PROGRAM.* 1,3 (2003).

may be simply to have the drug court judge not sign the agreement. The drug court judge's role can be more traditional or neutral and detached, with another treatment team member facilitating the plea agreement/drug court contract. Eliminating the drug court judge as a signatory removes the dual, conflicting roles currently operating. Another possible solution is to re-write the plea agreement/drug court contracts in such a way that the drug court judge is not granted such overarching powers as part of the agreement. Altering the language of the plea agreement/drug court contract itself may be a way of negating that power. Toning down plea agreement/drug court contract language that grants the drug court judge the "sole discretion" to determine whether the defendant has complied with the plea agreement/drug court contract would likewise provide a viable solution. Altering language that allows the drug court judge to unilaterally modify plea agreement/drug court contracts, essentially changing the "deal" to which the defendant initially assented would help alleviate the concern raised by the power the drug court judge now possesses as both signatory and fact-finder.

These plea agreement/drug court contract issues, where consideration may not be valid because the State is both party and fact-finder to the plea agreement/drug court contract, must be overcome to make the plea agreement/drug court contract binding. Removing the drug court judge's ability to render the consideration illusory is necessary. In the drug court context, the judge has such a high degree of discretion in interpreting and enforcing the plea agreement/drug court contract, that such discretion creates a unilateral right to terminate or an option contract. Affirmative language in the plea agreement/drug court contract, limiting the right of the judge to take such actions, may be another way of avoiding a lack or failure of consideration.

A more radical solution is to move the drug court process from the judiciary to the corrections segment of the criminal justice system. Again, the drug court judge would not be a signatory to the agreement, just as a probation hearing officer is not a signatory to a defendant's probation conditions. The drug court process could be run more like a probation hearing, utilizing drug court procedures. Further, the removal of the drug court from the judicial branch to the executive branch of government allows for a probation-like appeal. Probation hearings have a lower due process requirement than do court hearings, and this would facilitate the speed that drug courts require for proper therapeutic treatment.

Drug courts are rapidly expanding throughout the United States. As drug courts evolve and become more common, it is imperative to review their procedures and practices to ensure they are consistent with proper legal doctrine and constitutional principles.

WHISTLEBLOWER REFORM: INSUFFICIENT PROTECTIONS, UNCERTAIN FUTURE

by: DAVID A. GOODOF*

I. INTRODUCTION

Douglas Durant is a corporate whistleblower. Hired in 1995 as a vice president of sales at TAP Pharmaceuticals, he spent his employment building a fraud case against his company and a number of conspirators within the company. In addition, he filed a secret lawsuit against them. He helped the government build a case against TAP for the next eight years. As a result, when TAP and later Zeneca, Inc. settled with the government, Durant shared in the settlement to the tune of $126 million.[1] Durant was able to cash in despite the fact that no one was ever found guilty of the conspiracy he alleged even though he testified against eight defendants.

Nicholas Tides and Matthew Neumann were Audit IT SOX auditors at The Boeing Company in 2007. They saw what they thought were auditing irregularities and reported them to their supervisors. When no changes were made and they believed that the auditing culture was unethical, they contacted the press and provided information and documents to a reporter. When Boeing found out, they put both men on suspension and they went in front of an employee corrective action review board. After a hearing, the men were terminated. Subsequently

* Esquire and Associate Professor, Bertolon School of Business, Salem State College. The author acknowledges Lisa Scalisi, a graduate of Suffolk Law School who assisted with the research of this article.

1 Neil Weinberg, FORBES, *The Dark Side of Whistleblowing,* http://www.forbes.com/global/2005/0314/048 (March 14, 2005).

they filed complaints with OSHA and were issued letters authorizing them to sue in federal court. The United States District Court made a ruling that they were terminated for going to the media and that this is not a protected activity under Sarbanes-Oxley.[2]

Anne Mitchell, a nurse in Texas was charged with a felony after reporting a doctor to the state medical board for practicing unsafe medicine. She was charged with misuse of official information and, of course, was fired from her job. After a four day trial, a jury deliberated for about an hour and found her not guilty. She now has litigation pending relative to regaining her job and compensation for her lost time.[3]

In 2002, Time Magazine named three whistleblowers as persons of the year. Sherron Watkins was a whistleblower at Enron Corp, Cynthia Cooper uncovered massive fraud at WorldCom and Coleen Rowley was a midlevel attorney for the FBI who wrote a thirteen page memo regarding flaws in the pre 9/11 domestic terrorism investigation.[4] These three were lauded as heroes for coming forward to report wrongful behavior. Coleen Rowley later said that "the credibility of the investigation I helped launch into pre-9/11 was undercut by suspicions that I was motivated by the fame that came along with being on the cover of TIME. Still the publicity is what kept me from being fired from the FBI."[5]

All of these different matters had one thing in common. They all involved a whistleblower. The fact that Durant made millions by ignoring the responsibilities of his position and failing to rectify illegal activities within his department doesn't make him any less a whistleblower for statutory purposes.[6] The fact that Sherron Watkins may not have been so selfless as she likes to appear as she really never went outside the company with her concerns and she was selling off her own stock at the time of the demise of Enron doesn't make her less a whistleblower.[7] The fact that Nicholas Tides and Matthew C. Neumann

[2] Tides v. The Boeing Company, 2010 WL 537639 (W.D. Wash. Feb. 9, 2010).

[3] Kevin Sack, THE NEW YORK TIMES, *Whistle-Blowing Nurse Is Acquitted in Texas*, http://www.nytimes.com/2010/02/12/us/12nurses.html?scp=1&sq=Texas%20nurse&st=cse (Feb. 11, 2010).

[4] Richard Lacay and Amanda Ripley, TIME, *Persons of the Year 2002 Cynthia Cooper, Coleen Rowley and Sherron Watkins*, http://www.time.com/time/subscriber/personoftheyear/2002/poyintro.html (Dec. 22, 2002).

[5] *Persons of Years Past: Cynthia Cooper, Coleen Rowley and Sherron Watkins*, TIME, http://www.time.com/time/specials/packages/article/0,28804,1946375_1947772_1947759,00.html (Dec. 16, 2009).

[6] Weinberg, supra n.1, at 1.

[7] BUSINESSWEEK, *Was Sherron Watkins Really So Selfless*? http://www.businessweek.com/magazine/content/02_50/b3812101.htm (December 16, 2002).

went outside Boeing to the press does not make them any less whistleblowers.[8] All are whistleblowers whose cases ended up differently for numerous reasons.

The purpose of this article is to review whistleblower law and to try to determine if, in fact, whistleblowers are protected. A secondary purpose is to try to develop criteria for a wide ranging, uniform federal statute that will protect whistleblowers from retaliation and compensate them where necessary. In the same way that state statutes cover employment issues not covered by federal statutes, there should also be some uniform state laws to protect whistleblowers.

II. WHO ARE WHISTLEBLOWERS?

A. Definitions

Black's Law Dictionary defines whistleblower as "An employee who reports employer wrongdoing to a governmental or law-enforcement agency."[9] Under this definition, Sherron Watkins would not have been a whistleblower as she never reported to a government or law-enforcement agency. There is no provision in this definition for the innumerable employees who make reports to their immediate supervisors. Nor does Harry Markopolos qualify as a whistleblower under this definition as he was not an employee of Bernard Madoff when he informed the SEC of what he then believed was a Ponzi scheme being run by Madoff. The definition of whistleblowers should go far beyond that offered by Black's Law Dictionary. In fact, a number of statutes, including the Sarbanes-Oxley Act of 2002 now protect from retaliation, persons who also report internally to "a person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct).[10]

Social scientists give a much more generous definition of a whistleblower. Their definition encompasses both internal and external recipients of information.[11] Their assumption is that internal whistleblowing is much more beneficial to the organization.[12] This may be because it gives an opportunity to correct a situation prior to legal action or adverse publicity. Dworkin and Baucus discuss the factors that go into each type of whistleblower.[13] Their study did not show any

[8] Tides v. The Boeing Company, 2010 WL 537639 (W.D. Wash. Feb. 9, 2010).

[9] BLACK'S LAW DICTIONARY 1327 (Bryan A. Garner ed., 8th ed., West 2004).

[10] *Sarbanes-Oxley Act of 2002*, 18 U.S.C.A. §1514A (West 2006).

[11] Terry Morehead Dworkin & Melissa S. Baucus, *Internal vs. External Whistleblowers: A Comparison of Whistleblowering Processes,* 17 J. OF BUS. ETHICS 1281, 1282 (1998).

[12] *Id.*

[13] *Id.*

gender differences in who they reported the wrongdoing to. There was an indication that employees with longer tenure were less likely to go to external recipients.[14] They also found that external whistleblowers had more evidence of wrongdoing and more witnesses than internal whistleblowers.[15] The study did find that internal whistleblowing was on the whole ineffective while external whistleblowing often led to an investigation and organizational changes.[16]

Near and Dworkin studied companies' response to increased whistleblower protection statutes in the late 1990's.[17] The results were that not a large percentage of companies who responded to the survey had more than an open door policy for complaints. The discussion seems to indicate that it was business as usual.[18] Employees don't see an open door policy as accomplishing anything or in any way protective of their jobs.[19] The findings also indicate that employees want to sue companies for wrongful discharge in tort as they are dissatisfied with the limitation of most state statutes to equitable remedies. Additionally, if there is to be encouragement to disclose illegal and unethical acts, statutes have to be less restrictive.[20]

B. Hero or Villain?

Is Douglas Durant a villain for his actions leading to his multimillion dollar payoff? Often whistleblowers are characterized as villains or as heroes. Many whistleblowers are in fact vilified in their companies for their actions in speaking out about illegal or immoral behavior. Dworkin and Baucus showed that external whistleblowers suffered delayed firing and more extensive retaliation than internal whistleblowers. Internal whistleblowers were simply terminated while external whistleblowers were nullified, suffered verbal abuse, pressure and documented poor performance records.[21] Is someone a villain simply because he or she decides to stand up for what he or she believes is right? Many times a whistleblower is characterized as disloyal, disgruntled or incompetent by the employer and other employees who are affected by his actions.[22] There are a number of studies showing

[14] *Id.* at 1290.
[15] *Id.* at 1294.
[16] *Id.* at 1295.
[17] Janet P. Near & Terry Morehead Dworkin, *Responses to Legislative Changes: Corporate Whistleblowing Policies* 17 J. OF BUS. ETHICS 1551 (1998).
[18] *Id.* at 1557.
[19] *Id.*
[20] *Id.* at 1559.
[21] *Id.*
[22] Miriam A. Cherry, *Whistling in the Dark? Corporate Fraud, Whistleblowers, and the Implications of the Sarbanes-Oxley Act for Employment Law,* 79 WASH. L. REV. 1029, 1052

that whistleblowers are subjected to tremendous harassment after blowing the whistle.[23] A case on point is one in which the plaintiffs both testified as to the results of the harassment they received.[24] Plaintiff, Joseph Bowen, testified that one commissioner threatened him with a dig a hole for himself comment and that his barn was burned leading to an arson investigation.[25] He also testified that he feared for his own safety as well as that of other employees.[26] Plaintiff Thomas Del Rosario testified that he was threatened and harassed, leading to visits to his doctors with complaints of anxiety, stress and depression.[27] It is highly unlikely that most whistleblowers are doing so for personal gain and that Douglas Durant is an aberration. Anne Mitchell, for example, believed that patients would be harmed in the absence of her reports and hoped that, as a result of her actions, proper medical procedures would be instituted for the care of patients.[28]

III. WHISTLEBLOWER STATUTES

A. Federal Protections

There are over ninety federal statutes that contain whistleblower protection.[29] As discussion of these would be prohibitive, this paper will only look at a few of the more well known statutes. These will be the Federal False Claim Act,[30] Sarbanes-Oxley Act of 2002,[31] and the Internal Revenue Code.[32]

The Federal Civil False Claim Act was originally enacted in 1863. Abuses of the statute and lack of control led to its amendment in 1943. The amendment was designed to limit qui tam lawsuits.[33] Qui Tam is short for qui tam pro domino rege quam pro se ipso in hac parte sequitur "who as well for the king as for himself sues in this matter."[34] A qui tam action is one "brought under a statute that allows a private person to sue

(2004).

[23] *Id.* at 1053.

[24] Bowen v. Parking Authority of the City of Camden, 2003 WL 22145814 (D.N.J. Sept. 18, 2003).

[25] *Id.* at 4.

[26] *Id.* at 6.

[27] *Id.*

[28] Sack, *supra* n. 3.

[29] National Whistleblowers Center, *Federal Whistleblower Protections*, http://www.whistleblowers.org/index.php?option=com_content&task=view&id=816&Item (last visited Feb. 27, 2010).

[30] 31 U.S.C. §3730(h) (West 2006).

[31] 18 U.S.C. §1514A (West 2006).

[32] I.R.C. § 7632(a) (West 2008).

[33] Matthew S. Brockmeier, *Pulling the Plug on Health Care Law: The false claims act after Rockwell and Allison Engine*, 12 DEPAUL J. HEALTH CARE L. 277, 282 (2009).

[34] BLACK'S LAW DICTIONARY (Bryan A. Garner ed., 8th ed., West 2004).

for a penalty, part of which the government or some specified public institution will receive."[35] Under the False Claim Act, the relator shares in the award. The relator is the person who files suit on behalf of the government. If the government takes over the action, the statute calls for the relator to receive at least fifteen percent of the recovery but not more than twenty-five percent. If the government decides not to take over the prosecution of the action, the relator may continue and he will then be entitled to not less than twenty-five percent but no more than thirty percent of the award.[36]

False Claim Act cases are brought in a number of areas but the one that seems to garner the greatest publicity and the largest awards are in the area of health care. In 2009, False Claim Act cases brought in approximately 2.4 billion dollars in awards of which about 1.6 billion dollars came from health care fraud.[37] The pharmaceutical industry and medical device companies seem to be a focus at this time. The largest settlement was from Phizer and its subsidiary Pharmacia which is the second largest in history.[38] Qui tam cases have resulted in a major portion of the government recoveries since 1986. In 2005 qui tam lawsuits resulted in recovery of $1.1 billion and the relators gained over $150 million.[39] These recoveries serve as an incentive for people to report wrongdoing as Douglas Durant did.

The 1943 amendment to the False Claim Act put barriers to individual recovery and took away the incentives. The main barrier was called public disclosure bar. Under this provision, courts had limited jurisdiction to hear qui tam cases based on evidence or information that the government had when the case was brought. About forty years later, Congress passed the False Claims Amendment Act of 1986. The change to the public disclosure bar was that if the relator had given that original information to the government, then he would be allowed to proceed.[40]

The False Claim Act contains a relief from retaliation provision. It calls for making the employee whole if discharged, demoted, suspended, threatened, harassed or in any other manner discriminated against because of lawful acts of the employee. It calls for reinstatement, double back pay, and reasonable attorney fees among other relief. It allows the

[35] *Id.*
[36] 31 U.S.C. § 3730 (West 2006).
[37] Scott Becker & Julie Ann Sullivan, *Eleven Things to Know About the False Claims Act*, Mondaq (Pg. Unavail. Online) 2010WLNR 4434271 (March 3, 2010).
[38] *Id.* at p. 2.
[39] *Whistleblower Awards*, http://www.hirst-chanler.com/10.html (accessed Aug. 4, 2009).
[40] Brockmeier, *supra* n. 34 at 284.

employee to bring an action in the appropriate federal district court to enforce this provision.[41]

Sarbanes-Oxley Act of 2002 originated from the accounting scandals of 2000 through 2002, most particularly Enron and World Com. The statute contains a whistleblower provision that is designed to protect those who come forward to report and prevent accounting fraud.[42] Under the provisions of the act, workers are protected from retaliation whether they report fraud internally or to a government agency if they work at a publically traded company.[43] The company is forbidden from "discharging, demoting, suspending, threatening, harassing or otherwise discriminating against an employee who engages in certain forms of protected whistleblowing activity."[44] Protected employee activity would include reporting accounting fraud or other fraud against shareholders to a supervisor internally or to the appropriate government agencies externally. Reporting to the media would not be covered activity nor would discussing it with a peer or a subordinate internally.[45] It appears that retaliation against a whistleblower would also violate the criminal offense of retaliation against informants which is included within the Act.[46] The Act, however, has no procedures for responding to a complaint by a whistleblower. Additionally, the Act allows for complaints to be sent to arbitration, thereby prolonging the recovery process. Most employees would rather have the right to use the federal district court to enforce their claim of retaliation. These weaken the effect of the act.[47]

The Internal Revenue Service has a whistleblower scheme in place to incentivize reporting of those who are cheating on their taxes.[48] The Secretary of the Treasury is authorized to pay such sums as he in his discretion deems necessary. They may be given in either criminal proceedings or in civil actions. The rewards are to come from collections resulting from the information received and may come from interest on the sum payable as well. Currently, there is no information on who qualifies for the rewards and how much they are entitled to.[49] There is a separate section of the code for high value cases but there is a high threshold of at least two million dollars owed for a whistleblower to

[41] 31 U.S.C. § 3730 (West 2006).
[42] 18 U.S.C. §1514A (West 2006).
[43] Cherry, *supra* n. 22, at 1064.
[44] 18 U.S.C. § 1514A (West 2006).
[45] Cherry, *supra* n. 22 at 1065.
[46] 18 U.S.C. § 1107 (West 2006).
[47] Cherry, *supra* n.22, at 1070.
[48] I.R.C. § 7623 (West 2008).
[49] Edward A. Morse, *Whistleblowers and Tax Enforcement: Using Inside Information to Close the "Tax Gap,"* 24 AKRON TAX J. 1, 13 (2009).

qualify for a reward and the taxpayer involved must have gross income in excess of two hundred thousand dollars.[50] These are very difficult thresholds to reach. If they are reached, however, the award program entitles the claimant to a reward based on a percentage of the recovery. There is still discretion in the IRS as to whether or not to proceed against the delinquent taxpayer. Despite the fact that there are billions of dollars of unpaid taxes every year, the IRS has only recently paid out its first Big WhistleBlower Award under this section of the Internal Revenue Code. [51]

The Whistleblower Protection Act of 1989 seems to require employees who are the recipients of adverse employment actions taken as a result of whistleblowing to seek corrective action from the Merit Systems Protection Board. If the board allows corrective action, it may include the equitable remedies normally available: reinstatement in his position or one as close as possible to it, back pay and related benefits, attorney fees and costs. If the employee loses before the Merit Systems Protection Board, he has the option of obtaining judicial review of the order or decision.[52]

B. State Treatment of Whistleblower Protection

For those states that have not adopted whistleblower statutes to protect employees from retaliatory discharge, the common law is the basis of protection. There is an exception to the common law employment at will doctrine that has to do with public policy. An employer cannot retaliate against an employee for certain reasons that are deemed to be against public policy, such as refusing to commit an illegal act or refusing to give perjured testimony. These have resulted in inconsistent handling of cases of wrongful discharge. Some states, but not all, have given protection to employees under those circumstances through court decisions.[53] Although there may be some dissatisfaction with the judicial protections under the employee at will doctrine, only one state has enacted a statute that encompasses a for cause termination clause.[54] As of 2004, approximately twenty states had enacted whistleblower statutes that applied to private employers.[55] The statutes in the numerous states differ greatly. Some have broad

[50] I.R.C. §7623(b) (West 2008).

[51] Arden Dale, *US IRS Pays First Big Whistle-Blower Award*, February 24, 2010, available at http://www.whistleblowers.org/index.php?option=com_content&task=view&id=1047&item

[52] 5 U.S.C. § 1221 (West 2006).

[53] Cherry, *supra* n.22 at 1043-1044.

[54] *Id.* at 1044.

[55] *Id.* at 1045.

coverage while others apply only to specific types of industries, burdens of proof differ, and types of harm for which they apply differ. It is in this environment that people have to try to determine their rights and obligations.[56] The other problem with these statutes has been judicial interpretation of them and the inconsistencies in this area.

Sherron Watkins was working for Enron in Texas. Under Texas law at the time, she would have been unprotected. She would have had no legal option after the company demoted her and eventually would have terminated her. Cynthia Cooper, on the other hand, was employed by World Com in Mississippi. Had she been retaliated against, she would have had protection under Mississippi law at the time. The Mississippi Supreme Court had made a public policy exception to the employment at will doctrine for whistleblowers.[57]

A number of states have also adopted false claim acts that parallel the federal act.[58] These acts call for awards in the same fashion as the federal false claim act but in differing percentages. Some of the states have enacted statutes that are Medicaid specific. Others simply follow the federal statutes and a false claim act. Almost half the states have no such statute and therefore no protection for employees who feel the need to relate issues of illegality in the state.

IV. WHISTLEBLOWER CASES

Roger Sanders and Roger Thacker worked for General Tool Company, a subcontractor of Allison Engine, a subcontractor of Bath Iron Works and Ingalls Shipbuilding, who had a contract to build a new fleet of missile destroyers. There were baseline navy drawings and specifications to be followed. Each delivered product had to be accompanied by a certificate of conformance. Sanders and Thacker brought a qui tam suit against Allison Engine and the subcontractors saying that the products produced did not meet specifications despite the certificates of conformance. At the trial, although there was evidence that Allison et. al. had issued those certificates falsely stating that the work was completed in compliance and that they had presented invoices for payment, the plaintiffs had not introduced any of those invoices into evidence. Accordingly, judgment was granted to

[56] *Id.* at 1046-1048.

[57] Cherry, *supra* n. 22 at 1041.

[58] CAL. GOV'T CODE § 12650 (2009); DEL. CODE ANN. Tit. 6 § 1201 (2010); FLA. STAT. § 68.081 (2009); HAW. REV. STAT. § 661 (2009); IND. CODE § 5-11-5.5 (2009); MASS. GEN. LAWS ch. 159 § 18 (2009); MICH. COMP. LAW ANN. § 400.610(a) (2010); MONT. CODE ANN. § 17-8-401 (2010); NEV. REV. STAT. § 357.040 (2009); N.H. REV. STAT. ANN. § 167 (2009); N.M. STAT. ANN. § 44-9 (2010); N.Y. FIN. LAW § 188 (McKinney 2009); OKLA. STAT. Tit. 63, § 5053 (2009); R.I. GEN. LAWS § 9 (2009); TENN. CODE ANN. § 71-5-181 (2009); VA. CODE ANN. § 8.01-216.1 (2009).

defendants, Allison Engine et.al. On appeal the case was reversed in relevant part holding that such claims did not require proof of an intent to cause a false claim to be submitted to be paid by the government. The Supreme Court granted certiorari and, in ruling against the whistleblowers, held that submission of a claim under the Federal False Claim Act had to be for the purpose of getting the false or fraudulent claim paid by the government.[59] As part of the response to the financial crisis, Congress enacted amendments to the False Claims Act.[60] These amendments closed the loophole in the statute that allowed those federal subcontractors to avoid liability and extended whistleblower protection to those who report fraud by subcontractors.[61]

Bunnatine (Bunny) H. Greenhouse is a whistleblower. She was once a top procurement official for the U.S. Army Corps of Engineers. In February, 2003, she went to a Pentagon meeting and raised issues of Halliburton and its subsidiaries receiving no bid contracts and objected to Halliburton officials being at the meeting. There were a number of contracts being discussed and they were to be extremely lucrative.[62] As a result of her revelations about Halliburton, she was demoted, her pay reduced and she was stripped of her security clearance. The U.S. Army Corps of Engineers say that the actions were because of her poor work habits despite coming shortly after revealing these potential fraudulent acts and despite having had years of glowing employee evaluations.[63] The demotion, pay cut and loss of security clearance came within three weeks after she testified at a Congressional committee hearing on waste, fraud and abuse in contracting. She subsequently filed an action in federal district court.[64] The action contained counts for discrimination and violation of the Whistleblower Protection Act. The decision of the Court was that it lacked jurisdiction to entertain a whistleblower action brought before it in the first instance.[65] The ruling was that Ms. Greenhouse was obligated to take her case to the Office of Special Counsel before the court could hear it. If the Office of Special Counsel finds there is a prohibited personnel action, it reports that to the Merit Systems Protection Board. If it finds no prohibited personnel action, the

[59] Allison Engine Co., Inc. v. United States ex rel. Sanders, 553 U.S. 662 (2008).

[60] 31 U.S.C. § 3729 (West 2006).

[61] 31 U.S.C. § 3729 (West 2006).

[62] Adam Zagorin & Timothy J. Burger, *Beyond the Call of Duty*, TIME, Oct. 24, 2004 *available at* http://www.time.com/time/magazine/article/0,9171,733760,00.html.

[63] Neely Tucker, *A Web of Truth: Whistle-Blower or Troublemaker, Bunny Greenhouse Isn't Backing Down*, THE WASHINGTON POST, Oct. 19, 2005, available at http://www.washingtonpost.com/wp-dyn/content/article/2005/10/1.

[64] Greenhouse v. Geren, 574 F.Supp.2d. 57 (2008).

[65] *Id.* at 68.

employee may appeal directly to the Merit Systems Protection Board.[66] Ms. Greenhouse is lobbying for a whistleblower protection amendment that will allow initial access to the courts and for a jury trial.[67] The Department of Justice is on record as opposing giving national security whistleblowers those due process protections.

Robert MacLean is a whistleblower who has lost his job as a federal air marshall. He gave the media an unclassified document showing that there were to be cuts to the marshall coverage. He was fired three years after he came forward with the document. Although he claims that he is shielded from retaliation by the Whistleblower Protection Act, he is still unemployed and is in the review process for this type of case. The review process has taken more than four years. The scenario for the review process is as stated above, the Office of Special Counsel (which has had no leader since October, 2008), The Merit Systems Protection Board (uses administrative law judges who often decide in favor of the government), Circuit Court of Appeals (ruled for the whistleblower only three times in 203 cases dating back to 1994).[68]

Whistleblower cases can last for years as shown above. In a case where the Supreme Court recently denied a writ of certiorari, David E. Welch was fired in 2002 from his job as chief financial officer of a bank in Virginia.[69] All Mr. Welch did was complain about certain insider trading going on at the bank and financial irregularities and refuse to sign financial statements as provided in Sarbanes-Oxley. He was fired for "incompetence." Welch filed a complaint under Sarbanes-Oxley with the Occupational Safety and Health Administration alleging a violation of the whistleblower protections in section 806 of the act. The Secretary of Labor dismissed his case saying he was fired for other legitimate reasons. Welch appealed and got a hearing with an administrative law judge and was ordered restored to his job with back pay and the employer appealed. The circuit court dismissed his claim.[70] Certiorari was denied. Mr. Welch is out of appeals and out of luck.

The Securities and Exchange Commission (SEC) is a likely punching bag these days. It appears that whistleblowers like Harry Markopolos are not even listened to. Over a ten year period, Markopolos brought to the attention of the SEC his suspicions that Bernard Madoff was running a fraud.[71] No action was taken by the SEC. Eric Kolchinsky

[66] *Id.* at 64.

[67] Joe Davidson, *Whistleblower Makes Herself Heard on the Hill*, THE WASHINGTON POST, A21, (June 11, 2009).

[68] Peter Eisler, *Whistle-blowers Rights Get Second Look*, USA TODAY, 6A (Mar. 15, 2010).

[69] Welch v. Solis, 129 S. Ct. 1985 (2009).

[70] Welch v. Chao, 536 F.3d. 269 (2008).

[71] Beth Healy, *Markopolos Offers Guarded Praise for SEC*, Apr. 2, 2010 (http://www.boston.com/business/markets/articles/2010/04/02.

was an executive at Moody's who reported that they were approving mortgage backed investments which were dangerous. The SEC assured Mr. Kolchinsky that someone would contact him shortly but failed to do so.[72]

V. CONCLUSION AND RECOMMENDATIONS

It is obvious from examining the whistleblower statutes, both federal and state that some simplification of the process has to be undertaken. At both the federal and state level, statutes are being enacted on a regular basis that contain whistleblower provisions. As recently as March 23, 2010, President Obama signed into law the Patient Protection and Affordable Care Act which contains a whistleblower protection. This provision calls for a prohibition of retaliation against those who have "provided, caused to be provided, or is about to provide or cause to be provided to the employer, the Federal Government, or the attorney general of a State information relating to any violation of, or any act or omission the employee reasonably believes to be a violation of, any provision of this title."[73] Given the proliferation of these statutes, it appears obvious again that the Federal Government and the states have decided that whistleblowers should be protected.

There is also the issue of protection of whistleblowers as opposed to the rewards some look for. Is it even possible to protect a whistleblower from retaliation? Although, as discussed above, there is evidence that external whistleblowers may retain their jobs longer, there is also evidence that they will lose them. This, coupled with harassment from both employers and fellow workers may make the job intolerable. There should enough of a reward to ensure that this daunting prospect is not a factor in people doing the right thing. The SEC is planning on offering bounties to whistleblowers to encourage employees to provide information on investor fraud.[74] There must be, however, some limit on the awards that are being obtained in qui tam suits. These awards lead to the Douglas Durants of our society who come in and file the action without even attempting to do what is right or to accomplish what his position calls for.[75]

The National Whistleblower Center has a proposed National Whistleblower Protection Act. It provides for protection against

[72] Zachary A. Goldfarb, *At SEC, The System Can Be Deaf To Whistleblowing*, http://www.washingtonpost.com/wp-dyn/content/article/2010/01/20/AR2010012005125.html (Jan. 21, 2010).

[73] *Patient Protection and Affordable Care Act*, Pub.L. No. 111-148 (Mar. 23, 2010).

[74] Erika A. Kelton, *Encouraging Whistleblowers, Discouraging Fraud,* THE WASHINGTON POST, 12A (Mar. 21, 2009).

[75] Weinberg, *supra*, n.1.

retaliation of any sort for protected disclosure or the opposition of illegal practices or charged, testified, or assisted in the investigation of under federal law. Protected disclosure has to do with the belief that there is fraud, waste, violation of statute among other items. This proposed statute calls for the right to a first instance jury trial in the appropriate federal district court. The court may grant reinstatement, back pay, litigation costs and attorneys fees. There is also a provision for a reward in the same amount as defined in the False Claims Act.[76] In addition to these provisions, there should be some sort of monetary award that will allow whistleblowers to provide for themselves and their families while litigation may be in process and while they are searching for a new position.

[76] National Whistleblowers Center, *Proposed National Whistleblower Protection Act*, available at http://www.whistleblowers.org/ (last accessed Dec. 12, 2009).

COPYING COPYRIGHTED COURSEPACKS AT COPYSHOPS FOR CLASSROOM CONSUMPTION: COPYRIGHT OWNERS 3, COPYSHOPS 0

by WILLIAM E. GREENSPAN*

INTRODUCTION

The fictional Professor Miller compiles selected readings from a variety of copyrighted sources, thereby creating an anthology perfectly suited for his English Literature class. He makes a master copy and gives it to Carl, the owner of Carl's Copyshop, a commercial copy center. Neither Professor Miller nor Carl has obtained permission to make copies from the various copyright owners whose works appear in Professor Miller's anthology. Both Professor Miller and Carl believe that since the materials copied will be used for educational purposes at a non-profit institution, it is not necessary to obtain permission from the copyright owners to make copies.

Sam, a student in Professor Miller's class, comes to Carl's Copyshop with a pocket full of dimes. After Sam identifies himself as a student in Professor Miller's class, Carl gives the master copy to Sam who then copies all 200 pages on one of Carl's copy machines. Sam may be liable for copyright infringement, but what about Carl? Carl did not make any copies. Is Carl liable for copyright infringement?

The answer to this question may be of interest to many who are involved in the marketing of coursepacks, including students, professors, publishers, authors, copyshops, colleges, and universities. Authors seek

* Professor, School of Business, University of Bridgeport.

a fair return for their creative efforts. Publishers wish to maximize profits. Educators desire easy access to educational works.[1]

This paper will (1) review relevant statutory law and legislative history as it relates to copyshop copying of coursepacks, (2) identify and discuss a trilogy of cases directly addressing copyshop liability, and (3) make recommendations on what all involved parties should do to avoid copyright infringement. Finally, this paper will raise issues for future resolution.

II. RELEVANT 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,"[2] Congress enacted "a comprehensive statutory scheme governing the existence and scope of copyright protection for original works of authorship fixed in any tangible medium of expression."[3] The United States Supreme Court has observed that the "immediate effect of our copyright law[4] is to secure a fair return for the author's creative labor. But the ultimate aim is, by this incentive, to stimulate artistic creativity for the general public good."[5] 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."[6]

A. Requirements, Exclusive Rights, Subject Matter, Remedies

A person who creates an original[7] work of authorship in a fixed form[8] has six exclusive rights, two of which are to do and authorize

[1] *See, e.g.,* Salinger v. Colting, 2010 WL 1729126 (2nd Cir. Apr. 30, 2010) (demonstrating the respective copyright interests of authors, publishers, and the public in literary works and the fair use doctrine).

[2] U.S. Const., Art. I,§ 8, cl. 8.

[3] Reed Elsevier, Inc. v. Muchnick, No. 08-103, 2010 WL 693679, at *3 (U.S. Mar. 2, 2010).

[4] 17 U.S.C. §§ 101 et. seq. (2009).

[5] Twentieth Century Music Corporation v. Aiken, 211 U.S. 151, 156 (1975).

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

[7] "Original" or "originality" as the term is used in copyright "means only that the work was independently created by the author (as opposed to copied from other works), and that it possesses at least some minimal degree of creativity." Feist Publications, Inc. v. Rural Tel. Serv. Co., 499 U.S. 340, 345 (1991). See Utopia Provider Systems, Inc. v. Pro-Med Clinical System, L.L.C., Nos. 09-11160, 09-11447, 09-12887, 2010 WL 569892 (11th Cir. Feb. 19, 2010) (holding a set of charts for a physician to use to record a patient's medical history did not convey information or original expression, and thus was not copyrightable); Ho v. Taflove, No. 07 C 4305, 2010 WL 165869 (N.D. Ill. Jan. 15, 2010) (explaining a mathematical model lacked the necessary originality for copyright); Salestraq America,

reproduction of the work in copies,[9] and distribution of copies of the copyrighted work to the public by sale or other transfer of ownership.[10] The subject matter of a copyright falls into eight categories, one of which is literary works.[11] Any person who violates any of the exclusive rights of the copyright owner is liable for copyright infringement.[12]

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,[13] (2) the impoundment and destruction of all reproductions of the work made in violation of the owner's rights,[14] (3) a recovery of the copyright owner's actual damages and any additional profits of the infringer, or statutory damages ranging from as low as $200 for innocent infringement up to $150,000 per violation for willful infringement of a registered work,[15] and (4) an allowance for costs and a reasonable attorney's fee in the discretion of the court to the prevailing party.[16]

The exclusive rights of a copyright owner are not unlimited. There are several exemptions or limitations.[17] One of these limitations is known as the "fair use doctrine."[18]

B. The Fair Use Doctrine

The English Parliament established an author's copyright with the Statute of Anne in 1710.[19] Later, judges in the United States recognized as common law that the fair use of unauthorized reproduction of copyrighted material would not infringe any of an author's exclusive rights.[20] In *Folsom v. Marsh*,[21] Justice Story had to deal with the

LLC v. Zyskowski, No. 2:08-cv-01368-LRH-LRL, 2010 WL 186003 (D. Nev. Jan. 15, 2010) (deciding a compilation of floor plans for residential property was uncopyrightable for lack of originality).

8 17 U.S.C. § 102(a) (2009).

9 *Id.* at § 106(1) (2009).

10 *Id.* at § 106(3) (2009).

11 *Id.* at § 102(a) (1) (2009). "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 embodies. 17 U.S.C. § 101 (2009).

12 *Id.* at § 501 (2009).

13 *Id.* at § 502 (2009).

14 *Id.* at § 503 (2009).

15 *Id.* at § 504 (2009).

16 *Id.* at § 505 (2009).

17 *Id.* at §§ 107-122 (2009).

18 *Id.* at § 107 (2009).

19 Act for the Encouragement of Learning, 1709, 8 Anne, ch. 19.

20 *See* Pierre N. Leval, *Toward a Fair Use Standard*, 103 HARV. L. REV. 1105 (1990).

21 9 F.Cas. 342 (C.C.D.Mass. 1841)

"intricate and embarrassing" issue of whether the copying of letters written by George Washington could constitute fair use. He stated one must look to the "nature, extent, and value of the materials thus used; the objects of each work; and the degree to which each writer may be fairly presumed to have resorted to the same common sources of information, or to have exercised the same common diligence in the selection and arrangement of the materials."[22] These criteria were largely adopted by Congress when it first codified the fair use doctrine in Section 107 of the 1976 Copyright Act.[23]

The legislative history indicates the fair use bill endorsed the common law of fair use, and recognized, especially during a period of rapid technological change, "the courts must be free to adapt the doctrine to particular situations on a case-by-case basis. Section 107 was intended to restate the present judicial doctrine of fair use, not to change, narrow, or enlarge it in any way."[24]

Section 107, as codified, permits the fair use of a copyrighted work, including reproduction in copies, for purposes such as criticism, comment, news reporting, teaching, scholarship, or research. In determining whether use of a work is fair use, a court should consider four factors: "(1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes; (2) the nature of the copyrighted work; (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (4) the effect of the use upon the market for or value of the copyrighted work."[25]

The legislative history of Section 107 indicates the Ad Hoc Committee of Educational Institutions and Organizations on Copyright Law Revision, and of the Authors League of America, Inc., and the Association of American Publishers, Inc., working on the bill, concluded

[22] *Id.* at 344.

[23] 17 U.S.C. § 107 (2009).

[24] H.R.Rep. No. 1476, 94th Cong., 2d Sess. 169, *reprinted in* 1976 U.S. Code & Admin. News 5659, 5680.

[25] 17 U.S.C. § 107 (2009). See Harper & Row Publishers, Inc. v. Nation Enters., 471 U.S. 539 (1985) (finding publication of a short article containing excerpts from an unpublished manuscript of a book by President Ford was not fair use); Gaylord v. United States, No. 2009-5004, 2010 WL 653272 (Fed. Cir. Feb. 25, 2010) (holding when the U.S. Postal Service copied a stamp bearing the image of a copyrighted statue featuring an image of the Korean War Veterans Memorial, there was no fair use); A.V. v. iParadigms, 562 F.3d 630 (4th Cir. 2009) (deciding iParadigms had a good fair use defense when it used its Turnitin online plagiarism detection service to copy student papers because the use was transformative); Society of the Holy Transfiguration Monastery, Inc. v. Archbishop Gregory of Denver, Colorado, No. 07-12387-RGS, 2010 WL 548114 (D.Mass. Feb. 18, 2010) (stating even though the copying of Greek religious texts was not commercial, there was no fair use because the copying was not transformative).

that "a specific exemption freeing certain reproductions of copyrighted works for educational and scholarly purposes from copyright control is not justified." However the committee did establish minimum guidelines for classroom copying from books and periodicals in not-for-profit educational institutions. Basically, the guidelines permit a teacher to make a single copy for each student in a class provided the copying (1) meets a brevity test (the copying is brief in quantity and quality), (2) a spontaneity test (there is insufficient time to request permission), (3) a cumulative effect test (e.g. no more than nine instances of multiple copying from the same work during one class term), and (4) each copy includes a notice of copyright.[26] In addition copying is not permitted to create "anthologies," shall not "substitute for the purchase of books," and shall not "be repeated with respect to the same item by the same teacher from term to term."[27] Although these guidelines are not incorporated into Section 107, courts have recognized the guidelines as persuasive authority.[28]

III. THE COURSEPACK TRILOGY

During the past twenty years, three cases have directly addressed the issue of whether a copyshop may use the fair use doctrine as a defense when it has made copies (or permitted copies to be made) of coursepacks for classroom use in a non-profit educational institution, without securing permission from the copyright owners. In each instance courts have had to carefully balance the conflicting interests of the authors' exclusive rights in their creative works and the public's "fair use" interest in the free flow of information. The three cases are *Basic Books, Inc. v. Kinko's Graphics Corp.*,[29] *Princeton University Press v. Michigan Document,*[30] and most recently, *Blackwell Publishing, Inc. v. Excel Research Group, LLC.*[31]

A. Kinko's

In 1991, major publishers in New York City brought a copyright infringement suit against two Kinko's copyshops in New York City.[32] Kinko's prepared coursepacks, most notably, for professors at New York

[26] To view the complete "Agreement on Guidelines for Classroom Copying in Not-For-Profit Educational Institutions," *see* H.R. Rep. No. 1467, 94th Cong., 2d Sess. 169, *reprinted in* 1976 U.S. Code & Admin. News 5659, 5681-82.

[27] *Id.*

[28] *Id.*

[29] 758 F.Supp. 1522 (S.D.N.Y. 1991).

[30] 99 F.3d 1381 (6th Cir. 1996), *cert. denied*, 520 U.S. 1156 (1997).

[31] 661 F.Supp.2d 786 (E.D.Mich. 2009).

[32] *Kinko's*, 758 F.Supp. at 1526-29.

University, New School for Social Research, and Columbia University.[33] The professors prepared "anthologies" (a collection of selected literary pieces), and delivered the materials to Kinko's. Kinko's then photocopied the materials, bound them into coursepacks, and sold the coursepacks to university students. Kinko's did not seek permission from (or pay fees to) the publishers who owned the copyrights in these materials.[34] Predictably, Kinko's raised a fair use defense, claiming the materials were prepared for non-profit, educational purposes in the classroom.[35] Judge Motley proceeded to interpret and apply the four Section 107 factors for fair use, as well as the Ad Hoc Committee Guidelines.[36]

Concerning the Section 107 factors, for the first one - the purpose and character of the use - Judge Motley explained that even though the coursepacks were used for non-profit educational purposes "in the hands of the students," the use in the hands of Kinko's was commercial. Kinko's sold the coursepacks as part of its profit-making business.[37] In addition the copying was not transformative; it did not interpret the materials or add any value to the material copied (such as for criticism or comment). It was just copying. The commercial aspect and the non-transformative use weighed against fair use.[38]

The second factor – the nature of the copyrighted work – also did not favor fair use. "The scope of fair use is greater with respect to factual than non-factual works." The works copied in this case were all non-factual, fictional works.[39]

For the third factor – the amount and substantiality of the portion used – not only was a substantial percentage of works copied in quantity (14 to 110 pages, representing 5.2% to 25.1% of copied works), but also the copying was substantial in quality. The parts copied were at "the heart of" the works, the most "critical parts of the books copied, since that is the likely reason the college professors used them in their classes." The amount of copying in quantity and quality exceeded the bounds of fair use.[40]

Judge Motley explained that the fourth factor - the effect of the use on potential markets for or value of the copyrighted work - is "undoubtedly the single most important element of fair use." Even though Kinko's argued that "reading the packets whets the appetite of students for more

[33] *Id.*
[34] *Id.*
[35] *Id.*
[36] *Id.*
[37] *Id.* at 1530-1533.
[38] *Id.*
[39] *Id.* at 1533.
[40] *Id.* at 1533-34.

information from the authors," Judge Motley felt "it is more likely that purchase of the packets obviates purchase of the full texts." All four factors weighed against fair use.[41]

For proper analysis, Judge Motley proceeded to analyze the copying under the Classroom Guidelines, finding that even if Kinko's warranted review under the Guidelines, Kinko's copying was "excessive and in violation of the Guidelines requirements." More specifically, the copying violated the brevity test, both in quantity and quality. The copying violated the spontaneity test which requires that "the inspiration and decision to use the work and the moment of its use for maximum teaching effectiveness be so close in time that it would be unreasonable to expect a timely reply for permission."[42] In this case the professors planned what materials would be used well in advance of each semester, and the materials were created to last the full semester. Turning to the cumulative effect test, there were easily more than nine copyings per semester for each course. Finally there was no notice of copyright on each packet.[43]

Looking at other factors, the copying was not done by the professors; it was done by Kinko's, a commercial establishment, operating for profit.[44] Also the Guidelines specifically prohibit copying as a substitute for anthologies, and copying shall not be used as a substitute for the purchase of books. Kinko's admitted it advertised its coursepacks as anthologies and that it copied portions of books.[45]

Taking into account that Kinko's conduct was willful, and that substantial damages were necessary to deter Kinko's from future infringing copying, the court issued an injunction; awarded statutory damages in the amount of $50,000 for nine of 12 infringements, and $20,000 for three others, for a total of $510,000; and granted attorney's fees and court costs.[46] Now copyshops throughout the United States, including 200 Kinko's copyshops nationwide, were on notice that it would be wise to get permission from and pay royalty fees to publishers for copying copyrighted materials into coursepacks.

B. Michigan Document Services (MDS)

One would think that after *Kinko's* all commercial copyshops would now get permission from publishers to create educational coursepacks. Nevertheless, James Smith, the owner of Michigan Document Services

[41] *Id.* at 1534-35.
[42] *Id.* at 1535-37.
[43] *Id.*
[44] *Id.* at 1537.
[45] *Id.* at 1545.
[46] *Id.*

(MDS), a commercial copyshop serving students at University of Michigan, did substantial research and consulted an attorney. Mr. Smith concluded there were "flaws" in the *Kinko's* decision. So he decided to publish coursepacks for professors at the University of Michigan without securing copying permission or paying a royalty to each publisher.[47] Three of the publishers sued MDS and James Smith who claimed the Section 107 fair use defense obviated the need to obtain such permission. The federal court of appeals affirmed the decision of the district court, agreeing that MDS's commercial exploitation of the copyrighted materials did not constitute fair use.[48]

The court of appeals examined the four factors in Section 107 to determine whether MDS's copying war fair use. Similar to the findings in *Kinko's*, the court found the nature of the copying was of a commercial nature "performed on a profit-making basis by a commercial enterprise" even though students used the coursepacks for non-profit educational purposes.[49] The copying was not transformative. The nature of the copyrighted works was more creative than factual.[50] The amount and substantiality of the copying was significant in quantity (5% to 30% of each copied work) as well as quality (the professors thought the excerpts were sufficiently important). The copying had an adverse effect upon the potential market for or value of the copyrighted works, partly because the three plaintiffs had been collecting permission fees of approximately $500,000 a year.[51] "If copyshops across the nation were to start doing what the defendants have been doing here," stated the court, "this revenue stream would shrivel and the potential value of the copyrighted works of scholarship published by the plaintiffs would be diminished accordingly."[52] All four factors weighed against fair use.

Recognizing the four statutory factors "are not models of clarity," the court turned to the Classroom Guidelines to get a general idea of the type of educational copying Congress had in mind. The copying did not meet the brevity test (5% to 30% was not brief); it did not meet the spontaneity test (MDS had sufficient time to seek permission from the publishers); and the copying did not meet the cumulative effect test (there were more than nine copyings per course per term).[53] In addition there was no notice of copyright on the coursepacks, and the guidelines prohibit copying as a substitute for the purchase of books or to create

[47] *MDS*, 99 F.3d 1381, 1383-84.
[48] *Id.*
[49] *Id.* at 1388-89.
[50] *Id.*
[51] *Id.* at 1387.
[52] *Id.*
[53] *Id.* at 1390.

anthologies.[54] In the words of the court: "In its systematic and premeditated character, its magnitude, its anthological content, and its commercial motivation, the copying done by MDS goes well beyond anything envisioned by the Congress that chose to incorporate the guidelines in the legislative history."[55] Although finding against fair use, the court of appeals remanded the case to the district court to determine damages as an innocent (rather than willful) infringer, since there was evidence to show James Smith acted "reasonably and in good faith," believing he was protected by fair use.[56]

C. Excel Research Group

The fact situations in *Kinko's* and *MDS* are essentially the same for purposes of fair use analysis. The professor prepares a coursepack and delivers it to a copyshop. The copyshop makes copies and resells coursepacks to students at a profit. Most recently, another commercial copyshop tried a different approach.

Excel Research Group (Excel) made an arrangement with professors at the University of Michigan whereby the professors prepare coursepacks and deliver a "master copy" to Excel. Excel accepts the master copy, making sure it is in excellent condition for copying. A student comes to Excel's commercial copyshop and shows written proof of registration in a course. Excel gives the student the master copy for the appropriate course. The student proceeds to make a copy on Excel's copying machines, thereby creating a personal coursepack. (Excel does not make copies, but instead has staff available to make sure the machines are operating properly and to answer any student questions about the operation of the copying machines.) Excel provides optional binding services at the request of any student.[57]

Blackwell Publishing, Inc. and four other publishers sued Excel, claiming Excel committed copyright infringement by violating two of the publishers' exclusive rights: to reproduce and distribute copies of the copyright works. Excel admitted it (and the professors) did not obtain permission from or pay copyright fees to the publishers, which enabled Excel to charge lower fees to students than other copyshops in the area.[58] However, Excel defended claiming (1) "the publishers do not contend that the students or professors are infringers, a prerequisite to

[54] *Id.*
[55] *Id.*
[56] *Id.* at 1392.
[57] *Excel,* 661 F.Supp.2d 786, 788.
[58] *Id.* at 790.

finding Excel liable, and (2) Excel's activities fall within the fair use rights granted under the Copyright Act."[59]

Concerning the first defense, the court explained it was not necessary to prove the students or professors are infringers as a prerequisite to finding Excel liable. "Although students press the start button and make a copy of the coursepack," stated the court, "Excel is the source of the reproduction." Excel controls the entire copying process, retaining the master copy, maintaining its quality, giving it to a student, and accepting payment. Excel has control over the copy machines, the paper, and the utilities. Excel staff is available to assist students and to provide binding services at a student's request. In short, this is not student copying; Excel is a direct infringer, making copies (reproduction). In addition, Excel's delivery of the master copy to students violates the publishers' exclusive right of distribution.[60]

Turning to the second defense – fair use - now that the court determined Excel was a direct infringer, the court had no problem applying the four Section 107 factors. The first factor - the purpose and character of the copying - it was for profit. The publishers were not challenging the students' or professors' copying for non-profit educational purposes, but instead Excel's use which was clearly for profit.[61] For the second factor – the nature of the copyrighted work – both parties admitted the materials were creative, rather than factual.[62] Turning to the third factor – the amount and substantiality of the copying – the court found the copying was substantial in both quantity and quality.[63] Quoting from MDS, the court stated "the fact that the professors thought the excerpts were sufficiently important to make them required reading strikes us as fairly convincing evidence of the qualitative value of the copied material." Moving on to the fourth factor – the effect of the use upon the potential market for or value of the copyrighted work – the court explained that where Excel did not pay a fee, while other copyshops do pay royalties, it "adversely impacts the marketplace." All of these factors weighed against fair use. The court was not impressed with Excel's argument that the free exchange of materials used to advance higher education is a laudable goal.[64]

In summary, the court felt *Excel* was not "seriously distinguishable" from *MDS* or *Kinko's*. The fact that the students in *Excel* "push a button" on a copier was of no significance, especially since Excel had control over

[59] *Id.*
[60] *Id.* at 791-92.
[61] *Id.* at 792-94.
[62] *Id.*
[63] *Id.*
[64] *Id.*

the entire process. A student had to come to Excel to obtain a coursepack. Excel's argument that this is a case of protected student copying is "sophistry," concluded the court; "to pretend that Excel is not, in fact, reproducing plaintiffs' materials on a commercial basis is to elevate form, indeed pretense of form, over substance."[65]

IV. ANALYSIS

There is commentary, both critical and supportive of application of the fair use doctrine as it relates to copyshop liability. One commentator describes three policies in the Copyright Clause – "the promotion of learning, protection of the public domain, and benefit to authors – two are intended to benefit the public, only one the author." He argues that more weight should be given to the right of the people to learn, rather than the right of the author to earn a profit.[66] Stated otherwise, the "main function" of copyright is to "protect the entrepreneur against those who would pirate a work for competitive sale in the marketplace," and should not extend to those who make a copy (or have a copy made) for personal use to further their learning.[67]

Another commentator takes a more balanced approach. Allowing copyshops to step into the shoes of their customers and gain the same rights as their customers may discourage an author's incentive to create expressive works. On the other hand, "copyshops are merely helping the students engage in an ultimately desirable activity."[68] This commentator concludes that courts should "be more sympathetic" to companies (such as copyshops) to invoke the fair use rights of their customers.[69]

A more supportive approach comes from another commentator who explains the doctrine of fair use is a "rational, integral part of copyright, whose observance is necessary to achieve the objectives of the law." Fair use is designed "to increase and not to impede the harvest of knowledge." Authors receive a reward for their efforts, and the public benefits.[70] The absence of "precision" or a "clear standard" in fair use gives courts a chance to focus on the "utilitarian, public–enriching objectives of copyright" on a case–by–case basis.[71]

An examination of the decisions in *Kinko's*, *MDS*, and *Excel*, as well as the thoughts of several commentators sends one clear message. It

[65] *Id.* at 794.
[66] Ray Patterson, *Copyright and "the Exclusive Right" of Authors*, 1 JIPL 1, 24 (1993).
[67] *Id.* at 43.
[68] Joseph P. Liu, *Enabling Copyright Consumers*, 22 BERKTLJ 1099, 1102-04 (2007).
[69] *Id.* at 1118.
[70] Pierre N. Leval, *Toward a Fair Use Standard*, 103 HARV. L. REV. 1105, 1107 (1990).
[71] *Id.* at 1135.

appears no one is suggesting Section 107 or the Classroom Guidelines be revised or rewritten. There is no "bright-line" standard for fair use, especially as it applies to coursepack copying.[72] Fair use is a flexible doctrine courts need to apply on a case–by–case basis, balancing the interests of authors and publishers to reap the rewards of their creative works against the members of the public such as professors and students who enjoy the benefits of those creative works. The fair use Classroom Guidelines are minimum standards that a court can apply fairly in view of the present technological learning environment.[73]

V. RECOMMENDATIONS AND ISSUES FOR FURTHER RESOLUTION

Returning to the introduction to this paper where Professor Miller compiles a coursepack and delivers a master copy to Carl's Copyshop, and Carl makes the master copy available to students for making copies on Carl's copy machines, *Excel* teaches us that Carl would be liable for copyright infringement if he has not obtained permission from the copyright owners. It would be difficult and time consuming for Carl to obtain permission from each copyright owner. A better approach would be for Carl to obtain a "blanket license" from the Copyright Clearance Center.[74] In the alternative, the university may consider obtaining such a license. Professor Miller may wish to discuss this matter with his university's Intellectual Property Committee (or equivalent group).

What about the students and the professors? Would it be fair use for the students or professors to make their own copies of coursepacks? What if a student borrows a coursepack from a friend, goes to Carl's copyshop, and makes a copy of the courrsepack? Would it make any difference if Carl knows the student is copying a coursepack? Would Carl be obligated to question a student concerning what materials the student is copying on Carl's machine? Whether any of these scenarios would be copyright infringement or fair use is an issue for another time. Meanwhile, the prudent approach would be: If in doubt, get permission. One may agree that paying a small royalty fee is far more desirable than paying up to $150,000 in statutory damages for each willful copyright infringement.

[72] MDS, 99 F.3d at 1390.

[73] *Id.*

[74] The Copyright Clearance Center (CCC) is a nonprofit organization that clears copyright permissions, acting as a broker between the rights-holder and the user of the copyrighted material. Their most useful service for teaching is their "Academic Permissions Service," which clears copyrights for course packets and classroom use. The entire approval transaction can be done on-line at http://www.copyright.com.

VI. CONCLUSION

Fair use is a flexible doctrine that attempts to strike a balance between rewarding authors for their creative works, but ultimately benefiting society with the free flow of ideas and information. The Classroom Guidelines set forth minimum criteria courts should weigh in determining to what extent classroom copying is fair use. The guidelines are purposefully flexible so that courts can adjust their thinking on a case-by-case basis on what is fair use in light of modern technological times. In short: The language is there in Section 107 and the Classroom Guidelines. The difficulty is what you do with it. In the words of one commentator: "Adjudication according to a standard of fairness calls for the exercise of great judicial skill, or art. But it is not for that reason to be regretted. It is, in any case, what the Copyright Act prescribes. Fair is fair."[75]

[75] Lloyd L. Weinreb, *Fair's Fair: A Comment on the Fair Use Doctrine*, 103 HARV. L. REV. 1137, 1161 (1990).

AMERICA'S GAME: ONE HUNDRED YEARS OF THE BASEBALL RULE OR "THE TIMOROUS MAY STAY AT HOME."*

by CHET HICKOX**

I. INTRODUCTION

Baseball is an American game[1] and the national game[2]. As such, it holds a special place in our psyche and also enjoys special legal benefits.

* Murphy v. Steeplechase Amusement Co., 166 N.E. 173 (1929).

** Professor, College of Business Administration, University of Rhode island, Kingston, Rhode Island. The author acknowledges his student, Deana Melchiorre, who assisted with researching and writing this article.

1 Popular myth holds that Abner Doubleday invented baseball. In 1839, he supposedly diagramed the basis structure of the game with a stick in the dirt of Elihu Phinney's pasture near Cooperstown, New York. On December 31, 1907, a Special Baseball Commission, chaired by Abraham Mills, former president of the National League, adopted this conclusion. However, it now seems clear that there was a bias in the commission towards finding that baseball was uniquely American game and not a variation of the British game of rounders. It is probable, that the first prearranged baseball game, between two organized teams, was played between the New York Knickerbockers' Base Ball Club and another pick-up team from New York on June 18, 1846 at Elysian Fields, Hoboken, New Jersey. Allison Danzig and Joe Reichler, The History of Baseball 22-24 (Prentice-Hall Inc. 1959).

2 While the name America's National Game was already in use, it was popularized by Albert Spalding with the 1911 publication of his book about the early history of baseball. Much of the book is a first-hand account. Spalding was a pitcher for the Boston Red Stockings (forerunner of the Braves) from 1871-1876 and the Chicago White Stockings 1876-1877. In 1875, Spalding compiled a 57-5 record pitching all 62 games for the Boston Red Stockings. Spalding helped found the National League, wrote the first official rules of baseball, and founded the Spalding Sporting Goods Company. Albert Goodwill Spaulding,

Probably the best known of these, is a U.S. Supreme Court ruling, which exempts professional baseball clubs and leagues from antitrust laws.[3] However, a lesser-known and probably more financially advantageous rule is the "Limited Duty Rule," alternatively called the "Baseball Rule."

The baseball rule, first enunciated in 1908,[4] immunizes baseball clubs and stadia owners[5] from negligence-based liability when fans are injured by balls that are accidently thrown or batted into the stands. It is estimated that about one in every eighteen pitches is fouled into the stands, and that about 290 pitches are thrown in a Major League Baseball (MLB) game, resulting in an average of just over sixteen foul balls per game that could potentially cause injury to spectators.[6] A five-year study conducted by the Boston Red Sox in the 1990s showed that between 36 and 53 spectators per year were injured by foul balls.[7] Another estimate indicates that approximately 35 spectators are injured by foul balls for every one million MLB spectator visits.[8] This should result in between 3,000 and 4,000 injuries per year. [9] This article explores the origins of the baseball rule, traces its development and its unique application to baseball, and reviews three recent cases that might presage its future application.

II. ORIGIN OF THE LIMITED DUTY RULE IN BASEBALL

Baseball, and more specifically professional baseball, had been played for many decades before *Crane v. Kansas City Baseball and Exhibition Co.*[10] was decided in 1913. While this was the first case involving a spectator injured by a foul ball to reach an appellate court, the jurisprudence of landowner liability based on negligence was already

America's National Game; Historic facts concerning the beginning, evolution, development and popularity of baseball, with personal reminiscences of its vicissitudes, its victories and its votaries (General Books 2009) (1911).

[3] Federal Baseball Club of Baltimore v. National League, 259 U.S. 200 (1922).

[4] Blakely v. White Star Line, 118 N.W. 482 (Mich. 1908).

[5] While baseball clubs and stadia owners may be liable for spectator injuries, the player who accidently hit or threw a ball into the stands is not liability. For a discussion *see e.g.* Quinn v. Recreation Park Association, 46 P. 2d 144 (Cal. 1935).

[6] http://blogs.wsj.com/numbersguy/a-pair-of-lucky-baseball-fans-337/tab/article. (last visited March 3, 2010).

[7] Costa v. The Boston Red Sox Baseball Club, 809 N.E.2d 1090 (Mass. 2004).

[8] James E. Winslow, Adam O. Goldstein, *Spectator Risks at Sporting Events*, The Internet Journal of Law, Healthcare and Ethics, Vol. 4, No. 1 (2007) *available at* http://www.ispub.com/ostia/index.php?xmlFilePath=journalsijlhe/vol4n2 (last visited March 13, 2010).

[9] In 2008 and 2009, 78.5 million and 73.4 million fans that attended MLB games. http://www.baseball-reference.com/leagues/MLB/2009-misc.shtml. (last visited March 15, 2010).

[10] 153 S.W. 1076 (Mo. App. 1913).

well established. The duty owed by the landowner varies depending on how the second party is characterized. Spectators at baseball games are correctly characterized as business invitees.[11] The opinion in *Crane*, authored by Judge J. M. Johnson of the Court of Appeals of Missouri, established the level and extent of the duty owed by baseball clubs to their spectators. While Judge Johnson is not a famous jurist and the Missouri Court of Appeals is not a particularly famous court, they have had a positive and lasting impact on the game.

Crane paid fifty cents for a ticket to watch a game played at the defendant's baseball park in Kansas City, Missouri.[12] This field was the home park of the Kansas City Blues, a minor league team in the American Association. This ticket permitted Crane to sit in any unoccupied seat in the 6-7,000 seat grandstands.[13] While he could have chosen a seat protected by loose wire netting behind home plate, he instead chose to sit in an unprotected seat beyond third base.[14] Crane chose the seat he did even though he was a knowledgeable baseball fan and was aware of the risk of being hit by a foul ball. He was subsequently struck and injured by just such a foul ball.[15] The parties stipulated to the facts that: "Baseball is the national game, and the rules governing it and the manner in which it is played and the risks and dangers incident thereto are matters of common knowledge."[16] While the nature of Crane's injuries were unreported, they could not have been too severe because it was further agreed that if the facts alleged stated a good cause of action, the defendant would be liable in the sum of one hundred dollars.[17]

The *Crane* court affirmed the trial court's ruling which applied the general rule of landowner-business invitee duty to baseball club ownership. "Defendants are not insurers of the safety of spectators but, being engaged in the business of providing a public entertainment for a profit, they were bound to exercise care"[18] This level of care is the "care commensurate to the circumstances of the situation."[19] Crane claimed that this level of care could only be satisfied by protecting all of the spectators by screening the entire grandstand. The court held otherwise,

[11] Spectators are business invitees when a baseball club provides "public entertainment for profit and invites the general public to attend its games." McNeil v. Fort Worth Baseball Club, 268 S. W.2d 244 @ 246, (Tex. App. 1954).

[12] Crane v. Kansas City Baseball and Exhibition Co., 153 S.W. at 1077.

[13] *Id.*

[14] *Id.*

[15] *Id.* at 1078.

[16] *Id.* at 1077.

[17] *Id.* at 1076.

[18] *Id*. at 107.

[19] *Id.*

"the duty of the defendants towards their patrons included that of providing seats protected by screening from wildly thrown or foul balls for the use of spectators who desire such protection."[20] It seemed obvious to the court that many fans preferred to sit in unprotected areas either to avoid the visual obstruction of the screening or in the hopes that they would catch a foul ball as a souvenir.[21] By stipulating to all the facts, Crane gave up the opportunity to have a jury decide if the defendant had indeed exercised reasonable care. By leaving the determination of the level of care required to the trial judge, Crane may have inadvertently determined the future direction of baseball jurisprudence.

The following year, 1914, the Court of Appeals of Missouri and Judge Johnson had the opportunity to revisit its ruling in *Crane* when it decided *Edling v. Kansas City Baseball and Exhibition Co.*[22] This case involved the same defendant and ball park as *Crane*, but unlike Crane, Edling chose to sit about halfway up the stands on a line formed by the pitcher and the catcher's box. This seat was behind the chicken wire screen that was designed to protect fans in the grandstand. Edling alleged that the baseball club had allowed the screen to become so old, worn and rotten that holes had developed that were large enough to permit the passage of a baseball.[23] Edling lost sight of a foul ball, and it passed through a hole in the screen striking him in the eye. The trial court awarded Edling a verdict and judgment in the sum of $3,500.[24] In affirming this judgment, the court of appeals reiterated the duty it had established in *Crane*. It held that when a "defendant recognized this duty by screening that part of the grandstand most exposed to the battery of foul balls,"[25] it was then the duty of the defendant "to exercise reasonable care to keep the screen free of defects and if it allowed it to become old, rotten and perforated with holes larger than a ball … it did not properly perform that duty."[26] Judge Johnson's opinions in *Crane* and *Edling* have proved to be remarkably durable, surviving substantially unchanged for almost one hundred years.

The Washington Supreme Court was the next court to examine the adequacy of the protection provided for spectators when it decided *Kavafian v. Seattle Baseball Club Ass'n.*[27] Kavafian was injured when he attended a game at a new Seattle stadium that was, at the time,

[20] *Id.*
[21] *Id.* at 1078.
[22] 168 S.W. 908 (Mo. App. 1914).
[23] *Id.* at 908.
[24] *Id.* at 909.
[25] *Id* at 909.
[26] *Id* at 910.
[27] 177 P. 776 (Wash. 1919).

unfinished. Plans for the baseball field called for 120 feet of netting extending 60 feet to either side of the centerline of the grandstands. However, at the time Kavafian was injured, only 30 feet of netting had been installed on each side of the centerline. Kavafian was seated in the front row, more than 30 feet but less than 60 feet from the centerline, when he was hit in the knee by a ball and injured. In affirming a jury verdict for the plaintiff, the Washington court did not cite *Crane* but did follow similar reasoning. First, it reasoned that the danger and therefore the duty to protect were "greatest as to force and frequency…directly behind the batter,[28] the danger thence radiating and decreasing."[29] It then quoted Judge Cooley's treatise on torts that negligence consisted of the "failure to observe, for the protection of the interest of another person, that degree of care, precaution and vigilance which the circumstances justly demanded."[30]

When the Court of Appeals of Louisiana addressed the issue in *Lorino v. New Orleans Baseball & Amusement Co., Inc.,*[31] it chose to follow the rule established in *Crane.* Lorino, who arrived after the game began, chose to sit in the unprotected bleachers in order to save money. He was injured while standing at least 158 feet from home plate, looking for a seat. After holding that "one who invites the public to places of amusement…must exercise a high degree of care for the safety of those invited,"[32] the court continued:

> But this rule must be modified when applied to an exhibition or game, which is necessarily accompanied with some risk to the spectators. Baseball is not free from danger to those witnessing the game. But the perils are not so imminent that due care on the part of the management requires all the spectators to be screened in. In fact, a large part of those who attend prefer to sit where no screen obscures the view. The defendant has a right to cater to their desires. We believe that as to all who, with full knowledge of the danger from thrown or batted balls, attend a baseball game the management cannot be held negligent when it provides a choice between a screened in and an open seat; the screen being reasonably sufficient as to extent and substance.[33]

[28] There is considerable scientific evidence that this analysis is incorrect. When a bat strikes a ball and it is fouled straight back, the bat actually reduces the kinetic energy in the ball. By contrast, when a ball is sharply struck producing a line drive, either fair or foul, the bat adds kinetic energy to the ball. *See e.g.* Gil Fried, *Baseball Spectators Assumption of the Risk: Is it 'Fair or 'Foul'* 13 Marq. Sports L. Rev. 39, 58 (2002).

[29] Kavafian v. Seattle Baseball Club Ass'n. at 778.

[30] *Id* at 778.

[31] 133 So. 408 (La. App. 1931).

[32] *Id.* at 409.

[33] *Id.* quoting Thomas M. Cooley, The Elements of Torts (Callaghan and Co., Chicago 1895).

By 1940, the *Crane* rule had also been adopted and refined by courts in Minnesota,[34] California,[35] Ohio,[36] Oregon,[37] and New York.[38] By this time the rule was generally stated as a two part test: first, management was required to screen the most dangerous part of the stadium, and second, "management was not required to provide screened seats for all who may apply for them,"[39] but rather met its duty "when screened seats are provided for as many as may reasonably be expected to call for them on the ordinary occasion."[40] Over the last 70 years, the overwhelming majority of states who have faced this issue have adopted the baseball rule developed by *Crane* and its protégé.

While this rule has the advantage of certainty for the owners, who could build and maintain their stadia to meet these requirements, and for the insurers, who are better able to assess risk when setting rates, it failed to recognize several realities of the modern game. First, the seats behind home plate are the ones nearest to the batter and nearest to most of the action. Therefore, these seats are the most desirable for the fans. Since desirability equates with willingness to pay, these seats, are usually also the most expensive.[41] Further, since these seats are the most desirable, they are also often reserved for season ticket holders. Fans, other than season ticket holders, are often lucky to obtain any seat for a game and in reality have no meaningful choice of seats.[42] Because of this, a casual fan may not be able to purchase one of these screened seats as they are sold to the same fan for every game year after year. Second, the reality of the situation is that while many plaintiffs claim

[34] Brisson v. Minneapolis Baseball and Athletic Association, 240 N.W. 903 (Minn. 1932).

[35] Quinn v. Recreational Park Association, 46 P. 144 (Cal. 1935); Ratcliff v. San Diego Baseball Club Pacific Coast League, 81 P.2d 625 (Cal. App. 1938).

[36] Cincinnati Baseball Club v. Eno, 147 N.E. 86 (Ohio. 1925).

[37] Curtis v. Portland Baseball Club, 279 P. 277 (Ore. 1929).

[38] Adonnino v. Village of Mount Morris, 12 N.Y.S.2d 658 (N.Y. Sup. Ct. 1939) Blackhall v. Albany Baseball and Amusement Co., 285 N.Y.S. 695 (Co. Ct. N.Y. 1936).

[39] *Quinn,* 46 P. at 146.

[40] *Id.*

[41] *See, e.g.,* Fenway Park Seating and Ticket Prices, http://boston.redsox.mlb.com/ticketing/index.jsp?c_id=bos. (last visited April 18, 2010).

[42] On 18-June-2009, the Boston Red Sox sold out their 500th consecutive home game. John Barone, *MLB.com, Red Sox Fete 500th Straight Sellout, MLB.com,* June 18, 2009. http://www.mlb.com/news/article.jsp?ymd=20090617&content_id=5378306&vkey=news_mlb&fext=.jsp&c_id=mlb. (last visited February 12, 2010). The MLB average attendance last season was 30,338 with two teams the Boston Red Sox and The Philadelphia Phillies selling-out every game. Maury Brown, *Inside the Numbers: Final 2009 MLB Regular Season Attendance,* Bizofbaseball.com October 5, 2009, http://bizofbaseball.com/index.php?option=com_content&view=article&id=3592:inside-the-numbers-final-2009-mlb-regular-season-attendance&catid=56:ticket-watch&Itemid=136. (last visited April 18, 2010).

that they request screen seats for safety sake, baseball team management seldom, if ever, hear these requests.[43]

III. ASSUMPTION OF THE RISK

A. Primary Assumption of the Risk

Assumption of the risk is a defense that obviates the duty of the defendant because some dangers are so obvious that a reasonable person would protect himself from them. Primary assumption of the risk is a defense to negligence that presupposes that all people are aware of some of the risks incidental to being members of our society, and we accept those risks as a condition of membership in our society.[44] The baseball injury cases often blur the distinction between limited duty and primary assumption of the risk. That the line is blurred makes some intuitive sense. The total responsibility to a protect spectator must be divided, in some proportion, between the landowner and the spectator himself. Therefore the quantum of the landowner's duty would have to be the total duty to make the spectator safe, minus any risk the spectator assumed.[45]

In this context, landowner liability for injuries sustained by spectators who were hit by errantly thrown or hit baseballs was first addressed in dicta in *Blakely v. White Star Lines*.[46] Blakely's ankle was broken by a thrown baseball while he was standing near a dance pavilion at Tashmoo Park, a pleasure resort owned by the defendant that was located on an island in the St. Clair River near Detroit, Michigan. Tashmoo Park also included a baseball field that was situated some distance away from the dance pavilion. The ball that injured Blakely was not thrown as part of a game, but rather was thrown by a baseball player who had finished a game and was playing catch while he was walking away from the baseball field.[47] While not necessary for its decision, and in spite of this lack of nexus between the baseball field, the games played thereon, and the injury, the court stated:

[43] "Two veteran Dodgers' employee in charge of ticket sales stated that, as far as they were aware, no spectator had ever requested seats in a screened area for reasons of protection. They further declared that if a patron were to request a seat in a protected area, every effort would be made to accommodate them." Neinstein v. Los Angeles Dodgers' Inc., 229 Cal. Rptr. 612 at 614 (Cal. App. 1986).

[44] Restatement (Second) of Torts §496A cmt. c (1977).

[45] *See, e.g.,* Coleman v. Ramada Hotel Operating Co., 933 F.2d 470, 472-73 (7th Cir. 1991), Michael K. Steenson, The Role of Primary Assumption of Risk in Civil Litigation in Minnesota, 30 Wm. Mitchell L. Rev. 115 (2003).

[46] Blakely v. White Star Line, 118 N.W. 482 (1908).

[47] *Id.*

> That it is knowledge common to all that in these games hard balls are thrown and batted with great swiftness; they are liable to be muffed or batted or thrown outside the lines of the diamond, visitors standing in position that may be reached by such balls have voluntarily placed themselves there with knowledge of the situation.[48]

Because of this general knowledge, "in so far as various sports were allowed to be carried on in places allotted for them, visitors who went (go) to the vicinity of these places to witness the sports undoubtedly assume the risk of danger."[49]

While the *Crane*[50] court focused on limited duty, its opinion also foreshadowed assumption of the risk as a defense in spectator injury cases. First the parties stipulated that the "risks and dangers incident thereto are matters of common knowledge."[51] This general knowledge sounds very much like primary assumption of the risk. Next the court held that when a spectator is given the choice of two seats, one of which is a more dangerous position than the other, he "cannot be said to be in the exercise of reasonable care, if with full knowledge of the risks and dangers, he chooses the more dangerous place."[52] When the court says "he chooses" the "he" must refer to the plaintiff and therefore must be describing a defense to negligence not a question of duty by the defendant.

The primary assumption of the risk defense grew in parallel with the limited duty rule. In *Blackhall v. Albany Baseball and Amusement Co.*[53] the court stated, "The rule is equally well settled that a spectator at a baseball game assumes the risk of being struck by a foul or wild-thrown ball when sitting elsewhere else than behind the screen back of home plate. A spectator at a baseball game may be regarded as assuming such risks from balls as are necessarily incident to the game."[54]

In 1950, the Supreme Judicial Court of Massachusetts decided *Shaw v. Boston American League Baseball Company*.[55] The game that Mrs. Shaw attended was sold out "because it was Sunday and the game was being played with the "Yankees," a popular[56] club.[57] Shaw, a knowledgeable fan, and five other people were sitting in a front row box

[48] *Id.* at 483.
[49] *Id.*
[50] Crane v. Kansas City Baseball and Exhibition Co., 153 S.W. 1076 (Mo. App. 1914).
[51] *Id.* at 1077.
[52] *Id*. at 1078.
[53] 285 N.Y.S. 695 (Co. Ct. of N. Y. 1936).
[54] *Id* at 696, quoting Ingersoll v. Onondaga Hockey Club, Inc., 281 N.Y.S. 505 (1935).
[55] 90 N.E.2d 840 (Mass. 1950).
[56] It seems safe to assume that by popular the Supreme Judicial Court of Massachusetts meant well known not well liked.
[57] *Shaw,* 90 N.E.2d at 841.

situated between home plate and first base. While conceding that a spectator familiar with the game assumes the ordinary risk of being hit by a ball, the plaintiff's allegation was that the Red Sox were negligent by not providing enough space for her to escape the foul ball. In affirming a summary judgment for the defendants, the court held that the placement of the seats was a condition or circumstance and not a cause of the plaintiff's injuries.[58]

Three years later in *Schentzel v. Philadelphia National League Club,*[59] the Pennsylvania Supreme Court took judicial notice that frequently "foul balls go astray and land in the grandstand."[60] While the plaintiff claimed that she had no prior knowledge of baseball, that this was the first game she had ever attended, and that although she had viewed televised game she had never seen a ball go into the stands,[61] she was still found to assume the risk. "Since the basis of assumption of the risk is not so much knowledge of the risk as consent to assume it, it is possible for the plaintiff to assume risks of whose specific existence he is not aware. He may, in other words, consent to take his chances as to unknown condition."[62] Since there was nothing in the record to indicate that the plaintiff was of "inferior intelligence"[63] had "subnormal perception,"[64] or "that she had lead a cloistered life,"[65] she could be assumed to have the knowledge "with which individuals living in organized society are equipped."[66] This knowledge should include an understanding that baseballs are hard, are hit and thrown at high speed, and if a person is hit by such a ball it may cause injury. From the language above it is unclear if this court would have still used primary assumption of the risk if the plaintiff had shown that she was of inferior intelligence or had lead a cloistered life.

In 1994, the U.S. district court applied primary assumption of the risk in *Gunther v. Charlotte Baseball Inc,* [67] a South Carolina case. Like Schentzel, the plaintiff was a woman who was attending her first game and who had only watched sports on television "in passing."[68] The plaintiff, was distracted by a previous foul ball, and was hit in the face by a second foul ball, shattering the bony orbit of her eye. At the time

[58] *Id*. at 843.
[59] 96 A.2d 181 (Pa. 1953).
[60] *Id*. at 190.
[61] *Id.* at 184.
[62] *Id* .at 188.
[63] *Id*. at 190.
[64] *Id.*
[65] *Id.*
[66] *Id.*
[67] 854 F. Supp. 424 (S.C. 1994).
[68] *Id.* at 426.

she was injured, Gunther was sitting in the second row of the bleachers behind the third base dugout, 81 feet from home plate. The federal court applied state law. Although the South Carolina Supreme Court had never had occasion to decide whether the assumption of the risk doctrine applied to spectators injured at baseball games,[69] the federal court held:

> The overwhelming weight of authority from other jurisdictions holds that baseball patrons assume the risk of being struck at games. The California Supreme Court stated this dominant position nearly sixty years ago: One of the natural risks assumed by spectators attending professional games is that of being struck by batted or thrown balls; . . . the management is not required, nor does it undertake to insure patrons against injury from such source.[70]

It is noteworthy that in both *Schentzel* and *Gunther*, the court applied the primary assumption of the risk doctrine, in spite of the fact that in each case, the plaintiff appeared to have no actual knowledge of the danger that she faced. Instead, the court generalized knowledge to the entire public either because all people ought to know the dangers inherent in baseball or because the danger is so obvious that no one could help but appreciate it.

B. Secondary Assumption of the Risk

While primary assumption of the risk was being adopted as the dominant legal theory in baseball spectator injury cases, a number of states were applying secondary assumption of the risk. Secondary assumption of the risk differs from primary assumption of the risk in that secondary requires the plaintiff to possess actual knowledge of the risk as opposed to general or societal knowledge.[71] States that adopted secondary assumption of the risk usually did so under two different circumstances: first, in cases involving injured parties who are unfamiliar with the dangers inherent in the sport, and second, when spectators who may have known the perils of the game are injured because of a momentarily distraction caused, at least in part, through the fault of management. Some commentators believe that secondary assumption of the risk should be the default rule which should be used to "ensure just results in those cases where it is clear that the individual plaintiff could not have actually understood the risk of injury."[72]

Like primary assumption of the risk, the jurisprudence of secondary assumption of the risk in baseball spectator cases had its origins in 1913

[69] *Id.* at 427.
[70] *Id.* at 426.
[71] Restatement (Second) of Torts §496A cmt. b (1977).
[72] George D. Turner, *Allocating the Risk of Spectator Injuries Between Basketball Fans and Facility Owners*. 6 VA. SPORTS & ENT. L. J. 156, 164 (Fall 2006).

when the Minnesota Supreme Court decided *Echo Wells v. Minneapolis Baseball and Athletic Association*.[73] While Wells was attending a baseball game, she was struck by a batted ball and suffered a fractured collarbone. The Minnesota court distinguished *Crane* on the facts. In *Crane*, the parties stipulated that the rules and danger of baseball were common knowledge. The *Wells* court observed:

> We do think that all who attend baseball games would, or should, enter such a stipulation. Only those who have been struck by a baseball realize its hardness, swiftness, and dangerous force. Women and others not acquainted with the game are invited and do attend. It would not be a safe or reasonable rule to hold that...no duty rests upon the management to…protect the spectators from the attendant dangers of which they may be ignorant.[74]

This recognition that all baseball patrons are not equally knowledgeable and therefore should not be held to the same standards when this defense is used is the essence of secondary assumption of the risk.

Twelve years later, in *The Cincinnati Base Ball Club Co. v. Eno,*[75] the Ohio Supreme Court upheld the soundness of the primary assumption of the risk doctrine for injuries that occur during the course of a baseball game since "playing during the game is confined for the most part to the diamond."[76] However, Eno was not injured during a game but between games of a double-header. During this time, there are multiple distractions including: pitchers and catchers warming up, coaches hitting fungos to outfielders and players taking batting practice. "When several balls are simultaneously in play upon the field, it is impossible for the spectator to protect himself."[77] The court continued, "We do not think that a court should say as a matter of law that a spectator assumes the risk of every batting and throwing of the ball."[78]

Some courts have held that primary assumption of the risk should be used unless "the occurrence causing [the] injury [is] not a common, frequent, and expected part of the game of baseball."[79] Examples of the type of injury causing occurrences which may not be a common, frequent, and expected part of the game include injuries that occur: during batting practice,[80] when a spectator is walking in an partially

[73] 142 N.W. 706 (Minn. 1913).
[74] *Id.* at 711.
[75] 47 N.E. 86 (Ohio 1925).
[76] *Id.* at 95.
[77] *Id.*
[78] *Id.* at 96.
[79] Ratcliff v. The San Diego Baseball Club of the Pacific Coast League, 81 P.2d 625 (Cal. App. 1938).
[80] McNeil v. Fort Worth Baseball Club, 268 S.W.2d 244 (Tex. 954).

enclosed concourse and is struck by a ball passing through a portal,[81] when a spectator is struck while walking from a seat protected by netting to an unprotected exit,[82] when a ball passes through a camera mounting hole cut in the backstop screening,[83] when a spectator is distracted by being bumped by the team mascot,[84] or when a spectator is hit while standing in line at a concession stand with his back to the field.[85]

By contrast, cases where courts have rejected the secondary assumption of the risk argument for occurrences outside of the game itself include: a night game in 1941 before night games were common,[86] a patron who incorrectly believed that he was behind the screening,[87] where a usher assured the patron the seat was safe,[88] or where management did not notify the spectator that screened seats were available.[89]

Even in those states like Massachusetts and Michigan, which have respectively abolished assumption of the risk legislatively[90] and judicially,[91] something remarkably similar has developed in baseball spectator injury cases. In *Costa v. Boston Red Sox Baseball Club,*[92] the appeals court of Massachusetts affirmed the trial court's summary judgment for the defendant ball club. The court expressed surprise that anyone in "Red Sox Nation" could have "no subjective understanding of the risks posed by an errant foul ball"[93] or could have such " a marked ignorance of the sport of baseball."[94] It also noted that the ball that hit the plaintiff was traveling about 90 miles per hour, or 132 feet per second, and therefore took about 1.07 seconds from the time it left the bat until Costa was struck and injured.[95] Barely a second is precious little time to react and take evasive action. Still the court held that, "Where a danger would be obvious to a person of ordinary perception and judgment, the landowner may reasonably assume that a visitor has

[81] Jones v. Three Rivers Management Co., 394 A.2d 546 (Pa. 1978).

[82] Olds v. St. Louis National Baseball Club*,* 104 S.W.2d 746 (Mo. App. 1937).

[83] Correa v. City of New York et al*,* 66 A.D.3d 573; (N.Y. App. Div. 2009).

[84] Lowe v. California League of Professional Baseball*,* 65 Cal. Rptr. 2d 105 (Cal. App. 1997).

[85] Maisonave v. Newark Bears Professional Baseball Club, Inc., 881 A.2d 700 (N.J. 2005).

[86] Hummel v. Columbus Baseball Club Inc., 49 N.E. 2d 773 (Ohio App. 1943).

[87] Hudson v. Kansas City Baseball Club, Inc., 164 S.W. 318 (Mo. 1942).

[88] Anderson v. Kansas City Baseball Club, 231 S.W. 170 (Mo. 1950).

[89] Dent v. Texas Rangers Ltd., 764 S.W.2d 345 (Tex. App. 1989).

[90] *See, e.g.,* MASS. GEN. LAWS. ch.1123 **§**1 (2009).

[91] *See, e.g.,* Felgner v. Anderson, 133 N.W.2d 136 (Mich. 1965).

[92] Costa v. Boston Red Sox Baseball Club, 809 N.E.2d 1090 (Mass. 2004).

[93] *Id.* at 1091.

[94] *Id.* at 1090.

[95] *Id.* at 1091.

knowledge of it, 'any further warning would be an empty form' that would not reduce the likelihood of resulting harm."[96] While this may establish the level of duty expected of baseball clubs, in doing so it certainly incorporates the characteristics of assumption of the risk.

C. Statutory Protection

A few states have afforded sports teams and stadia owners statutory protection. For instance, the Illinois Legislature responded to *Coronel v. Chicago White Sox Ltd.*[97] with the Baseball Facilities Liability Act.[98] In *Coronel,* the Appellate Court of Illinois reversed a summary judgment for the owner of the baseball team. The plaintiff, who was sitting three seats outside of the edge of the screen, suffered a broken jaw when hit by a foul ball. Comiskey Park had a protective screen that was 39.7 feet wide, one of the smallest in the major leagues.[99] The court held that the limited duty rule was not the rule followed in Illinois and that the adequacy of the screening was a jury question.[100] During the next legislative session, the decision was legislatively overturned, by the law that actually provides baseball clubs greater protection than was provided by the baseball rule.[101] New Jersey,[102] Colorado,[103] Arizona,[104] and Utah[105] have similar laws, although the Utah statute applies to hockey and not baseball.

IV. TURNER–MANTOVANI–CRESPIN: THREE DIVERGENT VIEWS

In the last two years, a triad of cases with remarkably similar facts have been decided and have reached remarkably dissimilar results. *Turner v. Mandalay Sports Entertainment, LLC.,*[106] involved a female

[96] *Id.* at 1093.

[97] 595 N.E 2d 45 (Ill. App. 1992).

[98] Illinois Baseball Facility Liability Act, 745 Ill. Comp. Stat. Ann. 5/49 (1992).

[99] *Coronel,* 595 N.E 2d at 48.

[100] *Id.*

[101] The owner or operator of a baseball facility shall not be liable for any injury to the person or property of any person as a result of that person being hit by a ball or bat unless: (1) the person is situated behind a screen, backstop, or similar device at a baseball facility and the screen, backstop, or similar device is defective (in a manner other than in width or height) because of the negligence of the owner or operator of the baseball facility; or (2) the injury is caused by willful and wanton conduct, in connection with the game of baseball, of the owner or operator or any baseball player, coach or manager employed by the owner or operator.

[102] SPECTATOR SAFETY ACT OF 2006. N.J. STAT. 2A:53A-43 (2006).

[103] COLORADO BASEBALL SPECTATOR SAFETY ACT, COLO. REV. STAT. 13-21-120 (2009).

[104] LIMITED LIABILITY; BASEBALL FACILITIES; ARIZ. REV. STAT. ANN. 12-554 (2009).

[105] UTAH CODE ANN. SECT. 78B-4-508.

[106] 180 P.3d 1172 (Nev. 2008).

fan whose nose was broken and who was rendered unconscious was when hit by a foul ball. The spectator had been a season ticket holder at Las Vegas 51's games for two years prior to the injury. The injury occurred when the plaintiff and her husband were in the "Beer Garden" which was located on the upper concourse, several hundred feet from the field.[107] In the Beer Garden, from which the field was not visible, fans could sit at tables while eating and drinking.[108] According to the plaintiff, she was sitting at one such table and neither saw the ball that injured her, nor had any opportunity to get out of its way.[109] In affirming a summary judgment for the defendant, the Nevada Supreme Court held:

> Recognizing the importance of establishing parameters around personal injury litigation stemming from professional baseball in Nevada, we take this opportunity to expressly adopt the limited duty rule. … The limited duty rule establishes the totality of the duty owed by baseball stadium owners and operators to protect spectators from foul balls.[110]

The record showed that Turner had "conspicuously failed to demonstrate that any other spectator suffered injuries as a result of errant balls landing in the Beer Garden. … we conclude that she has failed to establish a genuine issue of material fact."[111] Since the risk of injury posed by the Beer Garden was not an unduly high risk, the court held as a matter of law that the defendant was not required to guard against it.[112]

In *Mantovani v.Yale*,[113] the plaintiff was attending a New Haven Bears game at Yale Stadium when a ball struck him causing a substantial eye injury. The right field pavilion area of Yale Stadium provides picnic tables for patrons' use, some of which are oriented so that people sitting on one side of the table sat with their backs to the game. At the time of his injury, Mantovani was sitting at one of these tables participating in a barbeque/cookout. The court relied heavily on *Maisonave* when it held "the limited duty rule only appl[ies] to injuries occurring in the stands, the rule does not apply… where the plaintiff was in a section [of the stadium] that encourages the plaintiff to engage in activities inconsistent with paying close attention to the action on the

107 *Id.* at 1174.
108 *Id.*
109 *Id.*
110 *Id.* at 1176.
111 *Id.*
112 *Id.*
113 2007 Conn. Super. LEXIS 1908, Decided, July 26, 2007.

field."[114] The court then held that the right field pavilion was designed to "make the baseball game experience more manageable for parents with small children or allow a patron to eat in a more comfortable setting than a cramped stadium seat."[115] Because of the very nature of these areas of stadia, "[f]ans foreseeably and understandably let down their guards … [they are] no longer trying to catch foul balls or even necessarily watching the game."[116] After the court denied the defendant's motion for summary judgment, the jury returned a verdict for the defendant apparently finding that the defendants had not breached any duty owed to Mantovani. The plaintiff's motion for a judgment NOV was subsequently denied.[117]

The New Mexico Court of Appeals reached a decidedly different result in *Crespin v. Albuquerque Baseball Club d/b/a Albuquerque Isotopes*.[118] Like the ballpark in the previous case, the Isotopes ballpark has picnic tables set up beyond the outfield fence. During pregame batting practice, Crespin, who was four years old, was hit in the back of the head by a home run off the bat of Dave Matranga.[119] Crespin suffered a fractured skull and was permanently disabled. The court found that the principles of comparative negligence permit the fact finder to weigh the duty of the landowner against the risks that the spectator assumed. In declining not to adopt the baseball rule, the court went on to hold, "While the baseball rule may have made some sense during the era of all-or-nothing contributory negligence doctrine, it no longer does. Under our present tort system, we discern no public policy reason to justify bestowing immunity on the business of baseball."[120] Further the court was not persuaded that their refusal to adopt the baseball rule would destroy the game of baseball.[121] The Isotope organization has stated that they intend to appeal this ruling to the New Mexico Supreme Court.[122]

114 *Id.* at 17.

115 *Id.* at 14.

116 *Id.* at 15 quoting *Maisonave v. Newark Bears Professional Baseball Club, Inc.,* 881 A.2d 700 (2005).

117 2008 Conn. Super. LEXIS 275.

118 216 P.3d 827 (N.M. App. 2009).

119 Although Matranga and his team, the Astros, were named as a codefendant, the trial court directed a verdict for them. Players generally have no duty to protect spectators and in fact "should attempt to and will hit balls into the areas where there are spectators." *Id.* at 836.

120 *Id.* at 835.

121 *Id.*

122 Cris Ornelas, *Boy injured at ballpark can sue, NM court says,* KOB.com, June 8, 2009, http;//www.kob.com/article/stories/s1071026.shtml. (last visited April1, 2010).

V. CONCLUSIONS

Sports other than baseball have generally not enjoyed immunity when spectators have been injured. Courts have held either that the limited duty rule does not apply or that the injuries are not a common, frequent, and expected part of these other sports. Sports as different as wrestling,[123] auto racing,[124] basketball,[125] and kick-the-can[126] and golf[127] have all been denied immunity in spectator liability cases. By contrast, baseball teams have generally enjoyed protection when balls that land in the stands injure spectators. While the reasons for this are murky, one possible rationale is that baseball and the baseball rule originated long before professional football,[128] basketball,[129] hockey,[130] and NASCAR.[131] Baseball, alone among the major sports, began in an era when courts were generally sympathetic to business interests. While the reasons for the baseball rule may be unclear, it seems safe to assume that it is, in part, the result of baseball's ubiquitous nature and the warm feelings it instills in most Americans.

Three recent cases demonstrate different possible directions for the baseball rule. Whether the bright line rule of *Crane* continues to prevail or is replaced by the more fact- intensive inquiry of *Mantovani* or *Crespin* remains to be seen. However, one thing does seem to be certain, if baseball clubs and stadia owners continue to build unprotected eating facilities and provide distractions like dancing mascots, more people will be injured by balls from which they are not able to protect themselves.

[123] Silvia v. Woodhouse, 248 N.E.2d 260 (Mass.1969).

[124] Huber v. Hovey, 501 N.W.2d 53 (Iowa 1993).

[125] McFatridge v. Harlem Globe Trotters, 365 P.2d 918 (N.M. 1961).

[126] Marchetti v. Kalish, 559 N.E.2d 699 (Ohio 1990).

[127] Duffy v. Midlothian Country Club, 415 N.E.2d 1099 (Ohio 1980).

[128] The NFL was founded in 1922, http://www.profootballhof.com/history/decades /1920s/founded.asp (last visited April 28, 2010).

[129] The NBA was founded in 1946, http://hoopedia.nba.com/index.php?title =Beginnings_of_the_NBA (last visited April 28, 2010).

[130] The NHL was founded in 1917, http://www.tmlfever.com/TheGame.html (last visited April 28, 2010).

[131] NASCAR was founded in 1948, http://www.nascar.com/news/features/history/ http://www.tmlfever.com/TheGame.html (last visited April 28, 2010).

THE CISG AFTER *MEDELLÍN*: THE SUPREME COURT AND SELF-EXECUTING TREATIES

by CAROLYN HOTCHKISS*

INTRODUCTION

The United States is a party to hundreds of bilateral and multilateral treaties on subjects ranging from human rights to agricultural marketing.[1] Many of those treaties form the legal basis for trade and investment around the world, creating the ground rules for the global economy. As a matter of international law, states entering into treaties undertake a good faith obligation to carry out the terms of their agreements. This idea that a treaty creates an obligation for states is most often expressed as a maxim of customary international law: *pacta sunt servanda*.[2] That principle of customary international law was restated by the Vienna Convention on the Law of Treaties, providing that "Every treaty in force is binding upon the parties to it and must be performed by them in good faith,"[3] and "A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty."[4]

* Professor of Law, Babson College

1 For a complete list, *see* United States Department of State Treaties in Force 2009, available at http://www.state.gov/documents/organization/123747.pdf.

2 Agreements must be kept.

3 Vienna Convention on the Law of Treaties, art 26, May 23, 1969, 1155 U.N.T.S. 331. Although the United States signed the treaty, the Senate has not given its advice and consent to the treaty. The United States considers many of the provisions to be restatements of customary international law. *See* United States State Department Office of the Legal Advisor, FAQs, *available at* http://www.state.gov/s/l/treaty/faqs/70139.htm.

4 *Id*. art. 27.

In 2008, the Supreme Court issued its decision in *Medellín v. Texas*.[5] The *Medellín* case was one of a series of death penalty cases involving the application of the Vienna Convention on Consular Relations (VCCR) and its Optional Protocol on the Compulsory Settlement of Disputes (Optional Protocol).[6] The United States is a party to the VCCR, and, until the litigation of which *Medellín* was a part, was a party to the Optional Protocol.[7] In the *Medellín* case, Chief Justice Roberts, writing for the majority, held that the VCCR required implementing legislation in order for it to become domestic law, and held that the President of the United States did not have the authority to order states to comply with non-self-executing treaties. The Court created a presumption that absent specific indications of intent, treaties could not be considered self-executing.[8]

The Supreme Court's decision in *Medellín* opened the door to challenges to the domestic enforceability of a wide array of existing treaties, including many of the commercial treaties underlying international trade and investment. The purpose of this article is to examine the effect of the *Medellín* decision on commercial treaties, using the particular example of the United Nations Convention on Contracts for the International Sale of Goods (CISG).[9] A close examination of the Supreme Court's criteria in *Medellín* leads to the conclusion that the CISG will retain its status as a self-executing treaty in United States law. It should withstand challenges to its status as domestic law in the United States.

THE *MEDELLÍN* DECISION

The Road to the Supreme Court

The *Medellín* case began when José Medellín, an 18 year old Mexican citizen, participated in the gang rape and murder of two teen-aged girls in Houston Texas. Medellín was arrested and confessed to the crimes. He was convicted and sentenced to death in 1997. Upon appeal, Medellín first raised the issue of his failure to be told of his right to notify the

[5] Medellín v. Texas, 552 U.S. 491 (2008).

[6] Vienna Convention on Consular Relations, Apr. 24, 1963, 21 U.S.T. 77, T.I.A.S. No. 6820 (1970) [*hereinafter* the VCCR]. Optional Protocol Concerning the Compulsory Settlement of Disputes to the Vienna Convention, Apr. 24, 1963, 21 U.S.T. 325, T.I.A.S. No. 6820 (1970) [*hereinafter the Optional Protocol*] .

[7] By a letter from Condoleezza Rice, U.S. Secretary of State, to Kofi Annan, U.N. Secretary-General, on March 7, 2005, the United States withdrew from the Optional Protocol. *Available at* http://untreaty.un..org/CNs/2005/101_200/186E.doc.

[8] Medellín, *supra* note 5 at 504-05 .

[9] United Nations Convention on Contracts for the International Sale of Goods, April 11, 1980, 1489 U.N.T.S. 3, *available at* http://www.cisg.law.pace.edu/cisg/text/treaty.html [*hereinafter CISG*].

Mexican Consulate under Article 36 of the VCCR. The Texas Court of Criminal Appeals denied his appeal in 1997.[10] Medellín then filed a petition for *habeas corpus* relief in Federal District Court in 2003, but the court denied relief, holding that the consular notification claim should have been made before the trial court and that Medellín could not show that the lack of consular notification prejudiced his case.[11] The Fifth Circuit Court of Appeals affirmed the decision of the District Court, holding that Texas' procedural default rules prevented the raising of the consular notification claim on appeal.[12]

In the meantime, the government of Mexico brought an action against the United States in the International Court of Justice. The action, known as the *Avena* case, alleged that the United States had failed to carry out its obligation to notify Mexican consulates in the cases of fifty-one Mexican nationals, including José Medellín, on death row in the United States.[13] The ICJ ruled that the United States had the obligation under the VCCR to inform arrested persons of their right to consular assistance and that the United States had violated that obligation. It further held that the United States had the obligation under international law to conduct a judicial review and reconsideration of the cases involving the Mexican nationals as a remedy for its intentional breach of the VCCR's consular notification provisions.[14]

In response to the ICJ's decision in *Avena*, the Supreme Court agreed to hear Medellín's appeal from the Fifth Circuit's decision.[15] More significantly for Medellín, on February 25, 2005, President Bush addressed a memorandum to the Attorney General, stating:

> I have determined, pursuant to the authority vested in me as President by the Constitution and laws of the United States, that the United States will discharge its international obligations under the decision of the International Court of Justice in the Case Concerning Avena and Other Mexican Nationals (Mexico v. United States of America), 2004 I.C.J. 128 (Mar. 31), by having state courts give effect to the decision in

[10] Medellín v. State, No. 71,997 (Tex. Crim. App. 1997).

[11] Medellín v. Cockrell, Civ. Action No. H-01-4078 (S.D. Tex. 2003).

[12] Medellín v. Dretke, 371 F. 3d 270 (5th Cir. 2004).

[13] Case Concerning Avena and Other Mexican Nationals (Mex. vs. U.S), 2004 I.C.J. 12 (Mar. 31).

[14] *Id*. at 48, para. 121. The *Avena* case was the third in a series of ICJ cases involving U.S. violations of its obligations of consular notification under the VCCR. In the Breard Case, Vienna Convention on Consular Relations, Provisional Measures (Para. v. U.S), 1998 I.C.J 248, (Apr.9) the ICJ ordered the United States to stay an execution pending the full hearing of the case. The Governor of Virginia refused, and Breard was executed. In LaGrand Case, (F.R.G. vs. U.S), 2001 I.C.J.104, (June 27 the ICJ held that procedural rules blocking the redress of violations of treaty obligations prevented effective review and reconsideration.

[15] Petition for Writ of Certiorari, Medellín, 128 S.Ct. 1346(No. 06-984).

> accordance with general principles of comity in cases filed by the 51 Mexican nationals addressed in that decision.[16]

On March 7, 2005 the United States withdrew from the Optional Protocol Concerning Compulsory Settlement of Disputes, thus divesting the ICJ of compulsory jurisdiction over further VCCR cases.[17] The Supreme Court dismissed its earlier grant of *certiorari*,[18] and Medellín filed a new *habeas corpus* petition in Texas state court. That petition was denied, with the Texas Court of Criminal Appeals holding that the ICJ's *Avena* decision did not govern Texas procedural laws restricting *habeas* petitions and that the President had no authority to order the State of Texas to overrule its state law.[19]

Medellín appealed again to the Supreme Court. The Court granted *certiorari* on two questions. The first was whether the ICJ's judgment in *Avena* was directly enforceable in state courts. The second was whether the President's memorandum created enforceable law that overrode state procedural rules preventing the filing of successive *habeas* petitions.[20] The court answered both questions in the negative on March 25, 2008.[21] On August 5, 2008, José Medellín was put to death by the State of Texas.

The Supreme Court's Decision

Although the *Medellín* case was part of a complex set of international, federal, and state court decisions concerning the death penalty, the case has significance for many different kinds of treaties. The Supreme Court's consideration of the question of the direct legal effect of treaties is particularly important in a wider context than the facts of *Medellín*. *Medellín* involved three treaty obligations on the part of the United States. The first was the obligation of consular notification under the VCCR. The second was the obligation to submit disputes concerning the VCCR to the compulsory jurisdiction of the ICJ. At the time of the *Avena* decision, the United States was a party to the Optional Protocol, giving the ICJ jurisdiction to hear the case and to render a decision. The third treaty obligation was that of member states of the United Nations to give effect to decisions of the ICJ. Article 94(1) of the U.N. Charter states: "Each Member of the United Nations undertakes to comply with

[16] Cited in Frederic L Kirgis, *President Bush's Determination Regarding Mexican Nationals and Consular Rights*, ASIL INSIGHTS, March 2005, http://www.asil.org/insights050309.cfm.

[17] Letter from Secretary of State Condoleezza Rice, *supra* note 7.

[18] Medellín v. Dretke, 544 U.S. 660 (2005).

[19] Ex Parte Medellín, 223 S.W.3d 315, 330, 332 (Tex. Crim. App. 2006).

[20] Medellín, *supra* note 5, at 498-99.

[21] *Id*.

the decisions of the International Court of Justice in any case to which it is a party."[22]

Chief Justice Roberts, writing for the majority, held that although *Avena* created an international obligation for the United States, that international obligation did not create binding domestic law. Even though the Constitution provides that "…all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby. . . ,"[23] the Supremacy Clause only applies to self-executing treaties.

> No one disputes that the *Avena* decision--a decision that flows from the treaties through which the United States submitted to ICJ jurisdiction with respect to Vienna Convention disputes--constitutes an *international law* obligation on the part of the United States. But not all international law obligations automatically constitute binding federal law enforceable in United States courts. The question we confront here is whether the *Avena* judgment has automatic *domestic* legal effect such that the judgment of its own force applies in state and federal courts.[24]

In order to determine whether a treaty is self-executing, the Court adopted the language of the First Circuit Court of Appeals in *Iguartua-De La Rosa v. United States*: "In sum, while treaties 'may comprise international commitments . . . they are not domestic law unless Congress has either enacted implementing statutes or the treaty itself conveys the intention that it be 'self-executing' and is ratified on these terms.'"[25]

Turning to the treaties in *Medellín*, the Court began with a presumption that unless evidence showed otherwise, treaties are not self-executing. Rather, a treaty is a "compact between independent nations . . . [depending] for its enforcement on the interest and the honor of the governments which are parties to it."[26] In *Medellín*, Congress had not enacted implementing legislation for any of the treaties involved, so the Court turned to an analysis of whether the treaties conveyed the intention to be self-executing.

In order to determine the intent of the treaties, the Court began its inquiry with the text of each treaty, adding as "aids to its interpretation" the negotiating and drafting history of each treaty and the post-

[22] U.N. Charter art. 94(1), 59 Stat. 1051, T.S. No. 993 (1945).

[23] U.S. CONST. art. VI, cl 2.

[24] Medellín, *supra* note 5, at 504.

[25] *Id.* at 505, *citing* Iguartua-De La Rosa v. United States, 417 F.3d 145, 150 (1st Cir. 2005).

[26] *Id.*, *citing* Head Money Cases, 112 U.S. 580 (1884).

ratification understanding of the signatory states.[27] The Court held that key treaty in *Medellín* was Article 94 of the U.N. Charter, discussing the obligation of member states to comply with decisions of the ICJ in cases to which they are parties. The text of the provision requires that each member state "undertakes to comply" with ICJ decisions. Holding that the language merely creates a commitment of the political branches to future action, Chief Justice Roberts wrote:

> The Article is not a directive to domestic courts. It does not provide that the United States "shall" or "must" comply with an ICJ decision, nor indicate that the Senate that ratified the U.N. Charter intended to vest ICJ decisions with immediate legal effect in domestic courts. Instead, "the words of Article 94 . . . call upon governments to take certain action." [28]

The Court further supported its conclusion that the U.N. Charter was not meant to be self-executing by examining the ability of parties to resort to the Security Council as a remedy for non-compliance with ICJ decisions, as well as the testimony before the Senate Foreign Relations Committee at the time of the ratification of the U.N. Charter.[29] The Court found no evidence that any of the treaties involved in the *Medellín* case could be considered self-executing.

Finally, the Court considered the effect of the President's Memorandum ordering state courts to comply with the *Avena* decision's requirement of a review and reconsideration of the convictions of the fifty-one Mexican nationals on death row, including José Medellín. The Court held that if a treaty was found not to be self-executing, the Executive Branch could not create binding federal law without an act of Congress. The Court stated that:

> A non-self-executing treaty, by definition, is one that was ratified with the understanding that it is not to have domestic effect of its own force. That understanding precludes the assertion that Congress has implicitly authorized the President—acting on his own—to achieve precisely the same result.[30]

While the President speaks for the United States in foreign affairs and carries the task of seeing that treaties are carried out, he does not have the power to create new law when Congress has failed to act. The Court further stated that: "The President has an array of political and diplomatic means to enforce international obligations, but unilaterally converting a non-self-executing treaty into a self-executing one is not among them. The responsibility for transforming an international

[27] *Id*. at 506-07.
[28] *Id*. at 509, citing U.N. Charter, art 94(2).
[29] I*d*. at 511.
[30] *Id*. at 527.

obligation arising from a non-self-executing treaty into domestic law falls to Congress."[31]

The majority's decision in *Medellín* was not without criticism from the other Justices of the Court. In his concurrence, Justice Stevens noted that the Supremacy Clause does obligate Texas and other states to "undertake to comply" with the provisions of the U.N. Charter giving effect to ICJ decisions:

> Under the express terms of the Supremacy Clause, the United States' obligation to "undertak[e] to comply" with the ICJ's decision falls on each of the States as well as the Federal Government. One consequence of our form of government is that sometimes States must shoulder the primary responsibility for protecting the honor and integrity of the Nation. Texas' duty in this respect is all the greater since it was Texas that—by failing to provide consular notice in accordance with the Vienna Convention—ensnared the United States in the current controversy. Having already put the Nation in breach of one treaty, it is now up to Texas to prevent the breach of another.[32]

Justice Breyer's dissent in *Medellín* expressed a more fundamental disagreement with the presumption the majority was creating toward non-self-executing treaties. Justice Breyer first returned to the language of the Supremacy Clause: "all Treaties . . . shall be the supreme Law of the Land,"[33]arguing that the drafting history behind this provision as well as more than two hundred years of practice yielded little evidence to support a presumption that treaties required implementing legislation. He then criticized the majority for its emphasis on searching for specific language in treaties indicating that the treaties would be self-executing, especially in view of the differing practices of nations concerning ratification and implementing legislation. Justice Breyer noted that the question of implementation is a domestic question, not often on the agendas of representatives negotiating treaties. He further noted that:

> The majority . . . looks for the wrong thing (explicit textual expression about self-execution) using the wrong standard (clarity) in the wrong place (the treaty language). Hunting for what the text cannot contain, it takes a wrong turn. It threatens to deprive individuals, including business, property owners, testamentary beneficiaries, consular officials, and others, of the workable dispute resolution procedures that many treaties, including commercially oriented treaties, provide. In a world where commerce, trade, and travel have become even more international, that is a step in the wrong direction.[34]

[31] *Id.* at 526-27.
[32] *Id.* at 536.
[33] *Id.* at 541.
[34] *Id.* at 562.

SELF-EXECUTING TREATIES AFTER *MEDELLÍN*

The Supreme Court's decision in *Medellín* created considerable controversy in the legal community. Questions over the height of the new hurdle to treaty enforcement, the reach of the decision, the effect of *Medellín* on the treaty negotiation practice of the United States, and debates over the proper interpretation of the original intent of the Supremacy Clause raged in academic journals,[35] blogs,[36] and court arguments. Some analysts argued that *Medellín* represented a mere clarification of the existing law and practice of treaty interpretation and the self-execution doctrine,[37] while others argued that the decision worked a substantial break with past practice, creating a "new paradigm" for treaty construction.[38]

The American Bar Association and the American Society of International Law convened a Joint Task Force on Treaties in U.S. Law to assess the range and impact of the *Medellín* case and make recommendations for responses to the new landscape of treaty law. Without reaching a conclusion on what the reach of *Medellín* ought to be, the Joint Task Force made several recommendations for existing and future treaty practice in order to accommodate the Supreme Court's methodology for determining the self-executing status of treaties. [39]

With respect to existing treaties, the Joint Task Force recommended general remedial legislation to enable the President to propose actions to implement treaty obligations, with a waiting period during which Congress could stop the implementation through a Joint Resolution of Disapproval. The mechanism would come into use in the face of imminent breaches of treaty obligations, or where a domestic challenge to a treaty would create a *Medellín*-type implementation problem.[40] Some members of the Joint Task Force further recommended the legislative enactment of the *Charming Betsy* principle, a long-standing

[35] *See, e.g., Agora: Medellin*, 102 AM. J. INT'L L 529 *et seq*. (2008).

[36] *See e.g.*, Julian Ku, *Medellin: an Insta-Symposium*, http://opiniojuris.org/2008/03/25/medellin-an-insta-symposium/ (Mar 25-July 23, 2008).

[37] Curtis A. Bradley, *Agora: Medellín: Intent, Presumptions, and Non-Self-Executing Treaties*, 102 A.J.I.L. 540, 540-41 (2008).

[38] David J. Bederman, *Agora: Medellín: Medellín's New Paradigm for Treaty Interpretation*, 102 A.J.I.L. 529 (2008).

[39] ABA/ASIL Joint Task Force on Treaties in U.S. Law, *Report*, March 16, 2009, a*vailable at* http://www.asil.org/files/TreatiesTaskForceReport.pdf. The ABA House of Delegates adopted the recommendations of the Task Force at its mid-year 2010 meeting. Recommendations Adopted by the House of Delegates (Feb. 9, 10 2010), *available at* http://www.abanet.org/leadership/2010/midyear/daily_jourmal/108C.pdf.

[40] *Id.* at 16.

principle of interpretation requiring courts to construe domestic law in a manner that avoids breaches of treaty obligations wherever possible.[41]

With respect to future treaties, the Joint Task Force recommended that the State Department process for authorizing and coordinating treaty negotiations specifically include analyses of any implementing legislation needed for the treaty and that, if the treaty is intended to be self-executing, that such language is included in the negotiating agenda.[42] The Joint Task Force further recommended that the transmittal letter or report to the President from the Secretary of State for each treaty:

> . . . specifically address whether the Executive Branch considers each provision self-executing or non-self-executing, and if the latter, state specifically whether the provision is considered aspirational or whether implementation is needed, and if implementation is necessary, how the provision will be implemented. . . . Generally, if new legislation is required to implement any provision, the Executive Branch should not deposit the U.S. instrument of ratification or accession or otherwise bind the United States to comply with the treaty until the legislation has been enacted.[43]

Finally, the Joint Task Force noted that the Senate Foreign Relations Committee had already changed its practice with respect to advice and consent to include in the Senate Resolution of advice and consent to any treaty a statement confirming the self-executing nature of the treaty, so as to meet the standard of the Court in *Medellín*.[44]

Courts, Commercial Treaties and Medellín

In addition to academics and experts, several courts have considered the scope and meaning of *Medellín*. In the context of commercial treaties, four decisions since *Medellín* have analyzed the effect of that decision on existing treaties. Two of the decisions do not seem to break new ground, but two others take a much more careful consideration of the Court's reasoning.

Elsevier B.V. v. United Health Group, Inc.[45] involved a claim for statutory damages and attorneys' fees in a copyright infringement case involving unregistered foreign copyrights. Elsevier sought to persuade the court that Article Five of the Berne Convention for the Protection of

[41] *Id.* at 18, note 72, *citing* Murray v. Schooner Charming Betsy, 6 U.S. (2 Cranch) 64 (1804).

[42] *Id.* at 18-19, citing the Department of State's Circular 175 process, codified at 22 C.F.R. 181.4. (2010).

[43] *Id.* at 19.

[44] *Id.* at 20.

[45] Elsevier B.V. *et al.* v. United Health Group, Inc. *et al.*, 2010 U.S. Dist. Lexis 3261, 93 U.S.P.Q.2d (BNA) 1408 (S.D.N.Y. 2010).

Literary and Artistic Works (the Berne Convention) was self-executing, so as to override the earlier provision of § 412 of the Copyright Act of 1976. In analyzing Elsevier's claim, the court looked first to the Berne Convention Implementation Act of 1988, which explicitly stated that the Berne Convention was not a self-executing treaty.[46] The Court then looked to the legislative history to confirm its initial conclusion.[47] Finally, the Court examined the actual language of the Berne Convention. Article 36(1) states that "any country party to this Convention undertakes, in accordance with its constitution, the measures necessary to ensure the application of this convention."[48] As a result of its analysis, the Court dismissed the motion brought by Elsevier.

Brzak v. United Nations[49] involved an employment discrimination claim brought by two employees of the United Nations. The U.N. and the individual defendants who worked for the U.N. claimed full or functional immunity from suit under the Convention on Privileges and Immunities of the United Nations (CPIUN). The plaintiffs argued that pursuant to *Medellín*, the CPIUN was not a self-executing treaty, so without implementing legislation was unenforceable in U.S. courts. The Second Circuit applied the Medellín analysis to the CPIUN: "In determining whether a treaty is self-executing, we look to the text, the negotiation and drafting history, and the postratification understanding of the signatory nations. . . . Additionally, the executive branch's interpretation of a treaty 'is entitled to great weight.'"[50] The Court found first that the text of the treaty supported its self-executing nature, that the ratification history clearly supported the conclusion that the treaty was self-executing, and that the executive branch's consistent support of the self-executing nature of the treaty all lent support to the legal conclusion that no implementing legislation was necessary.[51] The Court affirmed the District Court's dismissal of the plaintiffs' complaint for lack of subject matter jurisdiction.

Two additional cases provided closer questions of the effect of treaties in domestic law. *Capitol Records v. Thomas*[52] involved a motion for a new trial after the award of statutory damages against Thomas for using a peer-to-peer file sharing network to share copyrighted songs belonging

[46] *Id.* at 4.
[47] *Id.*
[48] *Id.* at 7.
[49] Brzak v. United Nations, 2010 U.S. App. LEXIS 4260, 108 Fair Empl. Prac. Cas. (BNA) 1025 (2d Cir. 2010).
[50] *Id.* at 6 (internal citations omitted).
[51] *Id.* at 7-8.
[52] Capitol Records v. Thomas, 579 F. Supp 2d 1210 (D. Minn. 2008).

to the plaintiffs. The particular question before the court was whether making works available for distribution over a peer-to-peer network constituted distribution of copyrighted works sufficient to support the award of statutory damages, or whether the plaintiffs had to show actual distribution of their copyrighted works. The Court's analysis turned on the application of the World Intellectual Property Organization (WIPO) Copyright Treaty (WCT) and the WIPO Performances and Phonograms Treaty (WPPT):

> It is undisputed that the WCT and the WPPT recognize a making available right that is not dependent on proof that copies were transferred to particular individuals . . . . Additionally, by ratifying and adopting the treaties, the legislative and executive branches indicated that U.S. law complied with the treaties by protecting that making available right.[53]

Without discussion, the Court held that the WCT and WPPT were non-self-executing treaties, based on the language of 17 U.S.C. § 104 (c) and (d).[54] It then discussed the applicability of the *Charming Betsy* principle to non-self-executing treaties:

> The Court acknowledges that past Presidents, Congresses, and Registers of Copyright have indicated their belief that the Copyright Act implements WIPO's make available right. The Court also acknowledges that given multiple reasonable constructions of U.S. law, the *Charming Betsy* doctrine directs the Court to adopt the reasonable construction that is consistent with the United States' international obligations. However . . . the Court concludes that Plaintiffs' interpretation of the distribution right is simply not reasonable. The *Charming Betsy* doctrine is a helpful tool for statutory construction, but it is not a substantive law.[55]

In granting the defendant's motion for a new trial, the Court held that domestic law defining the distribution of copyright-infringing materials was not altered by the terms of non-self-executing treaties and that international obligation to comply with the WIPO agreements could not alter substantive, pre-existing U.S. law.

The fourth case applying *Medellín* to a commercial context is *Safety National Casualty Corp. v. Certain Underwriters at Lloyd's, London*.[56] The case involved a series of reinsurance contracts, each of which contained a provision for mandatory arbitration of disputes. The case further involved four conflicting laws. At the state level, Louisiana law

[53] *Id.* at 1225.

[54] *Id.* at 1226. Subsection (c) refers to the Berne Convention, and subsection (d) to the WPPT.

[55] *Id.*

[56] Safety National Casualty Corp. v Certain Underwriters at Lloyd's, London, 587 F.3d 714 (5th Cir. 2009) *petition for cert. filed* Feb. 5, 2010 (No. 09-945).

prohibited arbitration clauses in insurance contracts.[57] A the federal level, the McCarran-Ferguson Act allowed state law to preempt federal law with respect to most insurance regulation, stating that "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act relates to the business of insurance. . . ."[58] At the international level, the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the Convention) required member States to recognize arbitration agreements and the courts of those States to compel arbitration when petitioned by a party to an international arbitration agreement.[59] Finally, returning to the federal level, Congress passed an implementation statute for the Convention, setting out rules for jurisdiction and venue, and stating that the Convention "shall" be enforced in U.S. courts.[60]

The Fifth Circuit Court of Appeals, sitting *en banc*, had considerable difficulty in applying the *Medellín* interpretive framework to this complex commercial case. The question before the Court was whether the Convention constituted an "Act of Congress" under the McCarran-Ferguson Act. If so, Louisiana law prohibiting arbitration clauses in insurance contracts would trump the Convention. If not, the Court would apply the Convention and compel arbitration on the reinsurance contracts.

Even though a treaty with an accompanying implementation statute might seem to be a clear example of a non-self-executing treaty, the Court began its analysis by stating that it was unclear to it whether the Convention was self-executing.[61] The Court then separated the international law obligation of the treaty from the domestic law obligation of any implementing legislation, holding that a treaty remains a treaty even if implemented by statute, stating:

> Even if the Convention required legislation to implement some or all of its provisions in United States courts, that does not mean that Congress intended an "Act of Congress" as that term is used in the McCarran-Ferguson Act, to encompass a non-self-executing treaty that has been implemented by Congressional legislation. Implementing legislation that does not conflict with or override a treaty does not replace or displace that treaty. A treaty remains an international agreement or contract negotiated by the Executive Branch and ratified by the Senate, not by Congress. The fact that a treaty is implemented

[57] *Id*. at 719.

[58] *Id.* at 720, *citing* 15 U.S.C. § 1012 (b).

[59] *Id.* at 719, *citing* the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, arts. II (1) and II (3), June 10, 1958 21 U.S.T. 2517, 330 U.N.T.S. 3.

[60] 9 U.S.C. § 201 *et seq*.

[61] Safety National, *supra*, note 56. at 721.

> by Congress does not mean that it ceases to be a treaty and becomes an "Act of Congress."[62]

In a concurring opinion, Judge Clement examined the Convention within the framework of *Medellín*, but came to a different conclusion. She found that even if the entire treaty was non-self-executing, the particular provisions compelling courts to recognize arbitration clauses and requiring courts to refer cases to arbitration when such a clause is present were self-executing. When provisions of treaties issue directives to the courts of contracting States, leaving no room for discretion or for the political branch, such provisions by their terms would be self-executing.[63] Such self-executing treaty provisions would not be Acts of Congress within the meaning of the McCarran-Ferguson Act, but would be the law of the land under the Supremacy Clause, thus displacing Louisiana law to the contrary.[64]

The dissent took a different approach to the analysis of the Convention under *Medellín*, concluding first that the Convention was a non-self-executing treaty, based on a pre-*Medellín* decision on the same question from the Second Circuit.[65] With that conclusion, the dissenters would look only to the implementing statute as having a legal basis in U.S. courts, stating:

> Simply put, implementing legislation—even if it fully implements a treaty—does not promote a non-self-executing treaty to the Supremacy Clause status it would have enjoyed had it been self-executing. As a matter of directly applicable domestic law, the non-self-executing treaty remains as inert as a provision of a model code, a source incorporated by reference. As a source of law, the implementing legislation is the alpha and omega of what may constitute a rule of decision in U.S. courts. For this reason, there can be no preemption in this case without construing an Act of Congress—the Convention Act rather than the treaty.[66]

Although the Fifth Circuit ruled in favor of the applicability of the treaty rather than the applicability of state law, its difficulty in applying the *Medellín* criteria to the treaty, its uncertainty about examining the treaty as a whole or by each provision, its decision to split the obligations of the treaty itself from the obligations of the implementing legislation, and its lengthy discussion of whether a self-executing treaty is an Act of Congress or some other equivalent all reflect the difficulty in applying the *Medellín* analytical framework. The Fifth Circuit's conflict

[62] *Id.* at 722-23,
[63] *Id.* at 734-35.
[64] *Id.* at 735-36.
[65] *Id.* at 742-43, citing Stephens v. American International Insurance Co., 66 F.3d 41 (2d Cir. 1995).
[66] *Id.* at 740-41.

with the earlier Second Circuit opinion involving the same treaty also seems to be inviting further Supreme Court review.

MEDELLÍN AND THE CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (CISG)

The *Medellín* decision raised questions about many treaties that had been considered self-executing for many years. In a blog post at the time of the decision, Professor Bruce Frier asked: "Does anyone know whether the CISG is among the treaties whose enforceability within the United States is endangered by today's Supreme Court decision?"[67] Now that commentators and courts have had the opportunity to consider the meaning and application of *Medellín*, it is possible to answer the question. Even under the presumption that treaties are non-self-executing, the CISG is a self-executing treaty, and thus, still the law of the land, binding federal and state courts.

Only a few commentators have addressed the question of the self-executing nature of the CISG, but have not addressed the question directly. Gregory Duhl concludes that "While it is likely that the CISG was self-executing, *Medellín* raises at least a lingering question of whether the CISG is enforceable as domestic law."[68] In one note, Mark Cantora concludes that the CISG is a self-executing treaty, pointing out the confusing nature of the opinions in *Medellín* concerning the specifics of analysis.[69]

Under the Supreme Court's decision in *Medellín*, the first source for determining whether a treaty is self-executing is the text of the treaty itself. In *Medellín*, the Court held that the language of the U.N. Charter obligating member States to "undertake to comply" with decisions of the ICJ[70] did not indicate an intent for the treaty to be self-executing. The text of the CISG does not contain explicit language indicating its intent to be a self-executing treaty. However, the preamble to the CISG states that one of the purposes of the treaty is to promote the development of international trade through "the adoption of uniform rules which govern contracts for the international sale of goods."[71] Articles 92-96 of the CISG contain a series of provisions allowing contracting States to tailor the CISG to their own particular circumstances. Article 92 allows states

[67] Jeremy Telman, *Medellin and the CISG*, Mar. 26, 2008, http://lawprofessors.typepad.com/contractsprof_blog/2008/03/medellin-and-th.html.

[68] Gregory M. Duhl, *International Sale of Goods*, 64 Bus. Law. __ (forthcoming 2010), *available at* http://ssrn.com/abstract=1546060.

[69] Mark Cantora, *Note: The CISG after Medellin v. Texas: Do U.S. Businesses Have It? Do They Want It?*, 8 J. Int'l Bus. & L. 111, 113-24 (2009).

[70] Medellín, *supra* note 5, text accompanying note 28.

[71] CISG, *supra* note 9, preamble.

to declare they will not be bound by Parts II or II of the CISG. Article 93 allows contracting states to extend the CISG to some or all of its territorial units, when those territories have different legal systems relative to contracts. Article 94 allows contracting states to exempt contracts with traders from closely related legal systems. Article 95 allows contracting states allows states to exclude the CISG when it would apply only as a conflict of law rule under Article 1 (b). Article 96 allows contracting States to continue to require that certain contracts be in writing to be enforceable.[72]

Although there is no one affirmative statement creating a self-executing treaty, the provisions of the Preamble and Articles 92-96 create a strong circumstantial case for self-executing status. If states are allowed to tailor the applicability of the CISG to a range of specific requirements, the implication is that they will apply and be bound by the remaining provisions.

A second aspect of the CISG that lends credence to the self-executing status of the treaty is the nature of the CISG itself. It is drafted not as a set of general principles or political commitments, but takes the form of a statute. The provisions of the CISG are specific, detailed, and directive in nature. They are meant to serve as gap-fillers and ground rules in international contracts for the sale of goods. Unlike many treaties, the provisions of the CISG are specifically designed to regulate the conduct of private parties, rather than states.

In addition to the structure and language of the CISG itself, other "aids to interpretation"[73] lend support to the proposition that the CISG is a self-executing treaty. In his Letter of Submittal to the President recommending ratification of the CISG, Secretary of State George P. Shultz wrote:

> The Convention is subject to ratification by signatory States (Article 91(2)), but is self-executing and this requires no federal implementing legislation to come into force throughout the United States. As already indicated, the Convention's effect is limited to foreign commerce of the United States and it will not affect purely domestic contracts of sale. [74]

While some commentators have compared this transmittal letter to the statements of President Bush with respect to the *Avena* case,[75] that comparison is inapt. President Bush's letter sought the enforcement of

[72] *Id.* arts 92-96.

[73] Medellín, *supra* note 5, text accompanying note 27.

[74] Message of President transmitting to U.S. Senate text of UN Sales Convention and legal analysis of Convention prepared by U.S. Department of State, Senate Treaty Doc. No. 98-9, 98th Cong., 1st Sess. (1983), *available at* http://www.cisg.law.pace.edu/cisg/biblio/reagan.html.

[75] Telman, *supra* note 67.

the *Avena* judgment under general principles of comity, not because state courts in the United States had any obligation under the Supremacy Clause to follow the provisions of a self-executing treaty. [76] Here, the conclusion of the executive branch that the CISG is self-executing is quite clear. The letter is consistent with the recommendations for good practice from the ABA-ASIL Joint Task Force.[77]

CONCLUSION

The Supreme Court's *Medellín* decision changed the framework for evaluating the application of treaties as domestic law. In so doing, it raised doubts about the enforceability of treaties that had long been assumed to be self-executing, including many commercial treaties upon which international trade and investment depend. Although the enforceability of the CISG has not specifically been challenged under the new *Medellín* framework, a close examination of treaty provisions and of the circumstances of ratification should lead a court to decide that the CISG is a self-executing treaty.

[76] Kirgis, *supra* note 16.
[77] Joint Task Force, *supra* note 43.

INDEPENDENT CONTRACTOR v. EMPLOYEE: THE NEVER ENDING BATTLE

by DR. DAVID S. KISTLER*

INTRODUCTION

The debate over whether a person is classified as an employee or independent contractor has been a long and hotly debated issue between the government (the Internal Revenue Service [IRS] and state agencies) and employers. Misclassification results in the employer paying back wages and benefits plus fines and penalties, which results in a significant financial liability. This paper examines the possible upcoming litigation between FedEx and the State of New York over the classification of its route drivers. FedEx has attempted to bypass the employee classification by allowing individuals to purchase routes. These individuals are classified as "independent contractors" and deliver the FedEx packages. An analysis is made of the FedEx classification using the New York State common law test and New York State cases that are appropriate to the current problem. The objective of the study is to determine if FedEx has a reasonable legal argument for its classification.

OVERVIEW

Misclassification has been significant. In February 2009, a Treasury Department report "found that misclassified workers account for a significant portion of the tax gap (taxes not paid)."[1] The New York State

* Assistant Professor, State University of New York at Potsdam.

[1] Christina Mucciolo, *Caught in the Crossfire*, Registered Rep. 3, April 1, 2009; http://www.lexisnexis.com/us/Inacademic/frame.do?reloadEntirePage=true&rand=126476.

Joint Enforcement Task Force on Employee Misclassification found approximately 12,300 situations of incorrect classification.[2] It has been stated that "few problems in the law have given greater variety of application and conflict in results than the cases arising in the borderland between what is clearly an employer-employee relationship and what is clearly one of independent entrepreneurial dealing."[3]

Classification as an independent contractor is sought after by employers because "it's cheaper to use independent contractors than to employ people."[4] Employers must pay the employee for overtime, sick leave, family and medical leave, vacations, and other fringe benefits. In addition, employers pay federal and state unemployment taxes, medical (and in some cases, dental and eye care) insurance, and workers' compensation for simply having employees. Also, there are limitations on working hours, scheduling of employees, conditions of employment, and collective bargaining that an employer must deal with. Classification as an independent contractor can avoid employment law problems such as Title VII claims for discrimination, harassment, or retaliation; Family and Medical Leave Act disputes; Age Discrimination claims; and wrongful termination lawsuits. Finally, another set of problems that can be avoided are vicarious liability claims.

Misclassification results in the employer paying back wages for the items mentioned above plus fines and penalties. "Fines for an intentional misclassification can equal the total amount of federal income and employment taxes owed for the weeks or months the individual worked going back three years."[5] FedEx was found guilty of misclassification of its employees in a California case where the company "agreed to pay $27 million in damages and attorneys' fees to 203 FedEx Ground drivers"[6] in December 2008. Keep in mind that a state action could lead to further action by the IRS on federal classification grounds.

In the past several years there have been several attempts to address this issue at the federal and state level. Federal legislation has been introduced (Independent Contractor Proper Classification Act of 2007, The Taxpayer Responsibility, Accountability and Consistency Act of 2008, and The Employee Misclassification Prevention Act of 2008) to

[2] John Ho, *Independent Contractor or Employee: An Old Question Continues to Haunt Employers*, Lexology, Dec 23, 2009, http://www.lexology.com/library/detail.aspx?g=dc2b6e3f-a94a-4407-80d4-926f5d687efc&utm_source.

[3] N.L.R.B. v. Hearst Publication, 322 U.S. 111, 121 (1944).

[4] Mucciolo, *supra* note 1, at 1.

[5] *Id.* at 2.

[6] Debbie Whittle Durban, *Independent Contractor or Employee? Getting it wrong can be Costly,* 21 S. CAR. LAW. 31, 33 (January 2010).

revise federal law to restrict the use of the independent contractor classification. In addition, state legislation has been introduced (an example is in the State of New York). Also, the IRS has focused in on employers using independent contractors. John Tuzynski, chief of Employment Tax Operations, stated that "almost a third (30 percent) of IRS audits . . . will be based on employee classification issues"[7] in 2010.

THE CURRENT PROBLEM

The situation under examination in this paper involves FedEx and its attempt to classify its package delivery truck drivers as independent contractors. Attorney General Cuomo for the State of New York has threatened to file suit against FedEx over its classification of the package delivery truck drivers.[8] Other states (Montana and New Jersey) have made similar indications.[9] FedEx must be concerned with both state and federal lawsuits.

Other companies in the same business as FedEx, which is the delivery of packages, treat package delivery truck drivers as employees. FedEx has attempted to bypass this classification by allowing individuals to purchase routes. All packages are provided to these independent contractors at a FedEx warehouse. After the pickup, the delivery is then in the hands of the route owners. How the route owners handle the truck drivers is within their control.

According to FedEx, their route drivers should be classified as independent contractors due to several factors: first, the person purchases a route from FedEx and is supposed to be in charge of its operation. Second, an independent contractor contract exists between the route purchaser and FedEx. This agreement clearly states that the route drivers are free to establish whatever work schedules they want. Third, the contract classifies the route drivers as independent. Fourth, those who purchase the routes must buy their own vehicles. Fifth, the route buyers are free to make a profit. Drivers are paid by a weekly settlement check which is based on a number of factors, but primarily on the number of packages to be delivered. Sixth, the route drivers are allowed to work elsewhere.[10]

However, an assortment of requirements is made compulsory by FedEx of its route drivers. Some examples include the fact that daily

[7] Mucciolo, *supra* note 1, at 3.

[8] Attorneys General Cuomo, Bullock and Milgram Announce Intent to Sue FedEx Ground over Violations of State Labor Laws, http://www.ag.ny.gov/media_center/2009/oct/oct20a_0
9.html (last visited Jan. 27, 2010).

[9] Ho, *supra* note 2, at 1.

[10] Todd D. Saveland, *FedEx's New "Employees": Their Disgruntled Independent Contractors*, 36 TRANSP. L. J. 95, 99 (Spring 2009).

delivery service is mandatory (except for Sundays), all packages are picked up from a FedEx terminal, all packages assigned to the route drivers are made by the FedEx management, FedEx scanners must be used when the packages are picked up and delivered, all vehicles used by route drivers must be approved by FedEx, FedEx logo is to appear on all vehicles, route drivers have to wear the requisite FedEx uniforms and badges, FedEx insists on certain cleanliness standards for the vehicles, FedEx management has the right to ride with route drivers to watch their performance, and route drivers must follow FedEx's policies and practices regarding delivery of packages.[11] A specific example of control exists where FedEx not only mandates the type of uniform, but also "the colors of drivers' socks."[12]

A further problem exists with the action by FedEx. "Dozens of other suits against FedEx Ground are pending in state and federal courts throughout the country."[13] With so many lawsuits pending and others being threatened, one would think that FedEx would examine this classification with the utmost care. It appears that the motivating factor in FedEx's situation is purely short term financial gain. The possible future negative consequences are ignored. Therefore, a serious ethical problem exists with the top management at FedEx.

STANDARD FOR REVIEW

Making a determination about whether a worker is an employee or an independent contractor has been problematic. Different standards have been used by federal and state courts and agencies. One author has stated that "none of the tests utilized relies on definitive factors."[14] The IRS, for example, until recently utilized a 20 factor list in an attempt to define the status of a worker. It now uses a three-category test.[15] The current standard looks at control and independence regarding: behavior, finance, and the type of relationship.[16] Other standards include: 1) the common law test, 2) the economic reality test and 3) a hybrid test.[17] "The traditional common law test, which originated with the IRS, contains 20 different factors" with the primary emphasis on control.[18] The economic reality test also utilizes several factors, as

[11] *Id.* at 103.

[12] Attorneys General Cuomo, Bullock and Milgram Announce Intent to Sue FedEx Ground over Violations of State Labor Laws, supra page 2.

[13] Durban, supra page 34.

[14] Ho, *supra* note 3, at 1.

[15] Independent Contractor (Self Employed) or Employee? http://www.irs.gov/business/small/article/0,,id=99921,00.html (last visited April 28, 2010).

[16] *Id.*

[17] Durban, *supra* note 6, at 32.

[18] *Id.* at 34.

explained below, and places the emphasis on control. A combination of the individual factors is utilized in the hybrid test, which "is often used by courts in cases brought under Title VII of the Civil Rights Act of 1964."[19] Whatever test is used, however, the classification determination is extremely fact intensive and subjective.

A serious problem exists in that "it is entirely possible for a worker to be classified as an independent contractor under one law or in one state and as an employee under another law or in another state."[20] Consider that, under very similar facts, FedEx was found guilty of misclassification by a California Appeals court[21] but not guilty by both a State of Washington court[22] and the U.S. Court of Appeals for the District of Columbia Circuit.[23] The reasoning of the Washington court was that the agreement between FedEx and the delivery drivers "lawfully categorized FedEx Ground drivers as independent contractors."[24] Arriving at the same outcome, the U.S. Court of Appeals emphasized the "drivers' abilities to operate multiple routes, hire substitute drivers without FedEx's permission and sell routes as well as their contract"[25] which indicated that an independent contractor status existed.

The Court of Appeal in California outlined the details of the drivers' work performance that were effectively under FedEx's control such as permissible hair styles and the use of specific scanners and forms.[26] The court highlighted the following facts:

> "Many standard employee benefits are provided, and the drivers work full time, with regular schedules and regular routes. The terminal managers are the drivers' immediate supervisors and can unilaterally reconfigure the drivers' routes without regard to the drivers' resulting loss of income. The customers are FedEx's customers, not the drivers' customers. FedEx has discretion to reject a driver's helper, temporary replacement, or proposed assignee. (…) Drivers—who need no experience to get the job in the first place and whose only required skill is the ability to drive—must be at the terminal at regular times for sorting and packing as well as mandatory meetings, and theymay not leave until the process is completed. The drivers are not engaged in a separate profession or business, and they are paid weekly, not by the job. They must work exclusively for FedEx. Although they have a

[19] *Id.* at 35.

[20] *Id.* At 33.

[21] Estrada v. FedEx Ground Packaging Sys., Inc., 154 Cal. App. 4th 1 (2nd Dist. 2007).

[22] Anfinson et al. v. FedEx Ground, Civil Action No. 04-2-39981-5 (Wash. Sup. Apr. 2009).

[23] FedEx Home Delivery v. NLRB, 563 F.3d 492 (D.C. Cir. 2009).

[24] *Supra* note 21.

[25] Court Rules for FedEx in NLRB Case, http://www.workforce.com/section/00/article/26/37/16.php (last visited April 27, 2010).

[26] *Supra* note 20, at 12.

> nominal opportunity to profit, that opportunity may be lost at the discretion of the terminal managers by "flexing" and withheld approvals, and for very slight violations of the rules."[27]

Stating that the evidence showed "that FedEx's conduct spoke louder than its words," the court ignored the "label" FedEx provided to its route drivers and concluded that they were, in fact, employees.[28]

Like the court in Estrada, other courts have applied a substance over form doctrine regarding classification. Mere classification of independent contractor by itself is insufficient to convince the courts of the proper designation of a worker.[29] Also, the requirement that a worker create a corporation and operate through that entity did not automatically create an independent contractor status.[30]

NEW YORK STATE CASE LAW

Although it has been stated that "the applicable statutory and common laws do not provide any meaningful guidance"[31] regarding the determination of a person's status, New York State cases provide a reasonable basis on which to make a determination. The first and most important factor is the degree of control. The Second Circuit Court of Appeals has instructed that "'the greatest emphasis' should be placed . . . on the extent to which the hiring party controls the 'manner and means' by which the worker completes his or her assigned task."[32] Where substantial control was found over workers, the courts found that employee status existed.

The State of New York currently relies on common law standards for a determination. An economic reality test is utilized.[33] This test examines five factors: "(1) the degree of control exercised by the employer over the employee; (2) the workers' opportunity for profit or loss and their investment in the business; (3) the degree of skill and independent initiative required to perform the work; (4) the permanence or duration of the working relationship; and (5) the extent to which the work is an integral part of the employer's business."[34] In articulating this test, the Second Circuit stated that "no one factor is dispositive"[35]

[27] *Id.*

[28] *Id.*

[29] Radio City Music Hall Corp. v. US, 50 F. Supp. 329, 331 (SDNY 1942).

[30] Gustafson v. Bell Atlantic Corp. 171 F. Supp. 2d 311, 325 (SDNY 2001).

[31] Saveland, *supra* note 10, at 97.

[32] Jon Gustafson v. Bell Atlantic Corp. 171 F. Supp. 2d 311, 321 (2001) (quoting Eisenberg v. Advance Relocation & Storage, Inc. 237 F.3d 111, 114 (2d Cir. 2000)).

[33] *See* e.g. Ansoumana v. Gristede's Operating Corp., 255 F.Supp 2d 184, 190 (SDNY 2003) and Brock v. Superior Care, Inc., 840 F.2d 1054 (2nd Cir. 1988).

[34] *Id.* at 1059.

[35] *Id.*

and that the essential concern is whether "the workers depend upon someone else's business to render service."[36]

Several cases from the State of New York, from both state and federal courts, illustrate the above standards and provide further guidance. All of the decisions made in the cases described below are consistent with utilizing the economic reality test. Primary emphasis was placed on the control factor as the most important guiding principle.

In *Mohel v. The Commissioner of Labor,*[37] the issue was whether limousine drivers were independent contractors. In this situation it was found that the drivers had no fixed work schedule and not even the company officials knew when a need would arise for a driver. All vehicles (i.e., cars) were kept at company facilities and maintained by the company. The drivers were required only to drive passengers from and to certain locations. What route to take was left completely up to the driver. No uniforms were mandated. The company paid for all expenses including insurance, parking fees, tolls, and gas. The driver was free to accept or reject an assignment and was given a fee based on the trip. The drivers received no training.

The court stated that "the burden [is] on the employer to prove that the individual who is performing service is exempt from"[38] being classified as an employee under New York labor laws. It was found that the company failed to provide sufficient evidence to qualify for the exemption. Under the economic reality test, several facts were found to the detriment of the company: the drivers had pay stubs with the company listed as employer and no evidence existed that the drivers were in any sort of business for themselves; "no opportunity for profit or loss"[39] existed; and the drivers "only investment was their time and service."[40] Driving the "limousines were an integral part of that business"[41] as the company could not function without their services. Therefore, misclassification was found.

In *Radio City Music Hall Corp. v. US,*[42] the court held that the right to control involves not merely the end results, "but also the details and means by which that result is accomplished."[43] Radio City Music Hall (Radio City) employed special artists for weekly stage shows. "What they should do and how they should do it, was theirs to develop and

[36] *Id.*

[37] Sanford J. Mohel and Walsh Limousine Service, Inc. v. The Commissioner of Labor, State of New York Industrial Board of Appeals, Docket No. PR 08-160 (November 19, 2009).

[38] *Id.* at 6.

[39] *Id.*

[40] *Id.*

[41] *Id.*

[42] *Supra* note 25.

[43] *Id.* at 331.

decide."[44] The time of the presentation was not fixed as the length of the performance was dependent upon popular demand. Each act had a negotiated price and the training for any performance was completely outside of Radio City.[45] All shows were conducted at Radio City.

Using the economic reality test, the court found that Radio City did not have sufficient control over the special artists for the latter to be classified as employee. It was found that there simply was an absence of control in that the details and means of the performance by the special artists were completely within the control of the performers plus the schedule of shows was very volatile. Misclassification was not found in this situation.

In *Ansoumana v. Gristede's Operating Corp,* [46] people were hired by a consortium of employers and then directed to specific supermarkets to work as delivery workers. The consortium of employers provided the workers with uniforms and delivery carts. Statements classifying the workers as independent contractors were signed. Each worker was assigned a specific store and was given specific directions on what to deliver and how any payment was to be received. Other activities of the workers were also supervised by the supermarket's management. If any free time existed for the workers, they were directed to other tasks as determined by the store manager.

Under the economic reality test, the court found that the workers were employees. A substantial degree of control was found to exist over the workers. The court stated that an "employer's characterization of an employee is not controlling."[47] It was found that the supermarket controlled virtually every aspect of the workers' routine. The defendants had the right to hire, fire, and transfer any worker without the worker objecting. No investment was made by the workers and the skill and independent initiative required by the workers was *de minis* at best. The work force was found to be transience and no permanent working relationship existed. Finally, the delivery service was found to be essential to the operation of the supermarket. The court held that both the consortium of employers and the supermarkets were joint employers. Thus, misclassification was found.

In *Gustafson v. Bell Atlantic Corporation,*[48] the plaintiff was hired as an independent chauffeur to drive vehicles for the company's management. The company required that all drivers form their own corporation. All drivers "were required to carry workers' compensation,

[44] *Id.* at 330.
[45] *Id.* at 332.
[46] *Supra* note 29.
[47] *Id.* at 190.
[48] *Supra* note 28.

unemployment compensation and no-owners liability insurance."[49] Only then was a contract signed classifying the drivers as independent contractors. The drivers used company vehicles and followed schedules determined by management.

Relying on the economic reality test, mixed results were produced. The court found that control was extensive as the driver had "little discretion over when and how long to work."[50] The conclusion by the court was that the company's demands on the drivers essentially precluded them from seeking other employment.[51] Also, no special skills were required of the chauffeurs and no major investment was found on the part of the chauffeurs as the company provided the vehicles which were to be used. However, the court found that the chauffeur services were not an integral part of the functions of the company. The fifth factor was found to be unclear. The driver had worked for the company for 10 years, but his contract was renewable on an annual basis. Weighing the first three factors against the fourth, the court held that the driver in this case was an employee of the company and misclassification was found.

In *Bynog v. Cipriani Group, Inc.,* [52] people were interviewed and hired as waiters by a temporary employment agency for work at various restaurants. The restaurants also employed unionized waiters. The unionized waiters received a salary plus a portion of the contract fee whereas the temporary waiters were paid an hourly rate. Both temporary and unionized waiters performed essentially the same task. The "only involvement with the . . . [temporary waiters] was to meet with them on the day of the banquet to discuss the menu and timing of the courses."[53] However, the temporary waiters were required to wear uniforms and were "to adhere to strict guidelines on how and when to serve food and set tables."[54]

The court concluded that the primary factor was the right of control. To assess this degree of control, the important factors were: "whether the worker (1) worked at his own convenience, (2) was free to engage in other employment, (3) received fringe benefits, (4) was on the employer's payroll and (5) was on a fixed schedule."[55] In essence, the court determined whether the worker "possessed sole decision-making power

[49] *Id.* at 317.

[50] *Id.* at 325.

[51] *Id.* at 325.

[52] Shyron Bynog et al. v Cipriani Group, Inc., et al. 1 N.Y.3d 193 (N.Y. Court of Appeals, 2003).

[53] *Id.* at 193.

[54] Shyron Bynog et al. v. Cipriani Group, Inc., et al., 298 A.D.2d 164, 164 (N.Y. App., Div. 1st Dept., 2002).

[55] *Supra* note 48, at 198.

regarding the type, nature, extent, duration, and follow-up"[56] work for each assignment. Applying the control criterion of the economic reality test, the court found that the temporary waiters were not employees because the temporary waiters: 1) "worked at their own discretion,"[57] 2) were free to work elsewhere and even worked for competitors of the defendant restaurants, and 3) "were under the exclusive direction and control of"[58] the temporary employment agency. Therefore, misclassification was not found.

In *303 West 42nd Street Enterprises, Inc. v. Internal Revenue Service,*[59] a different form of avoiding the employee status was attempted. In this situation females worked for an adult pornographic entertainment facility in one-on-one fantasy booths. The women were classified as 'visual telephonic communicators' and the facility claimed that a tenant-landlord relation existed. Details of the booth operations provided a curious mix of financial incentives. The booth operations accounted for between 15 and 30% of the gross revenue of the company. Each booth had two parts, one for the performer and one for the customer. A glass partition separated both parts so that no physical contact between the parties could be made. "What happens inside the booth is private, determined by the number of coins the customer deposits and conversation with the performer."[60] The performers engaged in sexually provocative actions. Patrons made two types of payments: 1) a fee for the selected performance (money deposited into a slot) and 2) a fee "to keep the window clear and the telephone operative"[61] (money deposited into a deposit box). The visual telephonic communicator kept all of the money from the slot and was paid 40% of the money deposited by the customer. The entertainment facility required the performers to sign a lease agreement for the booth and withheld the 40% as a security deposit for the current week. Performers were asked to sign their leases only after they utilized the booths. All performers were given 1099 tax forms at year end. All props (costumes, clothes, and other items) used by the performers for their show were purchased by them for their sole usage. Lastly, no uniform system of classification existed: performers were either tenants or independent contractors.

[56] Pramon Bhanti v. Brookhaven Memorial Hospital Medical Center, Inc., 260 A.D.2d 334, 335 (N.Y. App. Div., 2nd Dept., 1999).

[57] *Supra* note 48, at 198.

[58] *Id.* at 199.

[59] 303 West 42nd Street Enterprises, Inc. v. Internal Revenue Service, 916 F. Supp. 349 (SDNY 2004).

[60] *Id.* at 352.

[61] *Id.*

Several factors were held against the entertainment facility for the assertion of independent contractor status for these performers: 1) industry practice, 2) rental practices, 3) tax forms issued, and 4) the timing of the signing of the lease agreement. The court stated a landlord-tenant relationship did not exist here. The court noted that rent is a fixed amount over a certain time period and does not vary as did the fees paid by the performers. "If the performer generates no revenue in the fantasy booth's coin box, there are no proceeds to divide and . . . [the entertainment facility] receives no rent under the agreement."[62] The court also highlighted that whereas the signing of a landlord-tenant lease occurs before any occupancy takes place by the tenant, the exact opposite occurred in this case. Third, 1099 tax forms are not issued to tenants as they were in this case. Lastly, the court noted that no customary industry practice existed as "the industry cannot agree on a uniform practice"[63] to classify these performers. Therefore, no landlord-tenant relationship could possibly exist. In conclusion, the court stated that "the relationship between the taxpayer and the performer is a unique one, deliberately structured with a view towards the avoidance of the appearance of an employer-employee relationship."[64] Misclassification was found in this situation.

The case law developed by state and federal courts in New York is instructive in terms of analyzing a potential lawsuit against FedEx for misclassifying its route drivers. That analysis is provided in the following section.

ANALYSIS

In the present situation, FedEx exercises considerable control as the company has the right to dictate to the worker the working schedule, the mode of dress to be worn, approve whatever tools (i.e., vehicle) can be used, the time of work (Monday through Saturday time frame), policies and procedures to which must be followed, and right to watch the driver in the process of delivery of package. This factor favors an employer and employee relationship.

The second factor is the opportunity for profit or loss and what investment the worker contributions to work required. In cases such as *Radio City Music Hall* and *Bynog* the workers were free to work elsewhere and independent contractor status was found. There was sufficient time left during the typical week during which the workers could be engaged by competitors. This does not occur with FedEx as there is a mandatory delivery schedule of six days a week. Also, with

[62] *Id.* at 356.
[63] *Id.* at 354.
[64] *Id.* at 362.

FedEx there are no clear facts which state that the route drivers have been able to generate a profit or that their skill can determine their profits. FedEx states that the running of the route is totally within the control of the route driver. However, this is true only regarding the actual roads or streets taken to deliver the packages. Otherwise, all work is predetermined by FedEx. This factor favors the existence of an employer and employee relationship.

Although payment is primarily based upon packages to be delivered, there are a number of other factors. For example, different rates apply for daytime versus evening deliveries, extra payment is given for special deliveries such as those made by appointment and those where the customer's signature is required. Also, bonuses exist under certain circumstances such as for a positive safety record. A minimum compensation package exists for route drivers who experience a reduction in packages to be delivered. The method of payment is similar to a composite of wage incentives[65] and resembles a unionized employee package rather than that of an independent contractor. The latter would normally only receive a flat sum of money for the work involved.

The third factor is the degree of skill and initiative provided by the worker to carry out the tasks required. In cases such as *Ansoumana* and *Gustafson* a *de minis* degree of skill and initiative was found which lead to the conclusion that employee status existed. Here, FedEx requires very little of the drivers except the ability to safely drive a truck. There is no scheduling of clients, advertising or securing clients, or any other normal management function. All package deliveries are predetermined by FedEx. This factor favors an employer and employee relationship.

In the fourth factor, the duration of the working relationship, no permanence is guaranteed as route drivers could be disqualified for failure to follow FedEx's instructions. Failure to adhere to FedEx delivery standards allows FedEx to terminate route drivers. However, the existence of the route can not be eliminated unless FedEx ceases doing business in that geographic location. Here there could be an argument in favor of FedEx and the independent contractor status.

The final factor is the degree to which the route driver's job is an essential part of FedEx's business. If a person's work is "economically dependent on and within direct control of"[66] the parent company, then the person is an employee. In both *Mohel* and *Ansoumana* the workers were found to be an integral part of the business which lead to the conclusion that employee status existed. In the present situation, FedEx would cease doing business without the delivery of the packages as its

[65] Saveland, *supra* note 10, at 100.

[66] *Supra* note 26, at 324 (quoting McGuiggan v. CPC International, Inc., 84 F. Supp. 2d 470, 479 (SDNY, 2000)).

primary objective is to deliver packages. Therefore, the delivery of packages is absolutely critical to FedEx. This factor is found to be in favor of the employer and employee relationship.

Other considerations need to be addressed such as the structure of the relationship, the form of payment, and industry practice. The mere presence of a legal structure is not sufficient to determine the outcome. In one case, *303 West 42nd Street Enterprises, Inc.,* the court found that the rental agreement was simply a sham transaction meant to avoid calling its workers employees. In the FedEx situation, the existence of a contract referring to the route drivers as independent contractors, by itself, will be insufficient to convince a court. Also, the decisions in *303 West 42nd Street Enterprises, Inc.* and *Mohel* show that the form of payment is a strong indication of the workers' status. In *303 West 42nd Street Enterprises, Inc.,* a 1099 tax form was issued to the workers and in *Mohel* a pay stub was given out. Such actions gave evidence to the court that the workers were employees. FedEx has avoided this problem on the surface, but pays its delivery divers on a schedule that more resembles that of an employer and employee situation. Third, where industry practice differed among employers, such as in *303 West 42nd Street Enterprises, Inc.,* the court found that employee status existed. United Parcel Service Inc. (UPS), a direct competitor of FedEx, classifies its delivery drivers as employees. New York state case law appears to support the existence of an employment relationship between FedEx and its route drivers and does not support FedEx's claim that they are independent contractors.

CONCLUSION

Motivated by the tremendous financial savings it could achieve, FedEx reclassified its route drivers as independent contractors using a more elaborate scheme than previously attempted by any other company. This article analyzed FedEx's attempt to change the classification of workers from employee to independent contractor status by restructuring its operations for the delivery of packages. Although FedEx has succeeded in convincing at least two courts that its route drivers are independent contractors,[67] applying the economic reality test to the situation leads to the opposite result. Therefore, under New York case law, this analysis demonstrates that more adjustments would be needed for FedEx to achieve its goal and that no matter how hard FedEx tries to call a chair an elephant, the chair is still a chair.

[67] *Supra* note 21.

ONLINE BEHAVIORAL TARGETING: EFFORTS TO LIMIT UNFAIR INFORMATION PRACTICES

by CARTER MANNY*

I. INTRODUCTION

During most of the twentieth century, advertising supported much of the news and entertainment programming which consumers received through radio and television broadcasts.[1] Advertising also covered most of the cost of providing news supplied by newspapers and magazines sold at low prices through subscriptions and newsstands.[2] Today, much of the information formerly available only through broadcast and print media is available to consumers over the Internet.[3] Most commercial websites provide content at no charge and use advertising revenue to support the service.[4] The Internet is becoming the leading source of information supported by advertising.[5]

* Professor of Business Law, University of Southern Maine

[1] *See, e.g.,* Karl Erik Gustafsson, *Advertising and the Development of Media: The Forgotten Connection,* 3 J. MEDIA BUS. STUD. 19, 20 (2006).

[2] *See, e.g.,* Robert G. Picard, *News Has Never Been a Commercially Viable Product, available at http://the mediabusiness.blogspot.com/2010/03/news-has-never-been-commercially-viable.html* (visited May 23, 2010).

[3] *See, e.g.,* Kristen Purcell, Lee Rainie, Amy Mitchell, Tom Rosenstiel and Kenny Olmstead, *Understanding the Participatory News Consumer* 3-4, *available at* http://www.pewinternet.org/Reports/2010/Online-News.aspx (visited May 23, 2010).

[4] *See, e.g.,* Eric Pfanner, *Internet Pushes Concept of "Free" Content*, INT'L HERALD TRIB., Jan. 17, 2007, *available at* http://www.nytimes.com/ 2007/01/17/technoloby/17iht-media.4241040.html?_r=1& pagewanted=all (visited May 23, 2010).

[5] *See* Center for Democracy and Technology, *Online Behavioral Advertising: Industry's Current Self-Regulatory Framework is Necessary, But Still Insufficient On Its Own to Protect Consumers,* 37, *available at* http://www.cdt.org/files/pdfs/

Unlike traditional broadcast or print advertising aimed at a general audience, online advertising can be tailored to each consumer based upon his or her use of the Internet. The tailoring can raise privacy concerns, especially when the individual is not aware that his or her online activities are being used to direct ads.[6] A range of practices can be used to determine what type of ad will be delivered to the consumer's computer when viewing a web page. At one end of the spectrum is the delivery of an ad related to the page that the consumer has requested during the current online session. This practice, known as contextual advertising,[7] could involve the display of an ad for a product or service offered by the provider of the web page. For example, a visitor to a website for Disney World might be shown an ad for a Disney-owned hotel in Orlando, Florida. This type of contextual ad by the operator of the website raises few privacy concerns because little information about the consumer is used, and the consumer can readily infer why the ad is being shown. A contextual ad could also be offered by a third party, an airline with flights to Orlando, for example. Once again, this practice raises few privacy concerns because little information about the consumer is being used, and the connection between the web page and ad is obvious.

A more troublesome practice is the collection of information about a consumer's web browsing history over multiple online sessions to create a profile to be used for delivery of ads unrelated to web pages being viewed. This practice, known as behavioral targeting,[8] is usually done without the knowledge or consent of the consumer and raises potential

CDTOnlineBehavioralAdvertisingReport.pdf (visited Mar. 23, 2010) [hereinafter *CDT Report on Self-Regulation*].

[6] *See* Joseph Turow, Jennifer King, Chris Jay Hoofnagle, Amy Bleakley & Michael Hennessey, *Contrary to What Marketers Say, Americans Reject Tailored Advertising and the Three Activities That Enable It, available at* http://graphics8.nytimes.com/ packages.pdf/business/20090929-Tailored_ Advertising.pdf 3 (visited Feb. 4, 2010) [hereinafter *Turow Report*]; *See* Center for Democracy and Technology, *An Overview of the Federal Wiretap Act, Electronic Communications Privacy Act, and State Two-Party Consent Laws of Relevance to the NebuAd system and Other Uses of Internet Traffic Content from ISPs for Behavioral Advertising, available at* http://www.cdt.org/ privacy/ 20080708ISPtraffic.pdf (visited Mar. 23, 2010) [hereinafter *CDT Report on Use of ISP Content*].

[7] Center for Digital Democracy, Consumer Federation of America, Consumers Union, Consumer Watchdog, Electronic Frontier Foundation, Privacy Lives, Privacy Rights Clearinghouse, Privacy Times, U.S. Public Interest Research Group, The World Privacy Forum, *Online Behavioral Tracking and Targeting: Legislative Primer September 2009* 3, *available at* http://cdn.publicinterestnetwork.org/assets/s69h7yWnbOJE-V2uGd4w/Online-Privacy---Legislative-Primer.pdf (visited Feb. 25, 2010) [hereinafter *Privacy Group Coalition Principles*].

[8] *See, e.g., Id.* at 3.

privacy issues. In many cases, the profile is assembled by a network advertising company through arrangements with various website operators and is used to deliver ads of third parties.[9] A more comprehensive, and potentially abusive, form of behavioral targeting involves a system in which an internet service provider (ISP) agrees to send all of its subscribers' online traffic data, including email as well as web page visits, to a network advertising company for assembly into a profile.[10] Both forms of behavioral targeting, using website-level data or using ISP-level data, involve potential harm through aggregation of personal information. As noted in Daniel Solove's seminal article in the University of Pennsylvania Law Review, "aggregation can cause dignitary harms because of how it unsettles expectations."[11] By combining many pieces of information collected for different purposes at different times, a profile can reveal facts about a person in ways far beyond the person's expectations when the information was supplied.[12] If the data collected are incomplete, the profile can present a distorted picture of the person's life.[13] Moreover, because much of the information is collected surreptitiously, people are unaware that tracking is taking place, and are likely to feel angry and betrayed when they learn they have been monitored.

In the U.S., even though there is little legal protection for privacy online, behavioral targeting has been the subject of a small number of class action lawsuits and some enforcement activity by the Federal Trade Commission.[14] The FTC and Congress have considered regulating behavioral targeting,[15] which has caused the online advertising industry

[9] Network advertising companies which assemble profiles from online behavioral data supplied by Internet service providers include NebuAd. ISPs which have planned to participate in supplying online customer data for behavioral targeting include Charter Communications, Wide Open West, CenturyTel, Embarq and Knology. *See generally CDT Report on Use of ISP Content*, *supra* note 6.

[10] *See generally CDT Report on Use of ISP Content*, *supra* note 6.

[11] Daniel J. Solove, *A Taxonomy of Privacy*, 154 U. PA. L. REV. 477, 507 (2006).

[12] *Id.*

[13] *Id.*

[14] *See, e.g.,* In the Matter of Sears Holdings Management Corp., Federal Trade Commission Decision and Order, Aug. 31, 2009 *available at* http://ftc.gov/os/caselist/0823099/090604seardo.pdf (visited Mar. 22, 2010); Valentine v. NebuAd, Inc., Docket No. CV 08 5113 (N.D. Cal. 2008). The complaint is *available at* http://www.docstoc.com/docs/2497992/Nebuad-Class-Action-Suit (visited Mar. 22, 2010); Kirch v. Embarq Management, Docket No. 10-CV-2047 (D. Kan. 2010). The complaint is *available at* http://www. courthousenews.com/2010/01/28/spyware.pdf (visited Mar. 22, 2010).

[15] *See, e.g., FTC To Silicon Valley: Tech Companies Should Protect Consumer Data, available at* http://www.forbes.com/2010/01/28/advertising-ftc-privacy-technology-facebook-apple-cmo-network-privacy-regulation_print.html (visited Feb. 1, 2010; Kenneth Corbin, *Privacy Bill Nears Introduction in House, available at*

to propose stronger self-regulation as a strategy to deter the adoption of more restrictive laws.[16] In Europe, behavioral targeting can violate existing data protection laws and has prompted a change in the directive protecting privacy in electronic commerce, commonly known as the E-Privacy Directive.[17] Moreover, public interest groups and technology experts have been involved in the process of trying to make sure that laws, self-regulation and technology are applied consistent with recognized privacy principles, known in the U.S. as Fair Information Practices,[18] without unduly limiting legitimate online commercial activity. This article examines the efforts, as of March, 2010, to limit unfair information practices relating to behavioral targeting,

II. PRINCIPLES FOR PROTECTING PRIVACY

In the U.S., Fair Information Practices were articulated in a report made for the Department of Health and Education in 1973,[19] and were previously embodied in the first modern U.S. privacy statute, the Fair Credit Reporting Act of 1970.[20] The principles were the basis for the Privacy Act of 1974,[21] which applies only to the federal government. Fair Information Practices have never been imposed by law in a comprehensive way on the private sector in the U.S. Instead, Congress has adopted sector-specific privacy statutes, only some of which follow all of the principles first articulated in 1973. The most recent iteration of Fair Information Practices was issued by the Department of Homeland Security in 2008.[22]

http://www.esecurityplanet.com/trends/article/php/3861396/Privacy-Bill-Nears-Introduction-in-House.html (visited Feb. 1, 2010).

[16] *See, e.g., CDT Report on Self-Regulation, supra* note 5, 6.

[17] *See* Council Directive 2009/136, 2009 O.J. (L337) 11; Council Directive 2002/58, 2002 O.J. (L201) 37.

[18] U.S. Dept. of Health, Education and Welfare, *Records, Computers and Rights of Citizens, Report of the Secretary's Advisory Committee on Automated Personal Data Systems* (1973) [hereinafter *1973 HEW Report*]. The most recent version of the Fair Information Practices was formulated by the U.S. Department of Homeland Security in 2008. *See* U.S. Dept. of Homeland Security, *Privacy Policy Guidance Memorandum, available at* http://www.dhs.gov/ xlibrary/assets/privacy/privacy_policyguide_2008-01.pdf (visited Mar. 24, 2010). [hereinafter *2008 DHS Fair Information Practices*].

[19] *See 1973 HEW Report, supra* note 18. For the history of the evolution of privacy principles worldwide, *see* Robert Gellman, *Fair Information Practices: A Basic History, available at* http://bobgellman.com/rg-docs/rg-FIPshistory.pdf (visited Mar. 28, 2010).

[20] 15 U.S.C. §§ 1681-1681u.

[21] 5 U.S.C. § 552a.

[22] *See 2008 DHS Fair Information Practices, supra* note 18. The following is the DHS version of the Fair Information Practices:

- <u>Transparency:</u> DHS should be transparent and provide notice to the individual regarding its collection, use, dissemination, and maintenance of personally identifiable information (PII).

A similar set of principles evolved in Europe and was the basis for privacy guidelines issued by the Organization of Economic Cooperation and Development in 1980,[23] a Council of Europe Convention in 1981,[24] and the European Union's Data Protection Directive[25] in 1995. Because of the growth of the Internet, European Union privacy law was updated in 2002 with legislation known as the E-Privacy Directive[26] which explicitly extended privacy law to electronic communications generally.

In a broad sense, there are six areas of commonality between the Fair Information Practices in the U.S. and privacy principles in Europe.

- Notice: People should be informed that information about them is being collected, that the information will be used for a specified purpose and whether the information will be disseminated to others.
- Consent: The collection, use, dissemination and storage of personal information should be done with the individual's consent.
- Limits on Collection and Use: Only information which is relevant to the stated purpose should be collected. The information should only be used for the stated purpose, or for a compatible purpose. The information should be retained only as long as necessary to fulfill the

- Individual Participation: DHS should involve the individual in the process of using PII and, to the extent practicable, seek individual consent for the collection, use, dissemination, and maintenance of PII. DHS should also provide mechanisms for appropriate access, correction, and redress regarding DHS's use of PII.
- Purpose Specification: DHS should specifically articulate the authority that permits the collection of PII and specifically articulate the Purpose or purposes for which the PII is intended to be used.
- Data Minimization: DHS should only collect PII that is directly relevant and necessary to accomplish the specified purpose(s) and only retain PII for as long as is necessary to fulfill the specified purpose(s).
- Use Limitation: DHS should use PII solely for the purpose(s) specified in the notice. Sharing PII outside the Department should be for a purpose compatible with the purpose for which the PII was collected.
- Data Quality and Integrity: DHS should, to the extent practicable, ensure that PII is accurate, relevant, timely and complete.
- Security: DHS should protect PII (in all media) through appropriate security safeguards against risks such as loss, unauthorized access or use, destruction, modification, or unintended or inappropriate disclosure.
- Accountability and Auditing: DHS should be accountable for complying with these principles, providing training to all employees and contractors who use PII, and auditing the actual use of PII to demonstrate compliance with these principles and all applicable privacy protection requirements.

[23] Organization for Economic Cooperation and Development, *OECD Recommendation Concerning and Guidelines Governing the Protection of Privacy and Transborder Flows of Personal Data*, OECD Doc. C 58 (final)(Oc. 1, 1980) [hereinafter *OECD Guidelines*].

[24] Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data, Eur. T.S. No. 108 (Jan. 28, 1981 [hereinafter *Convention 108*].

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

[26] Council Directive 2002/58, 2002 O.J. (L201) 37 [hereinafter *E-Privacy Directive*].

stated purpose. Any use for a different purpose requires the individual's consent.
- Access and Rectification: An individual has the right to learn what information about the individual is being held, the right to challenge the accuracy of the information, and the right to correct or delete inaccurate information.
- Security: There should be safeguards to protect against loss of information, and unauthorized access to or use of information. The safeguards should also protect against destruction, modification or inappropriate disclosure of information.
- Accountability: An organization which collects or uses personal information should be held responsible for complying with the principles.

While there is agreement between the U.S. and Europe on general privacy principles, there can be considerable variation in how these privacy principles are implemented through laws and self-regulation. In general, Europeans tend to impose the principles comprehensively with enforcement by governmental agencies, while the U.S. tends to apply them selectively and incompletely through a combination of weak self-regulation and uneven governmental enforcement.[27]

III. ACTIONS AGAINST BEHAVIORAL TARGETING UNDER EXISTING LAWS

A. Under U.S. Laws

In 2009, a behavioral targeting system was dismantled as a result of an FTC investigation which resulted in a consent decree.[28] An affiliate of Sears and Kmart ran a pop-up ad on Sears and Kmart websites inviting visitors to join a service called "My SHC Community" where they could become part of an interactive online community.[29] Visitors who joined were not informed in advance that tracking software would be loaded on their computers to send information about nearly all of their online activities to Sears, including web browsing, online purchases, online applications, online banking transactions and the names of senders and recipients of web-based email and instant messaging.[30] Although a written explanation of software and its functions was available to consumers who requested more information, the statement provided

[27] *See* GELLMAN, *supra* note 19, 10. Robert Gellman correctly observes that businesses in the U.S. prefer to limit these principles by reducing the elements of notice, consent and accountability.

[28] In the Matter of Sears Holdings Management Corp., Federal Trade Commission Decision and Order, Aug. 31, 2009 *available at* http://ftc.gov/os/caselist/0823099/090604seardo.pdf (visited Mar. 22, 2010).

[29] *See Sears, Kmart Monitored All Users' Online Activity*, 35 PRIVACY JOURNAL 3 (2009).

[30] *Id.*

inadequate information about Sears' practices.[31] The Sears affiliate was investigated by the FTC for deceptive practices and entered into a consent decree in which it agreed to end the practice, destroy the information which was collected and notify consumers how to uninstall the tracking software.[32] The company agreed not to install any tracking software on consumers' computers in the future unless it first fully informed consumers of the types of information to be collected, how it would be used, and whether the information might be used by a third party; the company also agreed to obtain express consent to the downloads by having consumers click a button or link that was not pre-selected.[33]

Behavioral targeting using information acquired from an Internet service provider presents more significant privacy concerns. The technology behind ISP-level tracking systems differs from conventional online advertising systems.[34] In a conventional system, small files, known as "cookies," placed on users' computers enable the website operator to track which pages the user has viewed and to identify the consumer when he or she is returning to the website. Browser software allows the consumer to delete cookies at the end of each session. At the next session, new cookies could be acquired but the ones from the prior session would not be available. Accordingly, the deletion of cookies can limit the ability of a network advertising company to build a profile of the user's online behavior over an extended period of time. Under ISP-level tracking systems, like the one developed by NebuAd, the network advertising company is able to identify the user's computer each time he or she starts a new online session and send the computer cookies based upon the user's prior online sessions. The computer user's deletion of the cookies at the end of a session, therefore, has no effect on the network advertising company's ability to build a profile and track the user's online behavior over time. Moreover, the tracking system cannot be defeated by the user switching browsers or even switching computers.[35] In addition to monitoring online behavior, the NebuAd system interferes with the communication between the consumer's computer and the computer servers where web pages are stored by engaging in "packet forgery" which tricks the user's computer into

[31] *Id.*

[32] In the Matter of Sears Holdings Management Corp., Federal Trade Commission Decision and Order, Aug. 31, 2009 *available at* http://ftc.gov/os/caselist/0823099/090604seardo.pdf (visited Mar. 22, 2010).

[33] *Id.*

[34] *See* Robert Topolski, *NebuAd and Partner ISPs: Wiretapping, Forgery and Browser Hijacking, available at* http://www.freepress.net/files/ NebuAd_report.pdf (visited Mar. 22, 2010).

[35] *Id.* at 3.

accepting web page changes from a third party advertiser, contrary to the expectation of the operator of the web page the consumer wants to view.[36] The system is a type of "browser hijack" because it alters the normal behavior of the browser without permission, and violates the expectations of both the consumer and the software company that created the browser.[37]

Internet service provider-level tracking systems have prompted two class actions in federal court. *Valentine v. NebuAd, Inc.,*[38] was filed in the Northern District of California in November 2008. *Kirch v. Embarq Management*[39] was filed in a federal district court in Kansas in January 2010. The complaint in the California case alleged that network advertising companies and internet service providers violated the federal Electronic Communications Privacy Act,[40] the Computer Fraud and Abuse Act[41] and two California criminal statutes: the Invasion of Privacy Act[42] and the Computer Crime Law.[43] The complaint in the Kansas case alleged violation of the federal Wiretap Act,[44] the federal Computer Fraud and Abuse Act,[45] and the common law torts of invasion of privacy[46] and trespass to personal property[47] by downloading

[36] *Id.* at 2.

[37] *Id.* at 8.

[38] Valentine v. NebuAd, Inc., Docket No. CV 08 5113 (N.D. Cal. 2008). The complaint is *available at* http://www.docstoc.com/docs/2497992/Nebuad-Class-Action-Suit (visited Mar. 22, 2010). According to the website of a lawfirm representing some of the defendants, the case against the six ISP defendants was dismissed for lack of personal jurisdiction and failure to state a claim upon which relief could be granted. *See* Jenner & Block, *Firm Secures Important Victory for Embarq, Inc. and Century Tel, Inc.*, *available at* http://www.jenner.com/news_item.asp?id=000015177324 (visited Mar. 22, 2010).

[39] Kirch v. Embarq Management, Docket No. 10-CV-2047 (D. Kan. 2010). The complaint is *available at* http://www.courthousenews.com/ 2010/01/28/spyware.pdf (visited Mar. 22, 2010).

[40] 18 U.S.C. § 2510

[41] 18 U.S.C. § 1030

[42] CAL. PENAL CODE § 631

[43] CAL. PENAL CODE § 502

[44] 18 U.S.C. §§ 2510 - 2522

[45] 18 U.S.C. § 1030

[46] Section 652B of the Restatement (Second) Torts defines the intrusion upon seclusion form of invasion of privacy as "One who intentionally intrudes, physically or otherwise, upon the solitude or seclusion of another or his private affairs or concerns, is subject to liability to the other for invasion of his privacy, if the intrusion would be highly offensive to a reasonable person." RESTATEMENT (SECOND) OF TORTS § 652B (1977).

[47] Section 217 of the Restatement (Second) Torts defines trespass to personal property or trespass to chattels as "A trespass to a chattel may be committed by intentionally (a) dispossessing another of the chattel, or (b) using or intermeddling with a chattel in the possession of another." RESTATEMENT (SECOND) OF TORTS § 217 (1965). For a discussion of the tort of trespass to personal property as applied to online activities, *see* Ronnie Cohen and Janine S. Hiller, *Towards a Theory of Cyberplace: A Proposal for a New Legal*

surveillance software onto the computers of ISP subscribers.[48] The plaintiffs alleged that the defendants violated the Wiretap Act by intentionally intercepting the contents of communications without authorization and without being a party to the communication.[49] The claims under the Wiretap Act have been thoroughly analyzed in a report by the Center for Democracy and Technology which concluded that the tracking system would be permissible only with prior express consent of the ISP's customers, but that such consent might not be adequate under laws in twelve states requiring all parties to a communication (e.g. an e-mail message) to consent to its interception by a private party.[50]

B. Under European Laws

Testing of a similar ISP-based tracking system has generated controversy in Europe. In 2006 and 2007, a U.S. company, Phorm, secretly tested its technology on 18,000 broadband customers of a British ISP, British Telecom ("BT"), in the United Kingdom.[51] An internal British Telecom report of the secret testing was published in June, 2008, by the whistleblowing website Wikileaks.[52] The report revealed that Phorm's system caused some customers' browsers to malfunction and was believed by a small number of customers to have infected their computers with adware.[53] News of the tests prompted the British Office of Fair Trading to begin an investigation into behavioral targeting.[54] A criminal investigation was also begun.[55] Moreover, publicity about Phorm's plans and complaints by consumers to regulators prompted the European Commission to begin a proceeding against the United Kingdom alleging insufficient implementation of privacy protections

Framework, 10 RICH. J. L. TECH. ¶¶ 4 – 6 (2003), *available at* http://jolt.richmond.edu/v10i1/article2.pdf (visited May 24, 2010).

[48] Kirch v. Embarq Management, Docket No. 10-CV-2047 (D. Kan. 2010). The complaint is *available at* http://www.courthousenews.com/ 2010/01/28/spyware.pdf (visited Mar. 22, 2010).

[49] *Id*. at 10-11.

[50] *See generally CDT Report on Use of ISP Content*, *supra* note 6. The twelve states with all party consent laws are California, Connecticut, Florida, Illinois, Maryland, Massachusetts, Michigan, Montana, Nevada, New Hampshire, Pennsylvania and Washington. *Id*. at 11.

[51] *See, e.g., Leaked Report: ISP Secretly Added Spy Code To Web Sessions, Crashing Browsers*, *available at* http://blog.wired.com/27bstroke6/2008/06/isp-spying-made.html (visited June 20, 2008).

[52] *Id.*

[53] *Id.*

[54] *See Internet tracking company hit by OFT inquiry*, THE GUARDIAN, Aug. 21, 2009, at 26.

[55] *See Phorm's Secret Behavioral Targeting Tests Spark Criminal Probe, available at* http://www.mediapost.com/publications/?fa=Articles.show Article&art_aid=123344&nid=111602 (visited Mar. 1, 2010).

under the general Data Protection Directive and the E-Privacy Directive.[56] The Commission's investigation included review of potential misuse of technology that inspects the contents of customers' online activity, as well as the practice of conducting the tests without informing customers.[57]

IV. CONSUMER ATTITUDES TOWARD BEHAVIORAL TARGETING

Two university studies in 2009 examined consumer awareness of behavioral targeting. The first, by privacy expert Joseph Turow[58] and others at the University of Pennsylvania and University of California at Berkeley, involved a telephone survey of 1000 Americans and found that 66% of adults did not want advertisements to be tailored to their interests.[59] Even if tracking is anonymous, most respondents "definitely" (68%) or "probably" (19%) would not allow it.[60] Most interestingly, the survey refutes the oft-stated notion that young people do not care about privacy online.[61] Although young adults care less about privacy than older age groups,[62] the survey found that 55% of those in the 18 to 24 year old age group do not want advertisements to be tailored to their interests.[63] Moreover, 86% of this age group opposes tailored advertising if it involves websites other than the ones they are visiting.[64]

The Turow Report makes clear that Americans overwhelmingly support laws that would require websites and advertisers to abide by the principles of access and rectification stated in the Fair Information

[56] *See Commission launches case against UK over privacy and personal data protection, available at* http://europa.eu/rapid/pressReleaseAction. do?reference=IP/09/570&format= HTML&aged=0&language= EN&gviLanguage=en (visited Mar. 22, 2010); *Commission steps up IK legal action over privacy and personal data protection, available at*http://wuropa.eu/rapid/pressReleasesAction.do?reference=IP/09/1626 &format= HTML&aged=0&language=EN&guiLanguage=en (visited Mar. 22, 2010).

[57] *See UK Home Office Responds to EC Internet Privacy and Phorm Probe, available at* http://www.ispreview. co.uk/story/2010/02/04/uk-home-office-responds-to-ec-internet-privacy-and-phorm-probe.html (visited Feb. 8, 2010).

[58] Joseph Turow is the Robert Lewis Shayton Professor of Communication at the University of Pennsylvania's Annenberg School. Since 1999 he has been conducting surveys on Americans' understanding of, and attitudes toward, information privacy and digital marketing. *See*http://www.asc.upenn.edu/ ascfaculty/FacultyBio. aspx?id=128 (visited May 25, 2010).

[59] *Turow Report, supra* note 6, 3.

[60] *Id.*

[61] *Id.* at 16.

[62] The report found that the following percentages of each age group stated that they did not want online ads tailored to their interests: age 18-25, 55%; age 25-34, 59%; age 35-49, 67%; age 50-64, 77%; age 65-89, 82%; all age groups combined: 66%. *Id.* at 17.

[63] *Id.*

[64] *Id.*

Practices. Over two-thirds of respondents (69%) felt that they should have the legal right to know everything a website knows about them. There was overwhelming support (93%) for a law requiring a website or advertiser to delete all stored information about an individual when requested to do so, and considerable support (63%) for a law requiring immediate deletion of information about their online activity.[65]

Consumers mistakenly believe that current law prohibits companies from selling information about them.[66] They believe that businesses that illegally purchase or use personal information should be punished. The Turow Report shows that 70% of respondents supported a fine of at least $2500 for an offense, 38% supported requiring the offender to fund efforts to help people protect their privacy, 35% felt that an executive responsible for an offense should face jail time and 18% felt that the offending company should be put out of business.[67]

The second study, by computer science and privacy experts Aleecia McDonald[68] and Lorrie Faith Cranor[69] of the Cylab Usable Privacy and Security Research Laboratory at Carnegie Mellon University, involved in-depth interviews of fourteen people.[70] Although many participants raised privacy issues in the first few minutes of the conversation without any prompting about privacy, most had a poor understanding of how online advertising works.[71] They understood contextual advertising, in which the ad displayed relates to a web page viewed during the current session, but did not understand the practice of behavioral targeting in which information about them flows to third party advertisers who use their history of online activity to create profiles that determine what third party ads will be displayed.[72] Some of the participants were not aware of when they were being subjected to third party advertising, let alone aware of what information was being collected about them and

[65] *Id.*

[66] *Id.* at 4.

[67] *Id.*

[68] Aleecia McDonald is a researcher at the Cylab Usable Privacy and Security Research Laboratory at Carnegie Mellon University. Her research includes the efficacy of industry self regulation, behavioral economics and mental models of privacy, network traffic analysis to combat spyware, automotive privacy and radio frequency identification technology. *See* http://www.aleecia.com (visited May 25, 2010).

[69] Lorrie Faith Cranor is Associate Professor of Computer Science and of Engineering and Public Policy at Carnegie Mellon University where she is director of the Cylab Usable Privacy and Security Laboratory. *See* http://lorrie.cranor.org (visited May 25, 2010).

[70] Aleecia M. McDonald & Lorrie Faith Cranor, *An Empirical Study of How People Perceive Online Behavioral Advertising, available at* http://www.cylab.cmu.edu/files/pdfs/tech_reports/CMUCyLab09015.pdf (visited Mar. 21, 2010) [hereinafter *McDonald & Cranor Report*].

[71] *Id.* at 1.

[72] *Id.* at 6.

how it was being used.[73] The study's authors assert that self-regulatory guidelines of the online advertising industry "may assume an unrealistic level of media literacy on the part of Internet users."[74] They state that the current self-regulatory approach is grounded in the Fair Information Practice of notice, but that notice cannot be effective when the recipients of the notice do not understand the underlying system to which the notice relates.[75] The authors make a key point when they conclude that "consumers cannot protect themselves from risks they do not understand."[76]

Taken together, the two reports demonstrate that, with respect to online activities, adult consumers in all age groups: (1) value privacy, (2) expect legal protection for privacy, and (3) are not well-informed about how information about them is collected and used for behavioral targeting. The studies call into question the effectiveness of a self-regulatory approach when consumers lack sufficient awareness to make meaningful decisions about how to protect their personal information online.

V. REFORMS DIRECTED AT BEHAVIORAL TARGETING

A. Reforms in Europe

Online advertising within Europe is covered under existing European data protection law.[77] It is less than clear, however, whether European law can be applied to online advertising companies outside Europe that collect information about Europeans based on their online activities. Article 4 of the Data Protection Directive states that it applies to someone who makes use of equipment located within Europe.[78]

[73] *Id.* at 1.

[74] *Id.*

[75] *Id.* at 4.

[76] *Id.* at 10.

[77] The Data Protection Directive applies to the processing of personal data on the territory of a Member State. *Data Protection Directive, supra* note 25, Art. 4(1)(a). "Processing" is broadly defined to include any operation or set of operations which is performed upon personal data, including collection, use and dissemination. *Data Protection Directive, supra* note 25, Art. 2(b). Therefore, collection within Europe of information about the online activities of a user of a computer within Europe would be subject to the provisions of the Data Protection Directive. In addition, the E-Privacy Directive applies to the processing of personal data in connection with the provision of electronic communications services in public communications networks, including the Internet, located within the Member States. *E-Privacy Directive, supra* note 26, Art. 3(1).

[78] The Data Protection Directive applies when "the controller is not established on Community territory and, for purposes of processing personal data makes use of equipment, automated or otherwise, situated on the territory of said Member State, unless such equipment is used only for purposes of transit through the territory of the Community." *Data Protection Directive, supra* note 25, Art. 4(1)(c).

Arguably, if a network advertising company outside Europe is collecting information from the personal computer of a person within Europe as she browses the Internet, the company is using equipment within Europe. However, even if this argument is valid, there is the practical problem of how a European data protection agency or court can get jurisdiction over an online advertising company that has no other activities within Europe.

With respect to behavioral targeting, the E-Privacy Directive was amended in 2009 to clarify the need for consent before cookies or software can lawfully be downloaded to someone's computer.[79] The provisions of the amendment must be incorporated into the data protection law of each of the twenty-seven EU member states no later than May of 2011. The amendment makes clear that the user must be provided with clear and comprehensive information about the purpose of the item to be downloaded and give consent before the cookie or software is downloaded.[80] Prior law did not specify the timing of the consent and could be interpreted as allowing consent to be made after the download took place. Furthermore, language in recital 66 of the preamble to the amendment states that the methods of providing information and offering the right to refuse the download should be as user-friendly as possible.[81] Recital 66 provides some flexibility by stating that consent may be expressed by the settings of a browser or other application, so that there need not be separate consent for each item downloaded.[82] The language provides some latitude, so it is possible that there could be variation in how each member state incorporates the amendment's requirements into its national law.

B. Proposed Reforms in the U.S.

As of March 2010, there were three paths of possible reform regarding behavioral targeting and the online advertising industry in the U.S.: (1) possible federal legislation, (2) heightened interest in self-regulation as a means of placating a more active Federal Trade Commission, as well as deterring Congress from passing federal legislation, and (3) improved technical measures to provide more effective notice to consumers and better control over their personal information. Each path will be examined.

[79] Council Directive 2009/136, 2009 O.J. (L337) 11.
[80] *Id.* at Art. 2(5).
[81] *Id.* at (66).
[82] *Id.*

1. Possible Federal Legislation:

U.S. Representative Rick Boucher, a Democrat from Virginia who chairs the Energy and Commerce Subcommittee on Communications, Technology and the Internet, has repeatedly stated his intention to introduce a bill to regulate the online advertising industry.[83] The legislation had not been introduced as of March, 2010. An important issue was whether the bill would require advertising companies to obtain consent from consumers before engaging in behavioral targeting, known as "opt-in" consent, or whether behavioral targeting of a consumer would be allowed unless he or she asked that the targeting be stopped, known as "opt-out" consent. Representative Boucher announced that he did not favor requiring consumers to provide opt-in consent before receiving targeted online advertising, but felt that such advertising should be permitted, subject to a consumer right to opt-out.[84] Although opt-out systems can be effective when consumers fully understand the nature of a business practice, as shown by the popularity of opting-out of telephone solicitations by entering a telephone number on the Federal Trade Commission's Do-Not-Call Registry, an opt-out system for behavioral targeting is not likely to be effective as long as consumers remain uninformed about the information that is being collected and how it is used.

2. Self-Regulation: Industry, FTC and Public Interest Group Proposals:

In response to increased interest by Congress and the Federal Trade Commission in curbing abuses connected with online advertising, two industry groups published sets of self-regulatory principles in 2008 and 2009 relating to behavioral targeting. One set was issued by the Network Advertising Initiative,[85] and the other was issued by a group

[83] *See, e.g.,* Angela Moscaritolo, *Behavioral Advertising Bill Being Drafted, available at* http://www. scmagazines.com/Behavioral-advertising-bill-being-drafted/PringArticle/1288 (visited Mar. 18, 2009); Rick Boucher, *Behavioral Ads: The Need for Privacy Protection, available at* http://thehill.com/special-reports/technology-september-2009/60253-behavioral-ads-the-need-for-privacy-protection (visited Mar. 24, 2010); Kenneth Corbin, *Privacy Bill Nears Introduction in House, available at* http://www.esecurityplanet .com/trends/article.php/3861396/Privacy-Bill-Nears-Introduction-In-House (visited Feb. 1, 2010); Ken Hart, *Boucher Makes Plans for Telecom Reform While Ramping Up Re-election Campaign, available at* http://thehill.com/blogs/hillicon-valley/technology/85369-boucher-makes-plans-for-telecom-reform-while-ramping-up-re-election-campaign (visited Mar. 9, 2010).

[84] *See* Mike Shields, *Patrolling Bad Behavior: New FTC Powers, Boucher Bill Could Crimp Web $$, available at* http://www.mediaweek.com/ mw/content_display/news/digital-downloads/booadband/ e3id96098bledsefecd oblo54e6124dc5co (visited Mar. 24, 2010).

[85] Network Advertising Initiative, *2008 NAI Principles: the Network Advertising*

headed by the Interactive Advertising Board.[86] The FTC issued a set of self-regulatory principles[87] in early 2009, which was followed by a fourth set issued by a coalition of ten public interest privacy organizations several months later.[88] Finally, the four sets of principles were evaluated in late 2009 by another public interest organization, the Center for Democracy and Technology.[89]

All four sets of principles exclude contextual advertising from behavioral targeting, and thus exclude from self-regulation any advertising based on a consumer's current visit to a single web page.[90] However, the NAI Principles and IAB Principles exclude too many online activities from their provisions. For example, both sets of principles do not apply to tracking done by an affiliated entity.[91] The Principles from the two industry groups also limit the scope of their reach by taking a simplistic approach in narrowly defining "personally identifiable information" rather than recognizing that self-regulation should apply broadly to any information which can be used to identify, contact or locate an individual.[92]

The four proposals vary considerably with respect to notice. Both the NAI Principles and FTC Principles contain vague wording on mechanisms for providing notice, which presumably could be satisfied by the current practice of including a lengthy, difficult-to-comprehend disclosure somewhere on the website and labeling it as a "privacy policy." Such statements are unlikely to be read, much less understood, by consumers. Moreover, the CDT asserts that the label "privacy policy'

Initiative's Self-Regulatory Code of Conduct, *available at* http://www.networkadvertising.org/networks/2008NAIPrinciples_ finalforWebsite.pdf (visited Mar. 25, 2010) [hereinafter *NAI Principles*].

[86] Interactive Advertising Bureau, et al., *Self-Regulatory Principles for Online Behavioral Advertising, available at* http://www.iab.net/media/file/ven-principles-07-01-09.pdf (visited Mar. 21, 2010) [hereinafter *IAB Principles*].

[87] Federal Trade Commission, *FTC Staff Report: Self-Regulatory Principles For Online Behavioral Advertising, available at* http://www.ftc.gov/os/2009/02/ p085400/ behavioralreport.pdf (visited Feb. 25, 2010) [hereinafter *FTC Report*].

[88] Center for Digital Democracy, Consumer Federation of America, Consumers Union, Consumer Watchdog, Electronic Frontier Foundation, Privacy Lives, Privacy Rights Clearinghouse, Privacy Times, U.S. Public Interest Research Group, The World Privacy Forum, *Online Behavioral Tracking and Targeting: Legislative Primer September 2009*, *available at* http://cdn.publicinterestnetwork.org/assets/s69h7yWnbOJE-V2uGd4w/Online-Privacy---Legislative-Primer.pdf (visited Feb. 25, 2010) [hereinafter *Privacy Group Coalition Principles*].

[89] *See CDT Report on Self-Regulation, supra* note 5.

[90] *See CDT Report on Self-Regulation*, *supra* note 5, 8.

[91] *See CDT Report on Self-Regulation*, *supra* note 5, 9; *NAI Principles, supra* note 85, 4; *IAB Principles, supra* note 86, 10-11.

[92] *See CDT Report on Self-Regulation*, *supra* note 5, 11; *NAI Principles, supra* note 85, 5; *IAB Principles, supra* note 86, 11.

is a misnomer and should be replaced by a more accurate title like "data collection practices."[93] The IAB Principles take a different approach and imply that some sort of notice be given on each web page rather than through a single notice for an entire web site. The Privacy Group Coalition Principles also suggest that notice be provided on each web page. Furthermore, an industry-funded group, The Future of Privacy Forum, has developed an icon consisting of a white, small case letter "i" surrounded by a white circle on a blue background that could be displayed on each online ad. By clicking on the icon, the person viewing the ad would be directed to a page explaining how the advertiser uses his or her online history to send advertising.[94]

With respect to the content of the disclosures, both the NAI Principles and IAB Principles require that consumers be informed of the type of information to be collected, how the information will be used, how it will be transferred and be provided with a link enabling consumers to exercise control.[95] The NAI Principles require additional information including the length of time the information will be retained and the types of personal identifiable information that will be merged with other information.[96] If implemented, these provisions would provide adequate notice for many types of online advertising systems.[97]

As to systems that track all of a consumer's online activity, like those implemented at the internet service provider level, only the FTC and IAB Principles refer to the responsibilities of organizations that track substantially all consumer behavior online.[98] The CDT Report on Self-Regulation goes further than any of the four sets of self-regulatory principles and sets forth three specific standards that should be met: (1) consumers should be provided unavoidable notice and affirmative, express, opt-in consent to such tracking; (2) they should be provided with ongoing notice; and (3) consent should be revocable.[99] A self-regulatory system should follow the broader CDT approach.

With respect to material changes in privacy policies, the NAI Principles allow changes without consent of consumers whose information has already been collected, while the IAB Principles and FTC Principles require affirmative express consent from consumers

[93] *See CDT Report on Self-Regulation*, *supra* note 5, 13.

[94] *See, e.g.,* Stephanie Clifford, *A Little "I" to Teach About Online Privacy*, *available at* http://www. nytimes.com/ 2010/01/27business/media/27adco.html (visited Jan. 27, 2010).

[95] *See CDT Report on Self-Regulation*, *supra* note 5, 17; *NAI Principles, supra* note 85, 7; *IAB Principles, supra* note 86, 12.

[96] *See NAI Principles, supra* note 85, 7.

[97] *See CDT Report on Self-Regulation*, *supra* note 5, 17.

[98] *See CDT Report on Self-Regulation*, *supra* note 5, 18; *FTC Report, supra* note 87, 46; *IAB Principles, supra* note 86, 10.

[99] *See CDT Report on Self-Regulation*, *supra* note 5, 17.

before their information can be used under a changed policy.[100] Clearly, the NAI Principles are insufficient in this respect.

Regarding the principle of consumer consent, the CDT Report on Self-Regulation recommends that each website that collects personal information provide consumers with a clear and easy-to-use method to exercise control over their information, and that control decisions should be persistently honored.[101] The Privacy Group Coalition goes further and recommends that any information collected from consumers should automatically be deleted within twenty-four hours after collection, unless the consumer provides affirmative consent to use the information, which would last for up to three months.[102] The latter recommendation is superior because it gives consumers greater control over their information and is consistent with their expectations as documented in the Turow Report noted above. Opt-out technology needs to be improved. The use of an "opt-out cookie" is unlikely to be effective for very long because it will be deleted the next time the user deletes all cookies, thus allowing more cookies to be placed on the computer's hard drive during subsequent browsing activity. Furthermore, "local stored objects," commonly known at "Flash cookies" which can be placed on a hard drive when a user uses Adobe Flash software to view content online, and can be used for tracking, are not deleted by conventional cookie deletion techniques. The NAI approach to opting-out is deficient because depends on the use of "opt-out cookies."[103] The CDT Report on Self-Regulation takes a much more effective approach by insisting that opt-out methods persistently terminate tracking.[104]

With respect to the principles of access and rectification, the Privacy Group Coalition Principles most closely implement the Fair Implementation Practices. They give the consumer the right to learn whether an organization has information relating to him, the right to learn what the information is, the right to challenge the information, and, if the challenge is successful, the right to have the information corrected or deleted. In addition, they give the consumer an absolute right to delete information relating to him.[105] The CDT Report on Self-

[100] *See NAI Principles, supra* note 85, 9; *CDT Report on Self-Regulation*, *supra* note 5, 18; *FTC Report, supra* note 87, 47; *IAB Principles, supra* note 86, 3.

[101] *See CDT Report on Self-Regulation*, *supra* note 5, 20.

[102] *See Privacy Group Coalition Principles, supra* note 7, 7.

[103] Although NAI's website has a beta version of software that can be added on to a Firefox browser and which protects opt-out cookies from inadvertent deletion, the software only protects those opt-out cookies placed on the Firefox browser and "does not resolve the concerns raised by relying solely on opt-out cookies to protect against tracking." *See CDT Report on Self-Regulation*, *supra* note 5, 21.

[104] *See CDT Report on Self-Regulation*, *supra* note 5, 21.

[105] *See Privacy Group Coalition Principles, supra* note 7, 9-10.

Regulation mentions that Google's Ad Preferences page allows a consumer to see the categories that have been associated with that user for targeting and allows the user to "edit the profile."[106] Although Google reveals the alpha-numeric cookie which has been used for tracking, it does not reveal the underlying information upon which the profile is based.[107] Accordingly, Google's approach does not fully respect the principle of access.

As to the principles of purpose and use, the purpose for which the information is collected should be specified at the time of collection, and it should only be used for that purpose, or for a compatible purpose. Any use for a different purpose should require the consumers' prior affirmative consent. The CDT Report on Self Regulation and the Privacy Group Coalition clearly take this position, but the FTC and the industry groups do not.[108] With respect to transfer of information, the FTC does not address the issue and the NAI and IAB consider transfers only in connection with providing notice of transfers to consumers.[109] The CDT endorses the Privacy Group Coalition position that transfers of personal information are permissible only if specified in advance and only with the consent of the consumer, other than transfers authorized by law.[110] The CDT recommendations in this area most closely implement the Fair Information Practices and should be incorporated into self-regulatory systems.

As to limits on collection, the Privacy Group Coalition takes the most restrictive approach by limiting collection to information relevant to the purpose for which the information is to be used and by providing that it be deleted within twenty-four hours of collection, unless the consumer gives affirmative consent.[111] The CDT views the automatic deletion to be unworkable,[112] but ignores the possibility that online advertisers might successfully adapt to a consent-based system. Consent is one of the most basic principles of the Fair Information Practices and should figure prominently in any self-regulatory system. Moreover, prior consent could be expressed through the settings of a browser or other application, as contemplated in the 2009 amendment to the E-Privacy Directive in Europe.

With respect to the principle of retention, the NAI, IAB and FTC allow retention as long as necessary to fulfill a legitimate business

[106] *See CDT Report on Self-Regulation*, *supra* note 5, 26.
[107] *See CDT Report on Self-Regulation*, *supra* note 5, 27.
[108] *See CDT Report on Self-Regulation*, *supra* note 5, 28, 31.
[109] *See Privacy Group Coalition Principles, supra* note 7, 32.
[110] *See Privacy Group Coalition Principles, supra* note 7, 32.
[111] *See Privacy Group Coalition Principles, supra* note 7, 4, 8.
[112] *See CDT Report on Self-Regulation*, *supra* note 5, 29.

need.[113] The CDT points out that this is too broad and that retention should be only as long as necessary to fulfill the purpose specified at the time the information was collected.[114] The Privacy Group Coalition is more specific and provides retention only for twenty-four hours, unless the consumer gives affirmative consent, in which case, the information can be retained for three months.[115] The three month maximum is consistent with Yahoo's practice of anonymizing user log files after three months.[116] Although retention should relate to the purpose specified at the time of collection rather than to "business need," retention should also be based on consent. Accordingly, the Privacy Group Coalition position is the best approach.

Regarding the principle of data quality, the CDT takes the position that consumer access to the information is the best assurance that the information will be accurate.[117] The CDT endorses the FTC's security guidelines.[118] With respect to accountability, the CDT is skeptical of any purely self-regulatory approach and recommends that any such system be backed up by legislation and FTC enforcement.[119] The CDT agrees with the Privacy Group Coalition's recommendation that compliance reviews be done by an independent auditor and that the results be made public.[120] With respect to enforcement, the NAI and IAB Principles lack specifics, while the Privacy Group Coalition calls for government enforcement actions on behalf of consumers and private rights of action, and for a response to a consumer complaint within 30-days.[121] Clearly, the Privacy Group Coalition has the most effective set of enforcement principles.

Many of the positions taken by the two industry groups fall short of implementing the Fair Information Practices in an effective way. Moreover, the FTC has taken a number of positions that provide less-than-adequate protection for consumers. The Privacy Group Coalition Principles do the best job of implementing the Fair Information Practices and should be incorporated into a self-regulatory system that is backed up by legislation which provides for government and private enforcement.

[113] *See CDT Report on Self-Regulation*, *supra* note 5, 30.
[114] *See CDT Report on Self-Regulation*, *supra* note 5, 30.
[115] *See Privacy Group Coalition Principles, supra* note 7, 7.
[116] *See CDT Report on Self-Regulation*, *supra* note 5, 30.
[117] *See CDT Report on Self-Regulation*, *supra* note 5, 30.
[118] *See CDT Report on Self-Regulation*, *supra* note 5, 30.
[119] *See CDT Report on Self-Regulation*, *supra* note 5, 35.
[120] *See CDT Report on Self-Regulation*, *supra* note 5, 36; *Privacy Group Coalition Principles, supra* note 7, 11.
[121] *See CDT Report on Self-Regulation*, *supra* note 5, 37.

3. Proposals for Improved Privacy Enhancing Technology:

Technology can also help limit unfair information practices. For example, a group at Carnegie Mellon University is working on a project to design software that will learn from the computer user's behavior and then provide short, on-screen messages known as "privacy nudges," informing the user that information about to be sent has privacy implications.[122] Another project at Stanford University takes this idea further by providing the message as a "visceral notice" in a voice and animation that emulates a person.[123] Finally, a computer scientist at Princeton is working on re-engineering a web browser to enable truly anonymous browsing of the Internet.[124] The last approach is the most promising, as it would enable a computer user complete control over behavioral targeting based solely on browsing. The other two proposals might be so annoying that few would use them.

VI. CONCLUSION

Behavioral targeting practices need to be reformed to reflect that consumers value privacy protections for their activity online and expect that those protections will be provided by law. Consumers currently are poorly informed about how information about them is collected online and how it is used. Self-regulation by industry alone is unlikely to be effective because consumers cannot protect themselves from risks they do not understand. The reform of behavioral targeting should be based on full implementation of the Fair Information Practices that have evolved since the 1970s. Policy makers in Congress and the Federal Trade Commission should follow the recommendations of public interest groups because those recommendations tend to implement the Fair Information Practices most effectively, especially with respect to notice, consent and accountability. Consumers need to be provided with effective notice of how information is being collected and used. There needs to be meaningful consent by a consumer before behavioral targeting occurs. Organizations must be held accountable for non-compliance. While self-regulatory systems can be helpful, any such systems must be backed up by effective legal remedies in order to assure that there is meaningful accountability when a member of the online advertising industry fails to comply. Finally, new privacy enhancing technology, like software that permits truly anonymous browsing,

[122] *See* Steve Lohr, *Redrawing the Route to Online Privacy, available* at http://www.nytimes.com/ 2010/02/28/ technology/internet/28unbox.html (visited Mar. 1, 2010)
[123] *Id.*
[124] *Id.*

should be encouraged as another method for consumers to exercise control over how information about them is collected online.

PRACTICALLY PREEMPTING FEDERAL PREDATORY LENDING: A LOGICAL ROADMAP

by JASON H. PETERSON*

It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.[1]

[I]n analyzing whether state law hampers the federally permitted activities of a national bank, we have focused on the exercise of national bank's powers, not on its corporate structure.[2]

INTRODUCTION

Disagreement runs rampant concerning how to remedy the economic meltdown of 2008.[3] There may be some common ground, however, when it comes to identifying the causes.[4] Certainly, questionable practices by lending institutions and lax oversight by government regulators played at least a small part.[5] Critics should think twice, however, before lambasting state efforts to curtail the predatory lending practices of

* Assistant Professor, Suffolk University, Sawyer Business School

1 *New State Ice Co. v. Liebmann*, 285 US. 262, 311 (1932) (Brandeis, J., dissenting).

2 *Watters v. Wachovia*, 550 U.S. 1, 18 (2007).

3 *See* Nick Paumgarten, *The Death of Kings; Notes From a Meltdown*, NEW YORKER, May 18, 2009, at 40.

4 *Id.*

5 Eliot Spitzer, Editorial, *Predatory Lenders' Partner in Crime*, WASHINGTON POST, Feb. 14, 2008; Editorial, *Real Consumer Protection*, NEW YORK TIMES, June 24, 2009, at 28. *See also infra* notes 106-26 and accompanying text.

large lending institutions.[6] The National Banking Act (NBA), the Homeowners Loan Act (HOLA), and subsequent regulations by the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Services (OTS) has preempted state regulations in the predatory lending arena thereby tying the proverbial hands of state regulators.[7]

A single explosive passage from a 2007 United States Supreme Court decision further complicated the preemption conundrum.[8] Not only does the NBA preempt state laws as applied to national banks and their operating subsidiaries but it may also preempt state efforts to regulate the agents of those national banks.[9] The primary purpose of this article is to expose the scope of this challenge by examining case law and ensuing federal regulatory attempts.[10] After providing critical background information, this article will suggest that courts have categorized the preemption analysis as either involving the regulation of a product or an entity. Next, the argument is made that the court shifts its factual analysis depending upon the category.[11] Finally, highly relevant pending bills in the House and Senate are examined.[12]

BACKGROUND

The Dual Banking System

A federal and state component comprises the dual banking system in the United States.[13] Between 1791 and 1836 the First and Second Bank served the country's primary objective of financing government debt.[14] As early as 1819, in *McCulloch v. Maryland*, the United States Supreme Court held that the state of Maryland lacked the constitutional authority to impose a tax on the Second Bank of the United States because the tax would interfere with the establishment of the Second Bank pursuant to the Necessary and Proper Clause of the United States Constitution.[15] Around this time, state legislatures chartered their own

[6] *See infra* notes 69-105.

[7] Posting of Barry Ritholtz, *STUDY: Federal Pre-emption of State Anti-Predatory Lending Laws Led to More Mortgage Defaults*, http://www.ritholtz.com/blog/2009/10/pre-emption-of-state-anti-predatory-lending-laws-led-to-more-foreclosures/ (Oct. 7, 2009, 6:59 EST) (identifying upcoming research report out of University of North Carolina at Chapel Hill).

[8] *See supra* note 2 and accompanying text.

[9] *See infra* notes 69-105 and accompanying text.

[10] *See infra* notes 136-147 and accompanying text.

[11] *See id.*.

[12] See infra notes 148-160 and accompanying text.

[13] COMPTROLLER OF THE CURRENCY ADMINISTRATOR OF NATIONAL BANKS, NATIONAL BANKS AND THE DUAL BANKING SYSTEM 3 (2003) [hereinafter DUAL BANKING SYSTEM].

[14] *Id.*

[15] 17 U.S. 316 (1819).

banks to compete with the First and Second Bank respectively.[16] After President Andrew Jackson disbanded the Second Bank in 1836, the federal government permitted state organizers to incorporate state banks absent a legislative process.[17] The result was a highly fragmented banking system with little consistency from state to state without a federal counterpart.[18]

The Civil War prompted President Abraham Lincoln to establish the national banking system as it exists today.[19] In 1863, Congress passed the NBA and established the OCC as a bureau of the United States Department of Treasury.[20] The OCC examines, supervises, and regulates national banks.[21] The OCC currently regulates close to 1,600 national banks through a set of uniform regulations.[22]

Promoters of the dual system cite several benefits.[23] The flexibility and uniqueness of the state system permits states to develop new and innovative mechanisms for protecting consumers.[24] This benefit operates alongside the fact that protecting the health and safety of consumers is an historic police power largely reserved for the States.[25] For example, commentators have cited the effectiveness of state laws

[16] *See* DUAL BANKING SYSTEM, *supra* note 13.

[17] *Id.*

[18] *Id.*

[19] *See* DUAL BANKING SYSTEM, *supra* note 13.

[20] 12 U.S.C. §§ x-x (2006)

[21] About the OCC, http://www.occ.treas.gov/aboutocc.htm (last visited March 12, 2010). The Home Owners' Loan Act (HOLA) governs in a parallel manner to the NBA as applied to federal savings associations. 12 U.S.C. §§ 1461-1470 (2006). The Operation of Thrift Supervision (OTS) administers the statute in the same manner as the OCC administers the NBA. *Id.* § 1462a. The OTS passed a sweeping regulation sating that the OTS "occupies the entire field" of lending by federal regulations and further delineated specific examples of what state laws were and were not preempted. 12 C.F.R. § 560.2(a) (2006). To avoid the possibility of banks choosing a more favorable regulatory scheme, the Obama administration has proposed eliminating the consolidating and eliminating the OTS. Stephen Labaton, *As U.S. Overhauls the Banking System, 2 Top Regulators Feud*, NEW YORK TIMES, June 14, 2009 (describing conflict between comptroller of the currency and chairwoman of Federal Deposit Insurance Corporation).

[22] Labaton, *supra* note 21.

[23] *See infra* notes 24-25 and accompanying text.

[24] *See* DUAL BANKING SYSTEM, *supra* note 13 at 10. State banks "allow[] the states to serve as laboratories for innovation and change, not only in bank powers and structures, but also in the area of consumer protection." *Id.*, quoting Testimony of Joseph A Smith, Jr., North Carolina Commissioner of Banks, on behalf of the Conference of State Bank Supervisors, before the House Committee on Financial Services, June 4, 2003, available at http://www.csbs.org/AM/Template.cfm?Section=Home&CONTENTID=7049&TEMPLATE=/CM/ContentDisplay.cfm.

[25] *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1986).

regulating the insurance industry as a model for battling predatory lending practices in the banking industry.[26]

The state system permits close relationships between state regulators and the state chartered banks.[27] National banks, on the other hand, operate with uniform standards within national markets.[28] The OCC has specialized expertise tailored to the size of national banks.[29] An increase in the preemption of state laws as applied to national banks would likely result in a migration by national banks to those states in which preemption is more likely.[30] As a result, creative local state regulatory efforts would be less effective.[31]

The OCC's Increasing Focus on Preemption[*]

The OCC has used its power to expand the preemptive effect of the NBA whenever possible.[32] Between 1994 and 2000, the OCC and the OTS preempted state and local laws on 67 occasions.[33] Preempted regulations included efforts to curtail and limit automated teller machine fees, bank insurance sales, funeral trust services, and mortgage taxes.[34] Further, in 2003, the OCC directed national banks to contact the OCC if a state official sought supervisory authority over the bank.[35] The OCC also informed states that national banks do not have to satisfy state laws.[36]

[26] Steven M. Goldman, *States Have a Proper Role in Regulating Insurance*, STAR-LEDGER, May 21, 2009, at 19. "Federal pre-emption of state banking laws prevents New Jersey's predatory lending laws, some of the toughest in the nation, from reaching national and federal savings banks that operate in our state." *Id.* (quoting commissioner of New Jersey Department of Banking and Insurance).

[27] *Id.*

[28] *Id.*

[29] *Id.*

[30] Mark E. Budnitz, *The Federalization and Privatization of Public Consumer Protection Law in the United States: Their Effect on Litigation and Enforcement*, 24 GA. ST. U.L. REV. 663, 674 (2008).

[31] *Id.*

[*] This article focuses upon the OCC. As discussed *infra*, recent regulatory efforts may eliminate the OTS altogether and consolidate its supervisory role over federal savings associations.

[32] *See* Andrew Reardon, Note, *An Examination of Recent Preemption Issues in Banking Law*, 90 Iowa L. Rev. 347, 349 (2004). *But see* Post Cuomo, *Federal Preemption Becomes Top National Bank Issue*, CONSUMER FINANCIAL SERVICES LAW REPORT, July 22, 2009 (describing President Obama's directive to agency heads to limit preemption provisions).

[33] Michelle Heller, AMERICAN BANKER, March 13, 2000, at 2.

[34] *Id.*

[35] OCC Interpretive Letter No. 957 n.2 (Jan. 27, 2003).

[36] Office of the Comptroller of the Currency, Preemption Determination and Order, 68 Fed. Reg. 46, 264 (Aug. 5, 2003).

The criticism of the OCC's preemption obsession reached a fever pitch when the agency oddly interpreted § 92 of the NBA as it pertained to the sale of insurance.[37] Section 92 permits insurance agents of national banks to sell insurance in "any place the population of which does not exceed 5,000 inhabitants, as shown by the last preceding decennial census."[38] Insurance agents had consistently interpreted "place" synonymously with "town."[39] The OCC nonetheless surprised many commentators by interpreting "place" as concentrations of population identifiable by name but unincorporated.[40] The result was a significant broadening of the preemptive scope of the NBA in the insurance industry.[41]

Real Estate Lending

The NBA and several OCC regulations pertain to preemption in real estate lending. The NBA provides that national banks have "all such incidental powers as shall be necessary to carry on the business of banking."[42] The NBA further provides that the OCC may regulate national banks that engage in real estate lending by regulation or order.[43] Section 484 of the NBA limits state attempts to regulate national banks by mandating, "(n)o national bank shall be subject to any visitorial powers except as authorized by Federal law . . . ."[44] In 2004, the OCC defined visitorial powers as including "(i) Examination of bank; (ii) Inspection of a bank's books and records; (iii) Regulation and supervision of activities authorized or permitted pursuant to federal banking law; and (iv) Enforcing compliance with any applicable federal or state laws concerning those activities."[45]

[37] Steven Brostoff, *National Underwriter,* PROPERTY & CASUALTY RISK & BENEFITS MANAGEMENT, March 9, 1998, at 1.

[38] 12 U.S.C.§ 92 (2006).

[39] *See* Brostoff, *supra* note 37.

[40] *Id.*

[41] *Id.*

[42] 12 U.S.C. § 24 Seventh (2006).

[43] *Id.* § 371(a).

[44] *Id.* § 484.

[45] 12 C.F.R. § 7.4000 (2006). Courts have held that the OCC may define "visitorial powers." *Chevron U.S.A Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 844 (1984) (holding deference accorded to administrative agency interpretation). *But see Cuomo Clearing House Ass'n, L.L.C.*, 129 S. Ct. 2710, 2712 (2009) (holding unconstitutional when OCC interpreted "visitorial powers" to include prosecution of enforcement actions in state courts). It is unclear whether the NBA preempts private parties engaging in "visitorial" actions. *Fargo Bank N.A. v. Boutris*, F.3d 949, 964 (9th Cir. 2005) (noting visitorial authority preempts state visitation laws by state officials); *Hood v. Santa Barbara Bank & Trust*, 143 Cal. App. 4th 526, 542 (2006); *Bank of America, N.A. v. McCann*, 444 F. Supp. 2d 1227, 1231 (N.D. Fla. 2006) (holding congress expressly authorized injunction under anti-injunction act).

Courts analyze National Bank's preemption claims of predatory lending laws under the guise of conflict preemption and the analysis is often straightforward.[46] For example, in *Conrad v. Wells Fargo Bank*, a federal district court considered the plaintiff's claim that a "mortgage broker, appraiser and a lender act[ed] together to exploit consumers by persuading them to enter into mortgage loans that are not supported by the value of their homes."[47] The court found that the NBA preempted the unconscionable contract claim because the complaint merely cited an "exploding ARM."[48] Federal regulations clearly permitted national banks to engage in ARM loans regardless of contrary state laws.[49]

Watters v. Wachovia

Conrad suggests that approaching a preemption claim by a national bank consists merely of identifying the basis of the claim and then determining whether federal statute or regulation permits the activity.[50] More often, however, the analysis turns upon the ambiguities within the NBA. In 2007, the United States Supreme Court in *Watters v. Wachovia* set out to resolve whether OCC regulations preempted Michigan state laws.[51] Wachovia, a national bank offered real estate lending services in Michigan through a wholly owned operating

[46] The United States Constitution provides that "the Laws of the United States . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, cl. 2. Express preemption arises when (1) Congress explicitly states that federal law preempts state law; (2) Congress regulates so extensively that it is reasonable to infer that Congress did not leave any room for state regulation; and (3) when state law conflicts with federal law. *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25, 31 (1996). Conflict preemption arises when it is impossible to comply with both federal and state law or when state law obstructs the congressional intent of federal law. *United States v. Locke*, 529 U.S. 89, 109 (2000). Courts frequently refer to conflict preemption to "frustrating the purpose of the federal scheme." *Barnett Bank*, 517 U.S. at 31.

[47] *Conrad v. Wells Fargo Bank, N.A.*, No. 3:08-0829, 2009 U.S. Dist. LEXIS 211, at *1 (S.D.W.V. Jan. 5, 2009).

[48] *See id.* at *6. The court noted, however, that the claim may have survived had the plaintiff asserted that the defendants failed to consider the ability of the plaintiff to repay the loan. *Id.* The court further found that the predatory lending and "skimming" claims were not preempted because "[n]o federal law permits a national bank to misrepresent to borrowers the nature of its charges." *Id.* at *5-*6, quoting *Watkins v. Wells Fargo Bank, N.A.*, No. 3:08-cv-00132, 2008 U.S. Dist. LEXIS 47834, at *26 (S.D.W.V. June 19, 2008).

[49] *Conrad*, 2009 U.S. Dist. LEXIS at *5-*6. "A national bank and its subsidiaries may make, sell, purchase, participate in, or otherwise deal in ARM loans and interests therein without regard to any State law limitations on those activities." 12 C.F.R. § 34.21(a) (2006)

[50] *See supra* notes 47-49 and accompanying text.

[51] 550 U.S. 1 (2007).

subsidiary.[52] Michigan officials sought to enforce a state requirement that subsidiaries of national banks that engage in mortgage lending and services register with the Office of Financial and Insurance Services.[53]

The certified issue was whether the OCC was entitled to *Chevron* deference when it passed 12 C.F.R. § 7.4006 which stated, "[s]tate laws apply to national bank operating subsidiaries to the same extent that those laws apply to the parent national bank."[54] *Chevron* deference is the rule that administrative agencies receive broad deference when interpreting their own enabling legislation.[55] There was little doubt that 12 C.F.R. § 7.4000 would preempt the state's attempt to regulate Wachovia itself.[56] Most commentators had expected the Court to side with Wachovia because of recent trends favoring preemption and thus the Court's decision was not particularly noteworthy.[57]

The reasoning was noteworthy, however, because the Court declined to consider the *Chevron* deference argument concerning § 7.4006 and the definition of "visitorial" powers in § 7.4000. Instead, the Court looked no further than § 24 (Seventh) of the NBA and noted that the use of operating subsidiaries to engage in real estate lending was consistent with the national bank's incidental powers.[58] The opinion's concluding passage, "in analyzing whether state law hampers the federally permitted activities of a national bank, we have focused on the exercise of a national bank's *powers*, not on its corporate structure," formed the basis of an extension of the reasoning in *Watters* to the preemption of state regulations as applied to the agents of national banks.[59]

Agents of National Banks

Courts have historically permitted banks to operate through the use of agents.[60] In 1933, the Supreme Court of Nebraska noted that "[n]or do we deem that the rights of the parties to this litigation . . . are in any manner modified or impaired by the fact that the defendant bank chose

[52] *Id.* at 7.
[53] *Id.* at 8.
[54] *Id.* at 7.
[55] *Chevron U.S.A. v. Natural Resources Defense Council*, Inc., 467 U.S. 837 (1994).
[56] *See supra* note 45 and accompanying text.
[57] *See Searching for Chevron in Muddy Watters: The Roberts Court and Judicial Review of Agency Regulations*, 60 ADMIN. L. REV. 1 (2008).
[58] *See supra* note 42 and accompanying text.
[59] *See supra* note 2 and accompanying text.
[60] Christopher Peterson, *Preemption, Agency Cost Theory, and Predatory Lending by Banking Agents: Are Federal Regulators Biting Off More Than They Can Chew?*, 56 AM. U.L. REV. 515, 526-27 (2007). The cornerstone of agency law is predicated upon the relationship of three parties. Agency arises involves a willing relationship in which one party, the agent, acts on behalf of the other with the power to control the rights of the principal. RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt c. (2006).

to act in the transaction through . . . [an] agent . . . . instead of employing its corporate name."[61] The NBA, and federal regulations and court decisions interpreting the NBA, have further permitted national banks to operate through agents.[62] Federal regulations have specifically permitted national banks to use agents to market automobile loans and to sell money orders.[63]

In *Cades v. H.R. Block*,[64] the Fourth Circuit noted that the Supreme Court has permitted national banks to use agents to market credit cards to customers at the rate of the state in which the national bank resides.[65] *Cades* is closely aligned with *Pacific Capital Bank, N.A. v. Blumenthal* discussed *infra* because both include national banks offering Refund Anticipation Loans (RALs) through an in state agent.[66] Unlike *Pacific Capital*, however, the court in *Cades* did not address whether the NBA preempted the state law claims against the bank's agent.[67] Instead the court merely considered whether removal jurisdiction to the federal district court was proper.[68]

Recent Case Law

Since *Watters*, several circuit courts have wrestled with the scope of "power versus structure" as it pertains to the NBA and the preemption of agents.[69] The argument in each case is similar; the court should focus

[61] *Lincoln Joint Stock Land Bank v. Bexten*, 125 Neb. 310, 319 (1933). In *Bexten*, the court held that a bank was bound to a contract even though it was merely an undisclosed principle. *Id.* at 320.

[62] 12 U.S.C. § 24 (Seventh). *See also Sorensen v. Citizens' State Bank*, 126 Neb. 756, 761 (1934); *Perry v. Gore*, 56 P.2d 1142, 1143 (Or. 1936) (upholding wife of bank president acting as agent of national bank in holding pledged property on behalf of bank); *Dupree v. First Nat'l Bank of Merkel*, 146 S.W. 608, 612-13 Tex. App. 1912) (holding national bank vested apparent authority in agent who sold mortgagor's cattle thereby making bank liable in buyer's lawsuit).

[63] 66 Fed. Reg. 28, 593 (May 23, 2001); 12 C..F.R. § 7.1014 (2006).

[64] 43 F.3d 689 (4th Cir. 1994).

[65] *See Cades v. H & R Block*, 43 F.3d 689, 873 (4th Cir. 1994) (considering similar question for Refund Access Loans), *citing Marquette Nat'l Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299 (1978). The court in *Cades*, however, merely addressed preemption of South Carolina state law in the context of removal jurisdiction. *Cades*, 43 F.3d at 872. Further, in *Marquette*, the party soliciting was not only an agent of a national bank but was also a wholly owned subsidiary. *Marquette*, 439 U.S. at 302.

[66] *Id.* at 872. *See also infra* notes 86-95 and accompanying text.

[67] *See infra* note 68 and accompanying text.

[68] *Id.* at 872-74.

[69] *See Pacific Capital Bank, N.A. v. Connecticut*, 542 F.3d 341 (2d Cir. 2008); *SPGGC, LLC v. Ayotte*, 448 F.3d 525 (1st Cir. 2007)(affirming valid preemption claim on both expiration dates of gift cards and fees); *SPGGC, LLC v. Blumenthal*, 505 F.3d 183, 190 (2d Cir. 2007) (reversing and holding valid preemption claim on expiration dates of gift cards but not fees). *See also State Farm Bank, FSB v. Reardon*, 539 F.3d 336 (6th Cir. 2008)

on the restriction of the national bank's powers as enumerated in the NBA and not on the structure of the bank.[70] The two most prominent contexts in which the court has addressed this issue are gift cards and RALs.[71]

Gift Cards: National banks often issue bank-issued gift cards in which networks such as Visa and MasterCard support redemption of the card.[72] Customers may use the gift cards at any retailer that accepts debit cards over the network.[73] In *SPPGC, LLC v. Blumenthal*,[74] the United States District Court for the District of Connecticut allowed the Connecticut Attorney General's motion to dismiss after SPGGC sued to prevent the enforcement of state consumer protection laws geared towards bank-issued gift cards. The Connecticut law prohibited inactivity fees and expiration dates as part of any gift card program.[75] SPPGC, while neither a national bank nor an operating subsidiary of a national bank, was acting as an agent of Bank of America (BoA) by selling the BoA issued cards. SPPGC generated revenue through the fees it collected including several upfront fees at the time of purchase from the customer.[76]

SPGGC argued on appeal that because the gift card was a "national bank product" the NBA and the corresponding language in *Watters* preempted the state law.[77] The Second Circuit conceded that a National Bank which chooses to utilize a third could amount to a national bank exercising its incidental powers but the court noted that "it does not follow that a state's attempt to regulate the third party's conduct is necessarily preempted at it would be if directed toward the bank itself or toward an operating subsidiary."[78] The court further distinguished the operating subsidiary in *Watters* from the mere agency relationship between BoA and SPGCC.[79] Nonetheless, the court reversed the trial court and held that there was a valid claim for preemption regarding the

(reversing district court and holding Home Owners' Loan Act and OTS regulations preempt state registration requirements of federal savings association's exclusive agents).

[70] *Id.*

[71] *Ayotte*, 448 F.3d at 527; *Blumenthal*, 505 F.3d at 183.

[72] *Ayotte*, 488 F.3d at 527.

[73] *Id.*

[74] 408 F. Supp. 2d 87 (D. Conn. 2006).

[75] *Blumenthal*, 505 F.3d at 186. *See also* CONN. GEN. STAT. §§ 3-65c, 42-460 (2007).

[76] *Blumenthal*, 505 F.3d at 187. While, SPPGC sold the cards, all agreements identified Bank of America as the issuer and property owner. *Id.*

[77] *See id.* at 189. The lower court had found that SPGGC's close agency relationship with BoA was not analogous to the subsidiary relationship in *Watters*. 408 F. Supp. 2d at 95.

[78] *Blumenthal*, 505 F.3d at 190.

[79] *Id.* Unlike operating subsidiaries, the NBA fails to recognize any special status of agents. *Id.* The NBA defines national bank affiliates as distinguished from operating subsidiaries. 12 U.S.C. § 221a(b).

limitation on expiration dates because the OCC has expressly authorized National Banks to offer "electronic stored value systems."[80] Further, the court supported SPGCC's argument that expiration dates were necessary for BoA to participate in the Visa payment network.[81] The court, however, upheld the lower court's finding that the NBA had not preempted the law restricting inactivity fees.[82]

The same issue was before the First Circuit Court of Appeals in *SPGGC LLC v. Ayotte*.[83] In *Ayotte*, the court affirmed the district court's grant of summary judgment in favor of the issuer national bank on preemption of both fees and expiration dates.[84] Of note, the primary distinction between *Blumenthal* and *Ayotte* on the issue of the fees was two-fold: (1) the contractual relationship in *Ayotte* was between the consumer and the banks; and (2) SPGCC received quarterly commissions from the bank without receiving any revenue directly from the consumer.[85]

RALs: The other context in which courts have addressed the identical agency argument is RALs.[86] A RAL arises when a lender bank makes a loan to a taxpayer around the time the taxpayer files his income tax return.[87] The taxpayer receives his refund early minus the interest retained by the bank and the fee passed along from the bank to the third party that prepares the loan documents.[88] The lender bank expects repayment directly from the taxpayer's return.[89]

In *Pacific Capital Bank, N.A. v. Blumenthal*,[90] the Second Circuit held that the NBA preempted a Connecticut law that sought to limit the

[80] *See* 12 C.F.R. § 7.5002(a)(3)(2006); *Blumenthal*, 505 F.3d at 191.

[81] 505 F.3d at 191.

[82] *Id.* This was because inactivity those fees only affected the conduct of SPGGC and not BoA. *Id.*

[83] 488 F.3d 525 (1st Cir. 2007). The New Hampshire consumer protection statute allowed neither expiration nor administrative fees for gift certificates. N.H. Rev. Stat. § 358-A:2.

[84] *Id.* at 527. The decision focuses upon preemption as applied to U.S. Bank pursuant to the National Banking Act and the OCC Regulations and Metabank pursuant to the HOLA and OTS regulations. *Id.*

[85] 443 F. Supp. 2d 197 (D.N.H. 2006). *See also* 488 F.3d at 529, 534. Simon does not receive fees from the customer but instead receives a commission from the bank. *Id.* at 529. The bank and not Simon services the card and Simon plays no part in setting the terms and conditions of the contract between the bank and the consumer. *Id.*

[86] *Pacific Capital Bank, N.A. v. Connecticut*, 542 F.3d 341 (2d Cir. 2008) (affirming summary judgment to national bank on issue of preemption); *Pacific Capital Bank, N.A. v. Milgram*, No. 08-0223, 2008 U.S. Dist. LEXIS 19639 (D.N.J. March 12, 2008).

[87] *Id.* at 345.

[88] *Id.*

[89] *Id.*

[90] 542 F.3d 341 (2d Cir. 2008)

interest "facilitators" charge for RALs within the state.[91] The law placed a ceiling of sixty percent for the first twenty-one days of the loan and twenty percent for the balance of the loan.[92] The statute further established a fine on those facilitators of RALs who violate the statute.[93] Section 85 of the NBA, however, allows national banks to charge the interest allowed in the state in which the bank is located regardless of any limitations in another state.[94] The court reasoned that while it would be possible for a national bank to offer RALs without facilitators, thereby complying with the statue, "losing the assistance of facilitators would pose a significant obstacle to the offering of RALs by national banks . . . ."[95]

Predatory Lending: The most analogous case arose in 2008 when the Sixth Circuit considered "power versus structure" in the context of predatory lending.[96] State Farm Bank, a federal savings association,[**] marketed financial products through independent contractors licensed by State Farm Mutual.[97] State Farm sought to offer first and second mortgages and home equity lines of credit to Ohio homeowners.[98] Ohio state law required non-employees of depository institutions to maintain a state mortgage brokerage license.[99] The agents assisted customers

[91] *Id.* 344. Pacific, a national bank, offered RALs in Connecticut by using third-party tax preparers. *Id.* at 345. Pacific made the sole decision regarding the approval of a RAL and it would deduct the interest and fees and it would forward the fees to the third party and the balance to the taxpreparer. *Id.* The lower court awarded summary judgment to Pacific on preemption grounds finding that there was a conflict between the terms of the Connecticut statute and the NBA. *Pac. Capital Bank, N.A. v. Connecticut*, 2006 U.S. Dist. LEXIS 55627, at *3 (D. Conn. Aug. 10, 2006).

[92] *Id.* at 346. CONN. GEN. STAT. §§ 42-480(d) (2007).

[93] CONN. GEN. STAT. § 42-480(e) (2007). Facilitators are persons "who individually, or in conjunction or cooperation with another person, makes a refund anticipation loan, processes, receives or accepts for delivery an application for a refund anticipation loan, issues a check in payment of refund anticipation loan proceeds or in any other manner acts to allow the making of a refund anticipation loan. . . ." Id. § 42-480(a)(2)

[94] 12 U.S.C. § 85 (2006).

[95] *Pacific Capital Bank*, 542 F.3d at 354.

[96] *State Farm Bank,* 539 F.3d at 338.

[**] Unlike the cases discussed *supra*, which involved the NBA and subsequent regulations passed by the OCC, *State Farm* involved the Home Owners Loan Act (HOLA) and corresponding regulations passed by the Office of Thrift Services (OTS).

[97] *State Farm Bank,* 539 F.3d at 339. State Farm Mutual owned State Farm Bank. *Id.* Each agent had an exclusive contractual relationship with State Farm Bank. *Id.* The decision does not address a situation in which a federal savings association has contracted with non-exclusive, untrained, and unsupervised individuals, over whom it has no control for the products . . . ." *Id.* at 347 n.6.

[98] *Id.* at 339.

[99] *Id.* at 339-40; OHIO REV. CODE § 1322.01 (2008).

with the paperwork and forwarded the paperwork to State Farm Bank whose employees made all pertinent lending decisions.[100]

OTS regulations provide broad preemptive powers and in 2004, the OTS issued an opinion letter stating that the OTS had oversight authority not only over State Farm Bank but also over its exclusive agents.[101] Naturally, Ohio officials argued that § 560.2 of the regulations made no mention of extending preemption to the agents of Federal Savings Associations.[102] The court, however, citing *Watters*, noted that the focus is on the powers of the national bank and "not on whether the entity exercising that power is the bank itself."[103] The court further noted that HOLA mandates that the OTS have oversight and control over State Farm's exclusive agents.[104] As noted in the case, however, the exclusive nature of the agency relationship between the State Farm and its agents was critical.[105]

The Current Crisis

National banks and federal savings associations and their respective operating subsidiaries (the preempted banks) have contributed to the recent economic crisis.[106] A recent study by the National Consumer Law Center reported that in 2006, the preempted banks accounted for 31.5 percent of the sub prime loan market.[107] Further, the preempted banks

[100] *Id.* State Farm Bank administered training for all agents. *Id.*

[101] *Id.* at 340. OTS regulations provide in part that "the OTS hereby occupies the entire field of lending regulation for federal savings associations. OTS intends to give federal savings associations maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation. Accordingly, federal savings associations may extend credit as authorized under federal law, inducing this part, without regard to state laws purporting to regulate or otherwise affect their credit activities . . . ." 12 C.F.R. § 560.2 (2006).

[102] *Id.* at 345.

[103] *Id.*

[104] *State Farm Bank,* 539 F.3d at 346-47. *See also* 12 U.S.C. § 1464(d)(7)(D) (2006); 12 U.S.C. § 1464(d)(1)(B)(ii) (2006). The court made light of the Superintendent's argument that State Farm could merely alter its business model to comply with the statute. *State Farm Bank,* 539 F.3d at 348.

[105] *Id.* at 347 n.6.

[106] Lauren K. Saunders, *Preemption and Regulatory Reform: Restore the States' Traditional Role as "First Responder"*, NATIONAL CONSUMER LAW CENTER, Sep. 2009, at 11. The well-known harmful characteristics of sub prime loans include relaxed income documentation, exploding rates, and inflated appraisals. *Id.* But see Edward Yingling, *Who's to Blame for the Sub prime Mess*, WASHINGTON POST, Jan. 31, 2008, at 20 (noting Representative Barney Frank's opinion that mortgage brokers and not national banks responsible for sub prime lending).

[107] *Id.* This amounts to $190 billion. *Id.*

accounted for 40.1 percent of the Alt A loan market and 51 percent of the interest only loan market.[108]

Several suspicious characteristics of the mortgage process engaged in by the preempted banks were immune to state law.[109] For example, in some instances state regulators sought to cap excessive interest rates and those efforts were preempted.[110] State regulators also attempted to limit the up-front fees lenders charged and then added to the loan.[111] Occasionally, state regulators sought to prohibit balloon payments that required homeowners to repeatedly refinance thereby stripping any equity in the home.[112]

Regulatory Reform

Secure and Fair Enforcement Mortgage Licensing Act (SAFE): In the wake of housing market collapse, the legislature passed the Housing and Economic Recovery Act (HERA).[113] On several previous occasions legislators had failed to legislate SAFE, but they successfully included it in Title V of HERA. SAFE mandated that the Conference of State Bank Supervisors (CSBSS) and the American Association of Residential Mortgage Regulators (AARMR) develop a National Mortgage Licensing System and Registry (NMLSR).[114] Improving consumer protection and rooting out fraud are the chief objectives of SAFE.[115]

SAFE requires that loan originators register as either state-licensed loan originators or as registered loan originators if the loan originator is an employee of a federally insured depository.[116] Upon registering as state-licensed loan originators, states must conduct extensive background checks and qualify applicants through an education and

[108] *See* Saunders, *supra* note 106 at 12.The total value here was $161 billion. *Id.* Alt. A fall between a prime loan and a sub prime loan and have significant foreclosure rates.

[109] *See infra* notes 110-112 and accompanying text.

[110] *See* Saunders, *supra* note 106 at 13.

[111] *Id.*

[112] *Id.*

[113] See 110 Pub. L. No. 110-289, 122 Stat. 2654 (codified as amended at 12 U.S.C. §§ 1501-1507).

[114] 12 U.S.C. § 1502. The idea is that each organization will represent the interest of the banks and the states.

[115] *Id.* The nine other objectives include: (1) licensing requirements; (2) improving communication between regulators; (3) improving efficiency within the regulatory process; (4)improving the public's access to information; (5) implementing training and examination requirements; and (6) centralizing consumer complaints. *Id.*

[116] 12 U.S.C. § 1504. A loan originator is. *Id.* § 1502. There is some confusion regarding the limit of who is a "loan originator" because the Model State Law removed the "and" and substituted it with "or" thereby expanding the definition. MORTGAGE SERVICING NEWS, July 2009, p. 3

testing program.[117] The United States Department of Housing and Urban Development (HUD) must approve each state system and each state must have had its system in place by August 1, 2009.[118] States must license previously licensed loan originators by January 1, 2011 and states must register remaining loan originators by July 1, 2010.[119] Simultaneously, SAFE mandated that federal banking agencies develop a separate system for registering employees of federally insured depositories as registered loan originators.[120]

Banking Reform: President Barrack Obama took office in 2009 amid an historic financial meltdown and promised to reform Wall Street and the banking industry.[121] Both President Obama and the Congressman Barney Frank, Chairman of the House Financial Services Committee, criticized the banking business model and suggested that banks change their business goals.[122] President Obama called for the creation of a super consumer protection agency.[123] The President also called for allowing states to enact and enforce stricter laws against federally chartered companies including national banks.[124] Finally, he suggested eliminating several regulatory agencies including the OTS and perhaps the OCC.[125]

[117] 12 U.S.C. § 1505.

[118] *Id.* § 1508. As of August 5, 2009, only Minnesota had failed to either pass or enact legislation. *See* State SAFE Act Legislative Tracking, Conference of State Bank Supervisors, http://www.csbs.org/AM/Template.cfm?Section=SAFE_Act&Template=/CM/ContentDisplay.cfm&ContentID=21784website (last visited Jan. 5, 2010) (Noting state legislative progress in complying with S.A.F.E. as reported on CSBS website). States passed laws quickly to meet the deadline. *48 States Meet SAFE Act Deadline*, NATIONAL MORTGAGE NEWS, Aug. 17, 2009, at 11.

[119] 12 U.S.C. § 1508. The loan originator must have received its prior license by July 1, 2009 pursuant to a state regulatory scheme that had been in place prior to July 31, 2009. *Id.*

[120] *Id.* § 1503. Registered mortgage loan originators do not require a state license. *See* e.g. MASS GEN LAWS ch. 255F, § 1 (2009). Registered loan originators satisfy the definition of a loan originator and are an employee of either a depository institution or an employee of a depository institution. Id. § 1.

[121] *See infra* notes 122-124 and accompanying text.

[122] Joe Noccera, *'Nice' Wasn't Part of the Deal*, NEW YORK TIMES, Aug. 1, 2009. (explaining country's anger with large banks). Frank and President Obama critiqued bank's failure to change its shareholder first model and not acting to benefit those taxpayers who funded government bailouts. *Id.*

[123] Editorial Desk, *Real Consumer Protection*, NEW YORK TIMES, June 24, 2009, at 28 (touting President Obama's plan); Cheyenne Hopkins, *States Would Help New Agency Protect Consumer*, AMERICAN BANKER, June 18, 2009, at 1.

[124] *See* Hopkins, *supra* note 123, at 1.

[125] *Id.*

In December 2009, the House of Representatives passed the Wall Street Reform and Consumer Protection Act.[126] The bill echoed the President's agenda of creating a new federal consumer protection agency.[127] Two components of the bill pertained to preemption. First, the bill permits the OCC to preempt state laws that "prevent[] or signifigantly interfere" with the business of banking.[128] This would effectively eliminate the regulations passed by the OCC in 2004 that sought to define visitorial powers.[129] Second, section 4407 of the bill specifies, "[s]tate consumer financial law shall apply to a subsidiary or affiliate of a Federal savings association to the same extent that the State consumer financial law applies to any person [or] corporation."[130]

In March 2010, the Senate Banking Committee passed the Restoring American Financial Stability Act.[131] The Committee's approach to preemption differed slightly from the House bill because it directed courts to apply the standard outlined in a 1996 United States Supreme Court in determining whether the OCC can preempt state laws.[132] This is case-by-case basis analysis requires the court or the OCC to make an official ruling prior to a national bank ignoring a state law.[133] The Banking Committee bill, however, also calls for the reversal of the holding in *Watters* that preemption applies to operating subsidiaries to the same extent as national banks.[134]

[126] H.R. 4173, 111th Cong. (2009).

[127] Brady Dennis, *House Votes 223 to 202 to Approve Sweeping Bill to Overhaul Financial Regulatory System*, WASHINGTON POST, Dec. 12, 2009, at A01.

[128] Stacy Kaper, *House Deal Bolsters Defense of Preemption*, AMERICAN BANKER, Dec. 11, 2009, at 1.

[129] *Id. See also supra* note 45 and accompanying text.

[130] H.R. 4173, 111th Cong., § 4407(f).

[131] S. ___, 111th Cong. (as passed by S Comm. On Banking, Housing, & Urban Affairs, March 22, 2010). The bill calls for the elimination of the OTS with the OCC and the Federal Reserve dividing oversight of federal thrifts. Sen. Comm. On Banking, Housing, and Urban Affairs, Summary: Restoring American Financial Stability, at 5. It also calls for an a new Consumer Financial Protection Bureau inside the Fed thereby permitting President Obama to appoint its director allowing the oversight council to second guess its decisions. *The Hand of Dodd; Financial Reform in America*, THE ECONOMIST, March 20, 2010.

[132] Cheyenne Hopkins, *From Bad to Worse; OCC Sees Flaws in Dodd Bill; Preemption Process Would be Complex, More Burdensome*, AMERICAN BANKER, March 18, 2010, at 1.

[133] *Id.*

[134] S. ___, 111th Cong., § 1536C(f).

ANALYSIS

Suggested Approach

The case law cited *supra* suggests that courts categorize the regulatory attempts by states towards the agents of preempted banks as being attempts to regulate either products or entities.[135] If the state is regulating a product, the factual analysis by the court turns upon the relationship between the third party and the agent and between the third party and the principal. On the other hand, if the state is regulating an entity, the court's analysis focuses upon the relationship between the principal and the agent.

Product: In the *Blumenthal* and *Ayotte* cases, the state consumer protection laws clearly pertained to Gift Cards and reflected the state's attempt to regulate that product. In *Blumenthal*, the court emphasized that SPGGC as the agent had received fees directly from the consumers.[136] The court further noted that BoA as the principal had reviewed the gift card application from the consumer without any input from SPGGC.[137] The court also noted that the contract clearly delineated that the contractual relationship was between BoA and the consumers.[138] In *Ayotte*, on the other hand, the court noted that SPGGC did not receive any fees from the consumer and instead received the fees from the bank.[139] In *Pacific Capital*, the product at issue was RALs.[140] The court emphasized that consumers received refunds directly from Pacific and not from the tax preparer and that Pacific was the sole party to approve the application.[141]

These factors were critical to the decision in each of these cases. For example, in *Ayotte*, where the consumer received fees from the bank and not the consumer, the court upheld preemption where it did not in *Blumenthal*.[142] Therefore, it appears that if the state is attempting to regulate a product, the court will focus upon the relationship between the agent and the third party and the principal and the consumer.[143] While not articulated by the courts, the reasoning is sound because if the state is regulating a principal's product dealt through a third party

[135] *See infra* notes 136-147 and accompanying text.
[136] Blumenthal, 505 F.3d at 187.
[137] *Id.*
[138] *Id.*
[139] Ayotte, 488 F.3d at 529.
[140] *See supra* notes 86-89 and accompanying text.
[141] Pacific Capital Bank, 542 F.3d at 345.
[142] *See supra* note 82 and accompanying text.
[143] *See supra* notes 136-141 and accompanying text.

agent, the consumer's relationships are critical to determine whether the principal or the agent is more "connected" to the product at issue.

Entity: In other cases, the state appears to regulating an entity.[144] In those cases, the court turns its focus to the relationship between the principal and the agent. For example, in *Watters*, the Court focused on the nature of nature of the relationship between Wachovia and its operating subsidiary and very little attention was placed upon the relationship between the subsidiary and Michigan consumers.[145] Further, in *State Farm Bank*, the court emphasized that State Farm's independent agents had exclusive agreements with State Farm.[146] The agents had to satisfy training and educational requirements established by State Farm.[147] Once again, the analysis is sound because if the state is attempting to regulate an entity and not a product, the closeness of the relationship between the preempted banks and their agents is critical.

Impact of Recent and Impending Regulations

The court in *State Farm* acknowledged that SAFE may render the court's decision moot.[148] Pursuant to SAFE, *employees* of federally insured depositories must register as registered loan originators under the federal program.[149] Because the exclusive agents in *State Farm* were not employees of State Farm Bank, the requirements to register under the state's system would not be preempted.[150] However, there is no single definition of "employee" compared to "independent contractor" and both the OTS and the OCC are free to define "employee" under SAFE either narrowly or broadly.[151] In fact, during congressional

[144] *See supra* notes 96-100 and accompanying text.

[145] Watters, 550 U.S. at 7.

[146] State Farm Bank, 539 F.3d at 339.

[147] *Id.*

[148] *State Farm Bank*, 539 F.3d at 338 n.1.

[149] *See supra* note 120 and accompanying text (emphasis added). SAFE will result in many employees and exclusive agents shall require licensing for the first time. *See S.A.F.E. Mortgage Licensing Act: Industry Concerns Regarding State Implementation*, AMERICAN FINANCIAL SERVICES ASSOCIATION, Sept. 10, 2008, at 3, http://www.afsaonline.org/CMS/fileREPOSITORY/SAFE%20Act%20-%20Background%20and%20Industry%20Concerns%20sept%2010%202008%20(6).puff

[150] *See supra* note 117 and accompanying text.

[151] *See* Stefan L. Jouret, *Provision May Spark a Preemption Fight*, AMERICAN BANKER, Oct. 10, 2008, 1. *But see* Frequently Asked Questions, United States Department of Housing and Urban Development, at 1 http://www.hud.gov/offices/hsg/ramh/safe/safeactfaq.pdf (last visited January 11, 2010)(communicating HUD's views concerning the SAFE Act). HUD opined that "[a]n individual is generally considered to be an employee only if the manner and means of his or her performance of duties is subject to the control of an employer, and if his or her income is reported on a W-2 form." *Id.* at 4. A further ambiguity noted by HUD is whether the definition of a loan originator encompasses those

hearings, Congressman Jim Marshall confirmed that both the OTS and the OCC would have the authority to define "employee" under SAFE.[152] Consistent with the OCC's recent emphasis on broadening the scope of preemption, it would not be surprising to see the agency define employee in such a way that it might encompass more than a traditional definition might otherwise.[153]

The bills passed by the House and the Senate Banking Committee, however, would change the landscape altogether. Preemption rules would neither apply to operating subsidiaries nor to agents by analogy.[154] The likelihood, however, of either bill becoming law is questionable at best. For example, sweeping compromises have already gutted the House bill.[155] These concessions concerning preemption suggest that there may be more concessions further weakening President Obamba's broad agenda as the bill moves into the Senate.[156]

The Senate Banking Committee bill passed along party lines in committee and Republicans declined to offer any previously proposed amendments.[157] Republican and democrat leaders agreed to continue working towards a compromise but analysts have suggested that it is unlikely that the bill will ever pass.[158] The OCC and banking analysts have roundly criticized the legislature's reversal of *Watters* decision

who perform loan modifications. *Id.* The Internal Revenue Service (IRS) suggests three factors including behavior control, financial control, and the relationship between the parties but even that classification is often unclear. *See* Payroll Manager's Letter, New Bill Targets "Misclassified" Workers. For example, Section 530 of the under the Tax Code permits employers to treat those who fit the definition of employee as independent contractors in limited circumstances. *Id.* The employer may treat the employee as an independent contractor if the employer has done so since 1978 and if the employer has filed tax returns on that basis. Id. The employer further needs to have a reasonable basis for treating the employee as an independent contractor consistent with the definition of a "safe haven." *Id.*

[152] *See* 110 CONG. REC. H6997, (July 23, 2008) (statement of Cong. Frank). Congressman Frank responded, "[n]othing in this title changes existing Federal law with respect to the authority of the Office of Thrift Supervision and the Office of the Comptroller of Currency's preemptive authority and their right to regulate and oversee depository institution's products and services marketing and distribution system, and they do obviously have definitional authority under this legislation." *Id.*

[153] *See supra* notes 32-40 and accompanying text.

[154] *See supra* notes 130, 134 and accompanying text.

[155] Stacy Kaper, *House Deal Bolsters Defense of Preemption*, AMERICAN BANKER, Dec. 11, 2009, at 1. Since the bill's introduction in September, the House Financial Services Committee had already agreed to allow the OCC to preempt "on a case by case basis." *Id.*

[156] Stacy Kaper, *Reg Reform: Concession Time's Only Just Begun*, AMERICAN BANKER, Dec. 14, 2009, at 1.

[157] Stacy Kaper, *Panel Passes Reform; Now For the Real Heavy Lifting*, AMERICAN BANKER, March 23, 2010, at 1.

[158] *Id.*

because of the large number of national banks that have mortgage companies within their operating subsidiaries.[159] The administration has promised not to accept a bill that is too watered down absent real reform and consumer protection.[160]

CONCLUSION

This article has revealed emerging case law that extends the preemption of state predatory laws to the mere agents of national banks. Through a careful and thoughtful analysis of the court's reasoning in those cases, it appears that courts designate the regulatory attempts as being directed towards either products or entities. The court shifts its analysis depending upon the characterization of the regulatory attempt. Further, the recent bills discussed *supra* that were enacted in both the House and the Senate would drastically impact preemption as applied to those agents. The status of those bills, however, is uncertain at best. The same can be said for the state's role in battling predatory lending.

[159] Cheyenne Hopkins, *From Bad to Worse; OCC Sees Flaws in Dodd Bill; Preemption Process Would be Complex, More Burdensome*, AMERICAN BANKER, March 18, 2010, at 1.
[160] *See* Kaper, *supra* note 157.

GRUMBLING, RETALIATION AND THE FAIR LABOR STANDARDS ACT: *KASTEN v. SAINT-GOBAIN PERFORMANCE PLASTICS CORP.*

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

I. INTRODUCTION

> I asked the Mayor of Gary about the 12-hour day and the 7-day week.
>
> And the Mayor of Gary answered more workmen steal time on the job in Gary than any other place in the United States.
>
> "Go into the plants and you will see men sitting around doing nothing--machinery does everything," said the Mayor of Gary when I asked him about the 12-hour day and the 7-day week.[1]

The relationship between management and hourly employees may be a contentious one. Management's view of hourly employees can echo the sentiments of the mayor of Gary in Carl Sandburg's poem. In these cases, employees who raise grievances about their workplace may find themselves without a job. Various federal and state statutes have been enacted to protect workers from retribution, including retaliatory termination. This paper explores the split in the federal circuit courts of appeals regarding the nature of protected actions under the Fair Labor Standards Act of 1938 (FLSA).[2]

* Assistant Professor of Business Law, Arkansas State University, Jonesboro, Arkansas.
** Associate Professor of Accounting, Arkansas State University, Jonesboro, Arkansas.

1 Carl Sandburg, *The Mayor of Gary,* SMOKE AND STEEL-II. PEOPLE WHO MUST (1922).

2 29 U.S.C. §§ 201 et seq.

II. THE FAIR LABOR STANDARDS ACT OF 1938

The FLSA was enacted by Congress in response to "labor conditions detrimental to the maintenance of the minimum standard of living necessary for health, efficiency, and general well-being of workers."[3] Congress' stated goal for the FLSA was to correct poor labor conditions without increasing the unemployment rate or decreasing employees' earnings.[4] The U.S. Supreme Court stated that the "central aim of the Act was to achieve, in those industries within its scope, certain minimum labor standards."[5]

The FLSA contains numerous provisions for the protection of employees. The FLSA requires employers to pay a minimum wage to workers who are covered, and it includes provisions against "oppressive child labor."[6] The FLSA was amended by the Equal Pay Act of 1963 which contains prohibitions of wage discrimination on the basis of sex.[7] In addition, the FLSA requires employers to compensate covered employees who work longer than forty hours during a week at a rate of at least one and one-half times the regular rate of compensation.[8] The Department of Labor enforces the minimum wage and overtime provisions of the FLSA, and the Equal Employment Opportunity Commission enforces the Equal Pay Act.[9]

The anti-retaliation provision of the FLSA, which is part of §15 of the FLSA, provides in part as follows:

> [I]t shall be unlawful for any person… to discharge or in any other manner discriminate against any employee because such employee has filed any complaint or instituted or caused to be instituted any proceeding under or related to this Act, or has testified or is about to testify in any such proceeding, or has served or is about to serve on an industry committee.[10]

Anti-retaliation provisions exist in other statutes for protection of employees, such as Title VII of the Civil Rights Act of 1964 (Title VII),[11] the Americans with Disabilities Act (ADA),[12] and the Age Discrimination in Employment Act (ADEA).[13] However, the wording

[3] 29 U.S.C. §§ 202 (2000).
[4] *Id.*
[5] Mitchell v. Robert DeMario Jewelry, Inc., 361 U.S. 288, 292 (1960).
[6] 29 U.S.C. §§ 206, 212 (2000).
[7] 29 U.S.C. § 206(d) (2000).
[8] 29 U.S.C. § 207 (2000).
[9] 29 U.S.C. §§ 201, 204 (2000); 1978 Reorg. Plan No. 1 of Feb. 23, 1978, § 1, 43 Fed. Reg. 19807 (1978).
[10] 29 U.S.C.§ 215(a)(3) (2000).
[11] 42 U.S.C. § 2000e et seq. (2000).
[12] 42 U.S.C. § 12201 et seq. (2000).
[13] 29 U.S.C. § 623 (d) (2000).

of those anti-retaliation provisions is different from the wording of the FLSA anti-retaliation provision. Title VII of the Civil Rights Act prohibits employer discrimination against an employee "because he has opposed any practice, made an unlawful employment practice by this title…, or because he has made a charge, testified, assisted, or participated in any manner in an investigation, proceeding, or hearing under this title."[14] Similarly, the ADA anti-retaliation provision states that "[n]o person shall discriminate against any individual because such individual has opposed any act or practice made unlawful by this Act or because such individual made a charge, testified, assisted, or participated in any manner in an investigation, proceeding, or hearing under this Act."[15] The ADEA contains similar language.[16]

If an employer violates the anti-retaliation provision of the FLSA, the employer may be liable for "such legal and equitable relief as may be appropriate."[17] The relief may include, but is not limited to "employment, reinstatement, promotion, and the payment of wages lost and an additional equal amount as liquidated damages" plus reasonable attorney's fees and costs.[18] Penalties for willful violation of § 15 include a fine up to $10,000.[19] In addition, the penalty of imprisonment is available for persons who have already been convicted of a prior offense under § 15.[20]

The Circuits are split in their construction of the anti-retaliation provision in the context of internal, and often informal, employee complaints to their employer. While Title VII, the ADA and the ADEA provide that an employee who has "opposed any practice" prohibited under those laws is protected, the FLSA does not contain such language. The FLSA anti-retaliation provision prohibits retaliation against an employee who has "filed any complaint" under FLSA. There are three ways that the Circuits have interpreted this language. First, some Circuits construe the language "filed any complaint" in § 15 to include written, but not verbal, internal complaints made by employees to

[14] 42 U.S.C. § 2000e-3(a) (2000).

[15] 42 U.S.C. § 12203(a) (2000). In addition, the ADA does not permit an employer "to coerce, intimidate, threaten, or interfere with any individual in the exercise or enjoyment of . . . any right granted or protected by this chapter." 42 U.S.C. §12203(b) (2000).

[16] The ADEA prohibits discrimination against an employee or applicant, "because such individual, member or applicant for membership has opposed any practice made unlawful by this section, or because such individual, member or applicant for membership has made a charge, testified, assisted, or participated in any manner in an investigation, proceeding, or litigation under this Act." 29 U.S.C. § 623(d) (2000).

[17] 29 U.S.C. § 216(b) (2000).

[18] *Id.*

[19] 29 U.S.C. § 216(a) (2000).

[20] *Id.*

management. Second, some Circuits find that both verbal and written internal complaints fall under the protection of § 15. Third, other Circuits hold that the phrase "filed any complaint" in § 15 does not include internal complaints made to the employer, but only includes formal actions filed with the EEOC, the Department of Labor or a court.

III. CIRCUITS HOLDING THAT INTERNAL COMPLAINTS ARE PROTECTED ACTIVITY UNDER THE FLSA's ANTI-RETALIATION PROVISION

Employees have prevailed in several U.S. Circuit Court cases about FLSA retaliation for an internal complaint by an employee. Some of these cases involve adverse employment actions in response to written internal complaints and others involve verbal internal complaints. In many cases the Circuits have broadly construed the anti-retaliation provision of the FLSA to protect employees from such retaliation.[21]

The First and Tenth Circuits have considered an employee's claim of retaliatory termination in response to written internal complaints to the employer under the FLSA. In *Valerio v. Putnam Associates, Inc.*[22] the First Circuit held that the employee's action of writing a letter to her employer claiming that she was entitled to overtime pay under the FLSA was protected activity under the anti-retaliation provisions of the FLSA, and that filing a formal complaint with the Department of Labor was not a required activity for the employee to trigger the anti-retaliation provision. In *Love v. Re/Max of America, Inc.*[23] the Tenth Circuit held that the employer violated the FLSA's anti-retaliation provision when the employer discharged the employee within two hours after receiving a memo from the employee, requesting a raise, with a copy of the Equal Pay Act attached. The Tenth Circuit held that even if the employer had not in fact violated the Equal Pay Act, the employee had a right of action for retaliatory discharge under the FLSA if the employee had a good faith belief that the employer was violating the FLSA.[24]

The Sixth, Eighth, Ninth and Eleventh Circuits have considered employee claims of retaliatory termination in response to verbal internal complaints by the employee under the FLSA. For example, the Sixth

[21] *See, e.g.,* Lambert v. Ackerley, 180 F.3d 997 (9th Cir. 1999); EEOC v. Romeo Community Schools, 976 F.2d 985 (6th Cir. 1992); EEOC v. White and Son Enterprises, 881 F.2d 1006 (11th Cir. 1989); Brock v. Richardson, 812 F.2d 121 (3rd Cir. 1987); Brennan v. Maxey's Yamaha, Inc., 513 F.2d 179 (8th Cir. 1975).

[22] 173 F.3d 35 (1st Cir. 1999).

[23] 738 F.2d 383 (10th Cir. 1984).

[24] 738 F.2d 383, 387 (10th Cir. 1984).

Circuit in *EEOC v. Romeo Community Schools*[25] considered a retaliation claim under the Equal Pay Act arising from adverse employment actions occurring after the female employee's verbal complaints to an Assistant Superintendent in the employer's system about a difference in pay between male and female custodians. The employee told the Assistant Superintendent that she thought the employer was "breaking some sort of law" and discriminating based upon her sex.[26] The alleged retaliation occurred after the employee made these comments, and the Sixth Circuit deemed this adequate to trigger protections of the anti-retaliation provision, even though the employee did not file any formal complaints with the EEOC until after the adverse employment action occurred.[27]

Similarly, in *Brennan v. Maxey's Yamaha, Inc.*,[28] the Eighth Circuit considered claims of retaliatory termination in response to an employee's "outburst following her refusal to take part in what she thought was an unlawful scheme" to illegally deprive employees of some overtime pay.[29] Although such a scheme did not in fact exist, the employee had a reasonable belief that the employer was asking her to participate in such a scheme. The court in *Brennan* protected the employee's right to protest such a perceived scheme, stating that "[t]o hold otherwise would defeat the [FLSA's] purpose in [the anti-retaliation provision] of preventing employees' attempts to secure their rights under the Act from taking on the character of 'a calculated risk.'"[30] The court further stated that the employee's "protest of what she believed to be unlawful conduct on [the employer's] part was an act protected from reprisals and rendered her firing discriminatory regardless of the existence of other grounds for her discharge."[31]

Also, in *EEOC v. White and Son Enterprises*[32] the Eleventh Circuit examined an employer's response to six women who verbally requested pay equal to the pay of men doing the same job. The employer stated there would be no raise for the women and they could "take it or leave

[25] 976 F.2d 985 (6th Cir. 1992). *See also* Moore v. Freeman, 355 F.3d 558 (6th Cir. 2004), in which the Sixth Circuit reiterates that informal complaints may trigger the FLSA's anti-retaliation provision. The plaintiff in the *Moore* case, a male African American employee, complained that his salary was less than another employee, a white woman, who was hired to perform the same job. Subsequently, his employment was terminated. The Sixth Circuit affirmed the award of back pay and damages to the plaintiff in Moore for emotional and mental distress.

[26] 976 F.2d at 989.

[27] *Id.*

[28] 513 F.2d 179 (8th Cir. 1975).

[29] *Id.* at 181.

[30] Mitchell v. Robert DeMario Jewelry, Inc., 361 U.S. 288, 293 (1960) (quoted in *Brennan*, 513 F.2d at 182).

[31] *Brennan*, 513 F.2d at 181.

[32] 881 F.2d 1006 (11th Cir. 1989).

it."[33] At that point the employer "instructed the company secretary to make out the women's final paychecks," and the women left the place of employment.[34] The Eleventh Circuit broadly construed the anti-retaliation provision of the FLSA. Therefore, the Eleventh Circuit held that the adverse employment action by the employer in response to "the unofficial complaints" by the women was a violation of the FLSA, even though the women had not filed formal action with the EEOC at the time of the employer's adverse employment action.[35]

The Ninth Circuit considered cases of both verbal and written complaints made to the employer, the Seattle SuperSonics, in *Lambert v. Ackerley*.[36] The plaintiffs in that case alleged that the employer fired them in retaliation for verbally requesting overtime pay and having an attorney send a letter to the employer requesting that the employer pay overtime wages and abstain from threats or retaliation. The Ninth Circuit originally held that the anti-retaliation provision of the FLSA is not triggered by internal complaints to the employer,[37] but, upon a rehearing *en banc*, the Ninth Circuit held that an employer's retaliation for employees' internal complaints about FLSA violations do lead to a cause of action under the FLSA's anti-retaliation provision. The Ninth Circuit quoted the U.S. Supreme Court as follows:

> [The FLSA is] remedial and humanitarian in purpose. We are not here dealing with mere chattels or articles of trade but with the rights of those who toil…Those are rights that Congress has specifically legislated to protect. *Such a statute must not be interpreted or applied in a narrow, grudging manner.*[38]

In addition, the Ninth Circuit held that statutory construction of the FLSA and courts' construction of analogous provisions in other statutes also supported the employees' case in *Lambert*.[39] Therefore, the Ninth Circuit construed the FLSA broadly to hold that internal complaints by employees are sufficient to trigger the anti-retaliation provision.[40]

The Third Circuit Court of Appeals also broadly construed the employee's rights under the anti-retaliation provision of the FLSA in *Brock v. Richardson*.[41] The Department of Labor investigated the

[33] *Id.* at 1008.

[34] *Id.*

[35] *Id.* at 1011 (11th Cir. 1989).

[36] 180 F.3d 997 (9th Cir. 1999), cert. denied, 528 U.S. 1116 (2000).

[37] Lambert v. Ackerley, 156 F.3d 1018 (9th Cir. 1998), *withdrawn and reh'g en banc granted*, 169 F.3d 666 (9th Cir. 1999).

[38] Tennessee Coal, Iron & R. Co. v. Muscoda Local No. 123, 321 U.S. 590, 597 (1944) (emphasis added, quoted in *Lambert*, 180 F.3d 997, 1003 (9th Cir. 1999)).

[39] 180 F.3d 997.

[40] *Id.*

[41] 812 F.2d 121 (3rd Cir. 1987).

employer in response to a complaint about overtime violations. The employer fired the employee plaintiff in part based upon the employer's belief that the employee plaintiff had filed the complaint with the Department of Labor. However, the employee plaintiff was not the person who had filed the complaint. The FLSA's anti-retaliation provision prohibits discrimination against an "employee because such employee has filed any complaint." In response to the employee's suit for retaliation, the employer alleged that, because the employee had not filed a complaint, the anti-retaliation statute would not apply to the case. The court noted that "[t]he Fair Labor Standards Act is part of the large body of humanitarian and remedial legislation enacted during the Great Depression, and has been liberally interpreted."[42] The court, in order to prevent an "atmosphere of intimidation" in employment situations, held that "an employer's belief that an employee has engaged in protected activity is sufficient to trigger application" of the anti-retaliation provision of the FLSA.[43] The Eighth Circuit took a similar position in *Saffels v. Rice*.[44]

The Fifth Circuit Court of Appeals in *Hagan v. Echostar Satellite, LLC*[45] stated that "[W]e adopt the majority rule, which allows an informal, internal complaint to constitute protected activity under Section 215(a)(3), because it better captures the anti-retaliation goals of that section."[46] However, the employee did not prevail on his FLSA retaliation claim because the Fifth Circuit held that the plaintiff employee had not filed even an informal complaint. The plaintiff was a supervisor who objected to a schedule change for technicians that he supervised because this schedule change would result in less overtime pay to the technicians. In addition, although the plaintiff believed that the employer's actions were legal, he passed the technicians' questions about the legality of the schedule change on to the Human Resources department. Soon thereafter, the employer fired the plaintiff. The plaintiff had not objected to the legality of the schedule change. In addition, the plaintiff had not "stepped out of his role" as supervisor when he referred questions about the change to the Human Resources department. The employee had not taken on the role as advocate for the technicians in an adverse position to the employer. Therefore, the Fifth Circuit held that, although informal, internal complaints are protected

[42] 812 F.2d 121, 123 (3rd Cir. 1987).
[43] 812 F.2d 121, 123-125 (3rd Cir. 1987).
[44] 40 F.3d 1546 (8th Cir. 1994).
[45] 529 F.3d 617 (5th Cir. 2008).
[46] *Id.* at 626.

under the FLSA's anti-retaliation provision, the plaintiff in the *Hagan* case had not made such a complaint.[47]

The above cases indicate that the First, Third, Fifth, Sixth, Eighth, Ninth, Tenth and Eleventh Circuits have broadly construed the employee's rights under the anti-retaliation provision of the FLSA in the context of internal complaints by employees or an employer's mistaken belief than an employee has made a formal complaint under the FLSA. The internal complaint cases run the gamut from an employee's verbal complaint that the employer was "breaking some sort of law" by discriminating based upon her sex to a written letter or memo to the employer from an employee or attorney for the employee specifically citing the statute that the employer has allegedly violated.[48]

In summary, these cases indicate several reasons for broad construction of the anti-retaliation provision of the FLSA to include internal employee complaints. First, the FLSA is a "humanitarian" Act, and, therefore, the U.S. Supreme Court has held that it "must not be interpreted in a narrow, grudging manner."[49] The U. S. Supreme Court has stated that "fear of economic retaliation might often operate to induce aggrieved employees quietly to accept substandard conditions."[50] Such an inducement goes against the purpose of the FLSA.

Second, complaints by employees are a central enforcement tool for the FLSA. As the U.S. Supreme Court stated:

> For weighty practical and other reasons, Congress did not seek to secure compliance with prescribed standards through continuing detailed federal supervision or inspection of payrolls. Rather it chose to rely on information and complaints received from employees seeking to vindicate rights claimed to have been denied. Plainly, effective enforcement could thus only be expected if employees felt free to approach officials with their grievances. This end the prohibition of § 15 (a)(3) [the FLSA's anti-retaliation provision] against discharges and other discriminatory practices was designed to serve.[51]

Third, employees should be encouraged to communicate with their employers about any FLSA violations. Construing the word "filed" in the FLSA anti-retaliation statute to include only formal complaints will

[47] *Id.* at 630.

[48] *See., e.g.,* EEOC v. Romeo Community Schools, 976 F.2d 985 (6th Cir. 1992) (holding that a verbal internal complaint that the employer is "breaking some sort of law" is protected activity under the FLSA anti-retaliation provision); Valerio v. Putnam Associates, Inc., 173 F.3d 35 (1st Cir. 1999) (holding that a written internal complaint specifically referring to FLSA is a protected activity).

[49] Tennessee Coal, Iron & R. Co. v. Muscoda Local No. 123, 321 U.S. 590, 597 (1944), quoted in Valerio v. Putnam Assocs., Inc., 173 F.3d 35, 43 (1st Cir. 1999).

[50] Mitchell v. Robert DeMario Jewelry, Inc., 361 U.S. 288, 292 (1960).

[51] *Id.*

discourage communication between employees and employers. Internal complaints give an employer the opportunity to "remedy its own problems voluntarily and quietly," and they give the employee the opportunity to obtain a quick and inexpensive resolution of the employee's complaint.[52]

Fourth, internal complaints may "leverag[e] the government's limited enforcement resources."[53] Certainly, the internal resolution of FLSA problems without involvement of governmental agencies and courts will save governmental resources.

Fifth, if the words "filed any complaint" in the FLSA include only formal filings with the Department of Labor, the EEOC, or a court, employers who wait until after the formal filing to fire an employee will be penalized while employers who fire the employee before the formal filing will not be penalized. This reading of the word "filed" has the "bizarre effect" of giving employers who have a mere inkling that an employee might be considering an FLSA complaint the incentive to fire the employee quickly before the employee makes a formal filing with the Department of Labor, EEOC or court.[54] In addition, this narrow reading of the word "filed" creates an incentive for employees to file suit or make other formal filings before taking the less expensive and time-consuming route of making an in-house complaint.[55]

Sixth, statutory construction may permit a broad reading of "filed any complaint." Some courts read the dictionary definitions of "complaint" and "filed" broadly, and the addition of the word "any" in the FLSA supports this broad understanding of the phrase "filed any complaint" to "embrace all types of complaints, including those that might be filed with an employer."[56] In addition, if "filed any complaint" is not

[52] *Valerio*, 173 F.3d at 44.

[53] *Id.*

[54] *Id.* at 43.

[55] *Id.*

[56] *See, e.g., Valerio*, 173 F.3d at 41-42. *Valerio* cites Webster's Third Int'l Dictionary 464 (1971), which defines "complaint" in two ways: (a) "the act or action of expressing protest, censure, or resentment: expression of injustice" or (b) "formal allegation or charge against a party made or presented to the appropriate court or officer." *Id.* at 41. Since the FLSA uses the words "any complaint" and does not specify where the complaint must be filed, the *Valerio* court held that the more information definition in (a) would be appropriate. Also, the word "file" is defined in two ways: (a) to deliver (as a legal paper or instrument) after complying with any condition precedent (as the payment of a fee) to the to the proper officer for keeping on file or among the records of his office" or (b) "to place (as a paper or an instrument) on file among the legal or official records of an office especially by formally receiving, endorsing, and entering." The *Valerio* court held that the definition of "file: in (b) of the preceding sentence was "sufficiently elastic to encompass an internal complaint made to a private employer with the expectation the employer will place it on file among the employer's official records." The court further noted that the words "or instituted or caused

construed broadly to include internal complaints, then the words "or instituted or caused to be instituted any proceeding" in the FLSA anti-retaliation provision may be superfluous.[57]

Seventh, one argument for excluding internal complaints from the coverage of the FLSA anti-retaliation provision is that the "filed any complaint" language seems narrower than the "opposed any practice" language of later statutes, such as Title VII. However, it may be inappropriate to weight this difference in language heavily because Title VII was passed in the 1960s, whereas the FLSA was enacted in the 1930s. The difference in language may be attributed merely to a difference in the times, rather than a difference in Congressional intent.[58]

IV. CIRCUITS HOLDING THAT INTERNAL COMPLAINTS ARE NOT PROTECTED ACTIVITY UNDER THE FLSA'S ANTI-RETALIATION PROVISION

The Second and Fourth Circuits have construed the language of the FLSA anti-retaliation provision more narrowly than many other Circuits. The Second Circuit in *Lambert v. Genesee Hospital*[59] affirmed the District Court's grant of summary judgment to the defendant employer in connection with a retaliation claim under the Equal Pay Act. The plaintiff employees had complained to a supervisor that the employer paid a female worker a lower salary than a male worker, even though the duties of the male and female were substantially equal. The employees "merely complained that it was 'not fair'," but did not specifically state that sex was the reason for the unequal treatment.[60] Thereafter, the male was promoted.[61] The female plaintiffs alleged that this was retaliation in violation of FLSA.[62]

The Second Circuit in *Genesee Hospital* noted that the language of the anti-retaliation provision in the FLSA is different from the anti-retaliation language in Title VII of the Civil Rights Act.[63] The Court focused on the language in the FLSA that states that retaliation is not permitted against an employee who has "filed any complaint" under the FLSA. The language of the FLSA appears much narrower than the language of Title VII. Title VII prohibits retaliation against employees

to be instituted any proceeding" would be superfluous unless "file any complaint" is given a broader meaning. *Id.*

[57] *Id.*

[58] *Lambert* , 180 F.3d at 1005.

[59] 10 F.3d 46 (2d Cir. 1993).

[60] *Id.*

[61] *Id.* at 55.

[62] *Id.*

[63] *Id.*

who have, among other things, "opposed any practice made an unlawful employment practice by this title…, or because he has made a charge." The FLSA anti-retaliation provision does not contain the "opposed any practice" language.[64]

The Second Circuit Court of Appeals held that the language of the FLSA's anti-retaliation provision is "plain and unambiguous."[65] Therefore, the Second Circuit did not defer to language in the EEOC's compliance manual which states that the EPA retaliation provisions should "encompass informal workplace complaints."[66] The EEOC's compliance manual notes that, unlike Title VII, the ADA, and the ADEA, the "anti-retaliation provision of the Fair Labor Standards Act, which applies to the Equal Pay Act, does not contain a specific 'opposition' clause." However, the compliance manual further states, "courts have recognized that the statute prohibits retaliation based on opposition to allegedly unlawful practices."[67] The Second Circuit did not defer to this language, but vacated and remanded the plaintiff's claims of retaliation under the FLSA.[68]

In *Ball v. Memphis Bar-B-Q Co., Inc.*[69] the Fourth Circuit Court of Appeals narrowly construed the anti-retaliation provision of the FLSA in a different context. The Fourth Circuit considered the retaliation allegations of a restaurant manager whose employment was terminated. A waiter at the restaurant was preparing to file suit against the employer in connection with "turning back the clock" so that working hours were not reported correctly. The manager contacted the president of the employer corporation to alert him to this matter. In another conversation, the manager told the president that, if a lawsuit was filed by the waiter, the manager would testify truthfully about the allegations instead of testifying in the manner suggested by the president. A few days later, the employer fired the plaintiff restaurant manager. The manager filed suit under the portion of the anti-retaliation statute that

[64] *Id.* at 55-56.

[65] *Id.*

[66] *Id.* at 55 (citing Chevron U.S.A. v. Natural Resources Defense Council, 467 U.S. 837 (1984) ("If the intent of Congress is clear, that is the end of the matter."). The First Circuit in *Valerio* also held that the EEOC manual was not a dispositive interpretation of the statute but was merely describing case law interpretation of the statute. *Valerio*, 173 F.3d at 42 note 5.

[67] EEOC Compliance Manual, Section 8: Retaliation, a*vailable at* http: //www.eeoc.gov/policy/docs/retal.html. This manual favorably cites EEOC v. Romeo Community Sch., 976 F.2d 985, 989-90 (6th Cir. 1992); EEOC v. White & Son Enterprises, 881 F.2d 1006, 1011 (11th Cir. 1989). The compliance manual also notes the contrary authority of Lambert v. Genessee Hospital, 10 F.3d 46, 55 (2d Cir. 1993), cert. denied, 511 U.S. 1052 (1994). *Id.*

[68] *Id.*

[69] 228 F.3d 360 (4th Cir. 2000).

prohibited adverse action against an employee who "has testified or is about to testify in any such proceeding" under the FLSA.[70] The court noted that this case would not fall into the "file any complaint" language of the FLSA because the plaintiff manager merely relayed the waiter's complaint to the president, but the plaintiff manager did not make a complaint.[71] The court held that, since the waiter's proceeding had not been filed yet, the proceeding did not exist. Therefore, the plaintiff manager was not an employee who "is about to testify" in the proceeding. The *Ball* court held that:

> While we are instructed to read the FLSA to effect its remedial purposes, the statutory language clearly places limits on the range of retaliation proscribed by the Act. It prohibits retaliation for testimony given or about to be given but not for an employee's voicing of a position on working conditions in opposition to an employer. Congress has crafted much broader anti-retaliation provisions elsewhere, such as in Title VII….But the cause of action for retaliation under the FLSA is much more circumscribed…. [W]e would not be faithful to the language of the testimony clause of the FLSA's anti-retaliation provision if we were to expand its applicability to intra-company complaints or to potential testimony in a future-but-not-yet-filed court proceeding.[72]

Even though the Fourth Circuit stated that the alleged conduct of the employer was "offensive", the Court felt compelled to comply with the "plain language of the FLSA."[73]

Several rationales support the position that the anti-retaliation provision of the FLSA should not be broadly construed to prohibit retaliation for internal complaints to employers. First, the "plain language" of the statute has been read by some courts as unambiguously excluding internal complaints from the list of triggering events under the FLSA anti-retaliation statute. The FLSA does not say "has complained to the employer." Therefore, arguably, Congress did not intend for "filed any complaint" to include such internal complaints.[74]

Second, it is the job for "Congress-not the courts" to "modernize the FLSA." Congress may amend the FLSA to include internal complaints in the protected actions under the FLSA anti-retaliation clause if Congress so desires.[75] Until Congress takes such action, the courts should abide by the "plain language" drafted by Congress.

[70] *Id.*
[71] *Id.* at 364.
[72] *Id.*
[73] 228 F.3d at 365.
[74] *Lambert*, 180 F.3d at 1013-1014 (Rymer, J., Dissenting).
[75] *Id.*

Third, a good reason to limit the meaning of "filed any complaint" to filing a complaint with the Department of Labor, Equal Employment Opportunity Commission or a court is that "affording protection to employees who lodge purely intracorporate complaints 'unhelpfully leaves employers in the dark' as to what types of assertions will rise to the level of protected activity by their employees."[76] An employer could be uncertain whether "abstract grumblings" by a disgruntled employee will trigger the FLSA anti-retaliation statute.[77] A hint in *Valerio* about a potential standard is whether the internal complaint is "sufficiently definite to notify [the employer] that [the employee] is asserting her statutory rights" under the FLSA.[78] In *Valerio*, the employee wrote a letter including specific reference to the overtime provisions of the FLSA. However, employers may be a bit more "in the dark" about how to proceed in the face of vague, verbal, internal complaints that an employee is being treated "unfairly." A fear of litigation may skew employment decisions to favor "grumbling" employees whose attitudes may be detrimental to the working environment.[79]

Fourth, if the FLSA anti-retaliation statute is construed broadly to include internal complaints, courts may be required to use a "case-by-case" basis to determine whether a communication from employee to employee is "filing a complaint" under the FLSA anti-retaliation provision.[80] This additional litigation will be costly to the parties, and it may be burdensome to the court system.

Fifth, it is possible that Congress deliberately worded Title VII differently from the FLSA because the concerns addressed by Title VII may be more weighty or urgent than most FLSA concerns.[81] For example, Congress may have considered retaliation for complaints about race discrimination more serious than retaliation for complaints about overtime pay violations. This might justify a broader reading of the Title VII anti-retaliation provision than the FLSA anti-retaliation provision. However, this argument is not as persuasive in connection

[76] *Valerio*, 173 F.3d at 44.

[77] *Id.*

[78] *Id. at* 45.

[79] *Id.* at 44-45.

[80] *Id.* at 44.

[81] The *Valerio* court addressed the argument of the defendant that the words "filed a complaint" in the Surface Transportation Assistance Act of 1982 ("STAA"), 49 U.S.C. §31104 (a)(1)(a) (2000) should be construed more broadly than the FLSA language because "the STAA concerns public health and safety" so "it is essential that employees be encouraged to inform their supervisors of regulatory violations immediately so that they can be promptly remedied; in the FLSA context, however, the need for dispatch is diminished." *Valerio*, 173 F.3d at 45. The *Valerio* court was not persuaded by this argument. *Id.*

with the Equal Pay Act. The protected class under the Equal Pay Act is the same as a protected class under Title VII, i.e., persons experiencing discrimination based upon gender.

V. *KASTEN V. SAINT-GOBAIN PERFORMANCE PLASTICS CORPORATION*

The most recent case to examine this issue comes from the Seventh Circuit. Kevin Kasten (Kasten) was an hourly employee of Saint-Gobain Performance Plastics Corporation (Saint-Gobain) from October 2003 until December 2006.[82] In 2006, Kasten received a series of warnings from his employer related to his failure to properly record his arrival and departure times using the company's Kronos time clocks. The first warning came on February 13, and was titled a "Disciplinary Action Warning Notice-Verbal Counseling Warning."[83] The company documented the verbal counseling with a notice that provided "[i]f the same or any other violation occurs in the subsequent 12-month period from the date of verbal reminder, a written warning may be issued."[84]

On August 13, Kasten received a "Disciplinary Action Warning Notice – Step 2 Policy Violation – Written Warning."[85] The Warning Notice provided that "[i]f the same or any other violation occurs in the subsequent 12-month period from this date [sic] will result in further disciplinary action up to an including termination."[86]

The third warning came on November 10, and was a "Disciplinary Action Warning Notice – Step 3 Policy Violation – Written Warning," which was accompanied by a one-day suspension from work.[87] This Warning Notice repeated the language from the first written warning,[88] but had even stronger language stating that "[t]his is the last step of the discipline process."[89]

Kasten signed each of the first three notices acknowledging that he had read and understood them.[90] The fourth warning came on December 6, and was also accompanied by a suspension from work.[91]

[82] Kasten v. Saint-Gobain Performance Plastics Corporation, 619 F. Supp. 2d 608, 610 (W.D. Wis. 2008).

[83] *Id.*

[84] *Id.*

[85] *Id.*

[86] *Id.*

[87] *Id.*

[88] *Id.*

[89] Kasten v. Saint-Gobain Performance Plastics Corporation, 570 F.3d 834, 836 (7th Cir. 2009).

[90] *Id.*

[91] 619 F. Supp. 2d at 610.

Kasten was informed of his termination over the telephone on December 11, and this was reinforced by a letter dated December 19, 2006.[92]

Kasten filed a wage and hour complaint and a federal suit against Saint-Gobain in late 2007.[93] The facts listed above were undisputed, but there were some facts that the parties did dispute. Kasten alleged that he complained to management on several occasions about the location of the Kronos[94] time clocks because the location of the clocks prevented employees from being paid for time spend putting on and removing their protective gear.[95] Kasten alleged that between September and December of 2006 he brought up the time clock location with several members of management on at least five different occasions.[96] Kasten complained that the time clock locations were illegal, and even told one supervisor that he was thinking of starting a lawsuit over the issue.[97] His final complaint was in a meeting dealing with his fourth warning and subsequent suspension, and he again told members of management that he believed the time clock locations to be illegal and the company could lose a lawsuit if challenged in court.[98] The company denied that any of the complaints about the legality of the time clock locations were ever made.[99]

Saint-Gobain moved for summary judgment in the federal suit. Saint-Gobain's position was that, even if Kasten had made the disputed complaints, they did not provide grounds for relief because they were not "filed" under FLSA §215(a)(3).[100] Kasten countered that the complaints were protected assertions of his rights under the FLSA.[101]

Kasten did not file a complaint with any agency, state or federal, until well after he was terminated. If the court adopted a strict reading of the statute, summary judgment would be appropriate. Further, he did not "file," in the sense of preparing a document and giving it to someone else, until after he left the company. If the court adopted the view that

[92] *Id.*

[93] *Id.*

[94] Kronos is a brand of time clocks featuring software that allows for completely automated payroll processes. The company's term for this is "workforce management." http://www.kronos.com/why-kronos/why-kronos.aspx (last visited April 6, 2010). The brand name was mentioned by the Seventh Circuit. 570 F.3d at 836. If Saint-Gobain had a typical Kronos automated workforce management system, Kasten's failure to clock in must have been a significant problem for the company's human resource and payroll departments.

[95] 619 F. Supp. 2d at 611.

[96] *Id.*

[97] *Id.*

[98] *Id.*

[99] *Id.*

[100] *Id.*

[101] *Id.*

FLSA §215(a)(3) required, at a minimum, a written complaint, then summary judgment would also be appropriate. The only way for Kasten to receive a trial on the merits would be if the court adopted the broadest possible interpretation of the statute to allow not only complaints made to the employer but also oral complaints.

Judge Crabb described her approach as the "middle-of-the-road" approach.[102] She found that the FLSA "…protects informal complaints, including those made to employers, so long as they are in writing and are filed."[103] Accordingly, the court granted summary judgment to Saint-Gobain.

Kasten appealed to the Seventh Circuit. Upon appeal, the court looked at two specific issues. First, are internal complaints protected under the FLSA?[104] Second, are unwritten complaints protected?[105] With respect to the first question, the Seventh Circuit found itself in agreement with the majority of the circuit courts. The court focused on the language "any complaint" in the statute to conclude that internal complaints are protected activities.[106] With respect to the second question, the court found that "[t]he use of the verb 'to file' connotes the use of a writing."[107] To reach this conclusion, the court reviewed the dictionary definition of the term, common usage of the term, prior cases, and Congress' failure to use the term "opposed any practice" in the FLSA.[108] The Seventh Circuit joins the First and Tenth Circuits in this middle-ground approach.

Kasten asked the Seventh Circuit for a rehearing and suggested that the rehearing be *en banc*. This petition was denied.[109] Judge Rovner was joined by two other judges in a lengthy dissent. These judges would have concluded that a verbal complaint is protected under the FLSA.[110] The dissent pointed out that many federal statutes specifically require a written complaint, and Congress could have easily done this with the FLSA if that was their intent.[111] Kasten filed a petition for certiorari,

[102] *Id* at 613.
[103] *Id.*
[104] 570 F.3d at 837.
[105] *Id.* at 838.
[106] *Id.*
[107] *Id.*
[108] *Id.* at 839. The Seventh Circuit did not find persuasive the reasoning of the Sixth, Eight, and Eleventh Circuits. It stated that each of them held that oral complaints are protected without discussion of the distinction between oral and written complaints. *Id.* at 839-40.
[109] Kasten v. Saint-Gobain Performance Plastics Corporation, 585 F.3d 310 (7th Circuit 2009).
[110] *Id.* at 317.
[111] *Id.* at 314 (citing, among others, The Federal Election Campaign Act, 2.U.S.C. §473(g)(a)(1) ("Any person who believes a violation of this Act . . . has occurred, may file a

and the United States Supreme Court granted certiorari on March 22, 2010.[112]

VI. CONCLUSION

The *Kasten* case becomes the Supreme Court's first chance to review this issue since the Ninth Circuit's opinion in *Lambert v. Ackerley*. Since that action in 2000, the Fourth Circuit reached its decision in *Ball v. Memphis Bar-B-Q Company* and the Fifth Circuit decided *Hagan v. Echostar Satellite, LLC*. The *Ball* case was a 2000 case, but the Fourth Circuit's strict interpretation of the statute deepened the split among the circuits. The *Hagan* case in 2008 and the *Kasten* case further complicate things by placing the Fifth and Seventh Circuit Courts of Appeals in different camps with respect to the writing requirement for internal complaints.

The current split is as follows. The Third, Fifth, Sixth, Eighth, Ninth and Eleventh Circuits have adopted the broadest interpretation. These courts allow verbal, internal complaints to qualify as a filing under the FLSA. As discussed above, the Department of Labor shares the broad view of the statute. The First, Seventh and Tenth Circuits had adopted the middle-of-the-road approach. In these courts, an internal complaint is allowed, but it must be in writing. Finally, the Second and Fourth Circuits have adopted the strictest interpretation. They require a filing with an external agency.

The three-way split in the circuits indicates that the language of 29 U.S.C. § 215(a)(3) is clearly subject to interpretation. Congress had the authority to resolve the uncertainty, but, for some reason, waited to act. It is difficult to predict what the Supreme Court will do. The only thing that is clear is that the split between the circuits will be resolved.

complaint . . . such a complaint shall be in writing")).

[112] Kasten v. Saint-Gobain Performance Plastics Corporation, 176 L.Ed.2d 361 (2010).

NEW RULES FOR COMPUTING U.S. PATENT TERMS AFTER *WYETH v. KAPPOS*

by DAVID SILVERSTEIN*

I. INTRODUCTION

The January 7, 2010, Federal Circuit (CAFC) decision in *Wyeth v. Kappos*[1] has brought fresh chaos to the field of patent law by throwing into question one of the most basic aspects of a U.S. patent – namely, how long does it last? Only fifteen years ago, calculating the life of a U.S. patent was simple: with minor exceptions,[2] a U.S. patent lasted 17 years from the patent issue date, provided the periodic patent maintenance fees were timely paid.[3]

In 1995, however, to harmonize U.S. patent law with the rest of the world, the U.S. switched to a patent term that runs for 20 years from the patent application filing date.[4] Then, in 1999, to compensate patent applicants for excessive delays in the U.S. Patent Office process, Congress legislated a "patent term adjustment" period that added a term extension to certain patents.[5] The Patent Office was authorized to compute the proper term extension.[6]

* Professor of Business Law & Ethics, Sawyer Business School, Suffolk University.

[1] 591 F.3d 1364 (Fed. Cir. 2010).

[2] *See infra* part II (C).

[3] *See infra* part II (B).

[4] *See infra* part III (A). *See generally*, Symposium: Patent System Reform; John F. Duffy, *Harmony and Diversity in Global Patent Law*, 17 BERKELEY TECH. L. J. 685 (2002).

[5] *See infra* part III (B). *See generally* William Slate, *The Sky is Not Falling: The Effects of Term Adjustment Under the American Inventors Protection Act on Patent Prosecution*, 3 YALE J. L. & TECH. 7 (2001).

[6] *Id.*

More recently, however, challenges have emerged to the way in which the Patent Office has been calculating the "patent term adjustment." In a 2008 decision, the U.S. District Court for the District of Columbia held that the Patent Office had been misapplying the patent term adjustment rules and ordered that nearly a year of additional patent term be added to the litigated patents.[7] The 2010 CAFC decision affirmed that District Court decision and also opened the door to a host of additional patent term computation questions.[8]

The successful challenge to the Patent Office practice is already provoking additional litigation, and it is likely to take years for the dust to settle. In the meantime, the life of any U.S. patent issued since 2000 is open to question, which in turn may dramatically affect the value of that patent to the owner, as well as decisions by potential competitors who may be waiting in the wings for the patent to expire.

II. PATENT TERM – WHY IT MATTERS

A. Patent Owner and Competitor Perspectives

Knowing how long a patent lasts is important both to patent owners and to actual or prospective competitors. While a U.S. patent is in force, the patent owner enjoys the right to exclude others from making, using or selling the patented invention in the United States and from importing the patented invention into the United States.[9] When the term of the patent expires, however, the subject matter of the patent becomes part of the public domain and is thereafter freely available for use by others.

As a result, many important business decisions turn on a patent's expiration date. How much money a patent owner is willing to invest in commercializing and bringing to market a patented invention will depend, in part, on how long a period of exclusivity remains under the patent grant. For example, a newly-patented pharmaceutical composition may face many years (and millions of dollars!) of testing to obtain Food and Drug Administration (FDA) approval before it can be cleared for marketing. If the remaining patent term on the new drug is insufficient, a pharmaceutical company might decide that it is not worth the investment to jump through the many regulatory hurdles, and a potentially useful drug would never come to market.

[7] *Wyeth v. Dudas*, 580 F. Supp. 2d 138 (D.D.C. 2008).

[8] 591 F.3d 1364 (Fed. Cir. 2010).

[9] 35 U.S.C.§271(a) provides in part: "[W]hoever without authority makes, uses, offers to sell, or sells any patented invention, within the United States, or imports into the United States any patented invention during the term of the patent therefor, infringes the patent," (emphasis added).

Also, how much a patent owner can earn by selling, licensing or otherwise exploiting a patent will typically depend, in part, on the length of the patent term. Although some patents lose value over time as the patented technology obsolesces and is gradually superseded by newer and better technologies, in other cases a patent may increase in value over time as the patented technology (perhaps ahead of its time and of only limited utility when first patented) is found to be instrumental in enabling a rapidly developing related technology. Thus, several early e-commerce related patents, worth little at the time of patenting, eventually commanded hefty price tags as electronic commerce blossomed and exploded. Similarly, certain drugs, believed to be of limited utility when discovered, are later found to have broader and more valuable applications.

At the same time, prospective competitors may be anxiously awaiting the expiration of key patents belonging to others. In some cases, these may be businesses that envision an opportunity, once an important patent expires, to replicate the formerly patented technology, sell it at a lower price, and bring the technology to a whole new segment of the market. This might be the case, for example, with a generic drug company waiting for an important pharmaceutical to come "off-patent."

In other cases, however, rival businesses may be waiting for key patents owned by others to expire so they can practice their own (sometimes also patented) technology. Many businesses/managers are surprised to learn that obtaining a patent may give you the right to exclude others, but it does not necessarily give you the right to practice, much less to market, your own technology, if that technology is dominated by someone else's unexpired patent rights.

Thus, there was enormous value in the pre-1995 system where the term of a U.S. patent could be quickly, easily and definitively established from just looking at the patent issue date printed on the face of every U.S. patent.

B. Historical Evolution of the U.S. Patent Term

The U.S. Constitution authorized Congress to "promote the Progress of Science and Useful Arts by securing <u>for limited Times</u> to Authors and Inventors the exclusive Right to their respective Writings and Discoveries,"[10] (emphasis added). The precursor to this Constitutional provision was the 1625 English Statute of Monopolies.[11] In reaction to the hated but, at the time, widespread system of royally-conferred exclusive trading privileges in everyday commodities, the English

[10] U.S. CONST. art. I, §8.

[11] *See generally* David Silverstein, The Capsizing of Small Business in a "Perfect Storm" of Patent Reform, 19 SOUTHERN L. J. 153 (2009).

Parliament in 1625 prohibited these grants excepting only "letters-patent and grants of privilege, for the term of fourteen years or under, hereafter to be made, of the sole working or making of any manner of new manufactures...."[12] (emphasis added).

Thus, from the origins of the modern patent system, the principle that these special government-conferred exclusive trading rights should only be of limited duration has been a central feature. In the very first U.S. Patent Act of 1790, the patent term was established at 14 years from the patent issue date, identical to the maximum term set by the English Statute of Monopolies.[13] In the 1793 revision of the Patent Act,[14] authored by Thomas Jefferson, the U.S. patent term was maintained at 14 years.

Between 1793 and 1870, the Patent Act was revised nineteen times,[15] and each time the patent term was maintained at 14 years. As part of a new Patent Act revision in 1870, however, the U.S. patent term was increased to 17 years.[16] The patent term in the United States then remained at 17 years, with one added wrinkle (discussed below) for more than one hundred years until 1995.

C. The Hatch-Waxman Patent Term Extension

The one wrinkle to the 17-year patent term was the patent term extension provisions of the 1986 Hatch-Waxman Act.[17] The Hatch-Waxman Act was precipitated by a highly controversial 1984 Federal Circuit decision in *Roche Products v. Bolar Pharmaceutical Co.*[18] The fundamental question presented in the *Bolar Pharmaceutical* case was

[12] 21 Jac., ch. 3 (1625); *see also* LIPSCOMB'S WALKER ON PATENTS §1:5, AT 31 (3d ed. 1984).

[13] *Id. See generally* Forman, *Two Hundred Years of American Patent Law*, in 200 YEARS OF ENGLISH AMERICAN PATENT, TRADEMARK & COPYRIGHT LAW, BICENTENNIAL SYMPOSIUM PRESENTED BY THE A.B.A. SECTION OF PATENT, TRADEMARK & COPYRIGHT LAW 21 (1976).

[14] Act of Feb. 21, 1793, 1 Stat. 319.

[15] *See, e.g.,* WALKER ON PATENTS (6th ed. 1929). At pages 873-958, this old edition of this classic treatise on patent law contains the texts of the Patent Acts of 1790, 1793, 1794, 1800, 1819, 1832 (first and second), 1836, 1837, 1839, 1842, 1848, 1849, 1852, 1861 (first and second), 1862, 1863, 1864, 1865, 1866 and 1870.

[16] *Id.* In the most recent (1952) general revision of U.S. patent law, the patent term was maintained at 17 years, 35 U.S.C. §154. As discussed below, however, Sec. 154 has been amended several times over the last fifteen years.

[17] The patent term extension provision was part of a carefully crafted compromise between generic drug producers and the major patent-holding pharmaceutical companies. *See generally* James M. Flaherty, Jr. *PMA Primacy: Synthesizing the 35 U.S.C.§156 Patent Term Extension With the 35 U.S.C. §271(e)(1) Patent Infringement Exemption*, 56 FOOD DRUG L.J. 339 (2001).

[18] 733 F.2d 858, 221 U.S.P.Q. 937 (Fed. Cir. 1984).

whether a generic drug company could commence testing a generic equivalent of a patented pharmaceutical prior to the expiration of the patent(s). Bolar Pharmaceutical (the generic manufacturer) argued that, a lengthy amount of time was required to test a new drug (even a generic equivalent of an existing drug) and to obtain FDA approval before commencing marketing. If a generic drug company could not begin this lengthy process until patent expiration, then the patent owner would, *de facto*, receive an unjustified extension of its patent rights beyond the patent term and in contravention of the principle that a patent should only last for a defined limited term.

The Federal Circuit, however, gave a literal reading to the patent statute and held that pre-patent testing of a generic drug constituted patent infringement. The Court specifically refused to give a broader meaning to the long-standing "experimental use" exception to patent infringement sufficient to encompass the activities of the generic drug manufacturers.

The outrage provoked by this decision among the generic drug industry, the medical profession and consumer groups led to a rapid legislative "fix." The new law amended Sec. 271(e)(1) of the Patent Act[19] to provide:

> It shall not be an act of infringement to make, use, or sell a patented invention … solely for uses reasonably related to the development and submission of information under a Federal Law which regulates the manufacture of drugs.

At the same time, however, the major pharmaceutical manufacturers, who invested heavily in research and development and relied on patents to protect their investments, demanded something in return. They pointed to the protracted regulatory delays routinely experienced before the FDA, and they argued that these delays, often coming after patent issuance, meant in effect that these companies were being forced to sacrifice some of their legitimate patent terms to the regulatory process. The legislative compromise that enabled generic drug manufacturers to begin testing before patent expiration thus also included a provision establishing patent term extensions for pharmaceutical patents designed to compensate patent owners for FDA regulatory delays.[20] This legislation also set the precedent for what would later become patent term adjustments for Patent Office regulatory delays.[21]

[19] 35 U.S.C.§271(e)(1).
[20] *See, e.g.,* James M. Flaherty, *supra* note 17.
[21] *See infra* part III (B).

III. PATENT TERM CHANGES: 1995-2010

A. Patent Term Harmonization – 1995

In 1969, the Patent Cooperation Treaty (PCT) was signed by the founding countries, which included the United States, as a major step toward streamlining and harmonizing the global patent system. Over the next several decades, with strong support from the United States, PCT membership grew to encompass more than one hundred signatories, and efforts continued within the PCT framework to encourage greater standardization of patent procedures and criteria at the national and regional levels.

Yet, the United States stood out like a sore thumb on the issue of patent term. While other PCT member countries coalesced around the standard of a 20-year patent term measured from the earliest patent application priority date, the United States clung tenaciously to its more than one-hundred-year-old 17-years-from-issue term. Finally, in 1994, under growing international pressure to become a "team player," the United States gave in, and Congress amended Sec. 154 of the Patent Act to establish a 20-year-from-priority/filing date term, consistent with most other PCT countries.[22]

The revised patent term formally took effect on June 8, 1995, but Congress endeavored to provide a smooth transition between the old and new systems. Under the legislation, patents issuing on patent applications filed before June 8, 1995, would receive a patent term of either 17 years from the issue date (as under the old rules) or 20 years from the earliest claimed priority date, whichever period was longer. All patents issuing on or after June 8, 1995, however, would receive a patent term of 20 years from the earliest priority filing date.[23]

No longer could one just glance at the issue date of the front of a patent to easily determine the date of patent expiration. Now it became necessary to look at the actual patent application filing date to see if it was before or after June 8, 1995; then it was also necessary to identify the earliest claimed priority date and to perform alternative patent term computations. Unfortunately, this proved to be only the beginning of a long line of patent term complexities that has, at least for now, rendered the patent term computation process a job beyond the ability of any but skilled patent professionals.

[22] Pub. L. No. 103-465, §532, 108 Stat. 4809, 4984 (Dec. 1994).
[23] 35 U.S.C.§154(b).

B. The American Inventors Protection Act of 1999

Prior to the U.S. switch to a 20-years-from-priority/filing date patent term, the long history of U.S. Patent Office backlogs, sometimes running five years or longer, was little more than a continuing source of annoyance and frustration to inventors. As long as patent terms were being computed from the patent issue date, Patent Office processing delays had no impact on patent terms. But, with the new system of calculating patent term from the filing/priority date, inventors quickly realized that those Patent Office backlogs were eating into their patent terms.

In response to these complaints, in 1999 Congress enacted the American Inventors Protection Act (AIPA) to remedy the problem.[24] Specifically, the AIPA amended Sec. 154 of the Patent Act to compensate patent applicants on a one day for one day basis for three different types of common Patent Office processing delays.[25] First is what is called a Type A delay (because this type of delay is addressed in subsection (A) of the statute). A Type A delay arises if the Patent Office fails to meet certain specific deadlines during the patent prosecution procedure. For example, this provision requires a Patent Term Adjustment (PTA) if the Patent Office fails to generate a first response to a new patent application within 14 months of the filing date.[26]

Second is what is called a Type B delay.[27] A Type B delay occurs if the Patent Office fails to issue a patent within three years of the filing date. Finally, a Type C delay is caused by time lost because of the institution of an "interference" proceeding (requiring a determination of priority of invention between two or more applicants competing for a patent on substantially the same invention), imposition of a secrecy order (under U.S. national security rules covering sensitive technologies

[24] Pub. L. No. 106-113, 113 Stat. 1501A-557 (Nov. 29, 1999), codified at 35 U.S.C. §156(b). *See generally* Richard Neifeld, *Analysis of the New Patent Laws Enacted November 29, 1999*, 82 J. PAT. & TRADE. OFF. SOC'Y 181 (March 2000); William Slate, *The Effects of Term Adjustment Under the American Inventors Protection Act*, 3 YALE J.L. & TECH. 7 (2001); and Hay Kyung Chang, *Patent Term Extension: What to do and What to Avoid*, INTELLECTUAL PROPERTY TODAY (Nov. 2001). This piece of legislation also became known as the Patent Term Guarantee Act of 1999.

[25] *Id. See also* 35 U.S.C.§154(b).

[26] 35 U.S.C.§154(b)(1)(A) confers a "Guarantee of prompt Patent and Trademark Office responses". This provision has also become known as the "14-4-4-4 Rule," requiring an Official Action within 14 months of filing, a response to a reply or appeal within 4 months, action on a Board of Appeals decision within 4 months, and issuing an allowed patent within 4 months of the fee payment.

[27] 35 U.S.C.§154(b)(1)(B) confers a "Guarantee of no more than 3-year application pendency".

like nuclear power), or a successful appellate review of an adverse Patent Office decision.[28]

Recognizing that two or more of these various types of Patent Office delay can occur contemporaneously, and not wanting to confer an undeserved windfall on patent applicants, the AIPA also contained a specific overlap provision intended to prevent double-counting.[29] The overlap provision specified that only one day of patent term adjustment should be awarded for one day of delay, regardless of how many different types of delay occurred on the same day.[30] Furthermore, the legislation provided that PTA should be reduced for delays that were caused by the patent applicant, for example in filing late responses to Patent Office Actions.[31]

C. Patent Office Implementation of the AIPA

The AIPA empowered the U.S. Patent Office to compute the proper PTA for U.S. patents issuing in 2000 and thereafter.[32] Initially, however, the Patent Office proceeded slowly with its PTA-related rulemaking and largely tracked the statutory language.[33] Finally, in 2004, the Patent Office proceeded more deliberately in issuing new, more detailed PTA regulations.[34]

In the 2004 regulations, the term "periods of adjustment" was replaced with "periods of delay."[35] The Patent Office asserted that this

[28] 35 U.S.C.§154(b)(1)(C) confers a "Guarantee or adjustments for delays due to interferences, secrecy orders, and appeals."

[29] The "guarantee" provisions of 35 U.S.C.§154(b)(1) were made expressly subject to the "general" limitation of 35 U.S.C.§154(b)(2)(A): "To the extent that periods of delay attributable to grounds specified in paragraph (1) overlap, the period of any adjustment granted under this subsection shall not exceed the actual number of days the issuance of the patent was delayed."

[30] *Id.* In other words, the limitation of 35 U.S.C.§154(b)(2)(A) restricts the period of adjustment when any of the "periods of delay" overlap.

[31] *See* U.S.C.§154(b)(2)(C) and 37 C.F.R. §1.704(c). *See generally* Robert A. Matthews, Jr. Annotated Patent Digest, §9:24 "Extensions for PTO Delays".

[32] 35 U.S.C.§154(b)(3) directs the Patent Office to "prescribe regulations establishing procedures for the application for and determination of patent term adjustment under this subsection."

[33] In 2000, the Patent Office promulgated 37 C.F.R. §1.703(f) which, except for minor wording changes, substantially repeated the text of 35 U.S.C.§154(b)(2)(A). Later in 2000, 37 C.F.R. §1.703(b) was amended to define "periods of adjustment" as "the number of days, if any, in the period beginning on the day after the date that is three years after the date on which the application was filed…." No explanation about implementation or application of this regulation was provided.

[34] 69 Fed. Reg. 21706 (2004).

[35] *Id. See generally* James P. Longfellow and Irving Kayton, *Assessing the PTO System for Calculating AIPA Patent Term Adjustment*, INTELLECTUAL PROPERTY TODAY (April 2004) at 35.

substitution was intended to clarify its previous rulemaking, explaining that: "The language of former §1.703(f) misled applicants into believing that [periods of Type A delay] and [periods of Type B delay] were overlapping only if the [period of Type A delay] occurred more than three years after the actual filing date of the application."[36]

But, in the 2004 regulations, the Patent Office also adopted a more expansive definition of "overlap" that resulted in shortening the PTA in many patents.[37] Under this "clarified" definition, the Type B guarantee started with the filing of the application, not three years later, the consequence being increased "overlap" between Type A delays (Patent Office failures to meet specific processing deadlines) and Type B delays (failure to issue a patent in three years), and a reduction in patent term. For example, under this system, if 30 days of Type A delays occurred during the first three years of the patent prosecution process, and then the patent finally issued 40 days after the three-year mark, the PTA would be computed as 40 days, not 70. Thus, the Patent Office approach used the greater of the Type A delay or the Type B delay to determine the PTA, but would never combine the two.

IV. THE WYETH AND ELAN PHARMA CASE

A. The Patent Office PTA Computations

U.S. Patent Nos. 7,179,892 (the '892 patent) and 7,189,819 (the '819 patent), directed to treatment of Alzheimer's disease, were issued in 2007 to Wyeth and Elan Pharma International Limited (Wyeth). During prosecution of the respective patent applications, Type A and Type B delays occurred that entitled these patents to patent term adjustments.

For the '892 patent, the Patent Office calculated that there were 610 days of Type A delay (with 51 of those days occurring after three years from the application filing date), 345 days of Type B delay, and 148 days of delay caused by the applicants. Using its "greater of A or B" rubric, the Patent Office calculated the PTA for the '802 patent as follows: 610 (the greater of A and B) minus 148 (applicant delay) = 462 days.[38]

Wyeth argued, however, that the Type B delay period should not have started until three years after the filing date and, therefore, that any

[36] *Id.*

[37] The clarification in the new regulation provided that: "If an application is entitle to a [Type B] adjustment … the entire period during which the application was pending before the [Patent Office] …, and not just the period beginning three years after the actual filing date of the application, is the period of delay under 35 U.S.C. 154(b)(1)(B) [used] in determining whether periods of delay overlap under 35 U.S.C. 154 (b)(2)(A)," *id.* For practitioner suggestions to make the most of these arcane rules, see Scott E. Kamholz, *Patent Term Adjustment for Fun and Profit*, INTELLECTUAL PROPERTY TODAY (Aug. 2006).

[38] 591 F.3d 1364, 1368 (Fed. Cir. 2010).

Type A delay that occurred before the three-year mark could not possibly have overlapped with Type B delay. Thus, Wyeth calculated the correct PTA for the '892 patent as follows: 610 (Type A delay) + 345 (Type B delay) – 51 (portion of Type A delay occurring after the three-year mark) – 148 (applicant delay) = 756 days, 294 days more than the Patent Office calculation.[39]

For the '819 patent, the Patent Office calculated that there were 336 days of Type A delay (with 106 of those days occurring after three years from the application filing date), 827 days of Type B delay, and 335 days of delay caused by the applicants. The Patent Office calculated the PTA for the '819 patent as follows: 827 (the greater of A and B) minus 335 (applicant delay) = 492 days.[40] Wyeth, however, calculated the PTA to which it believed it was entitled as follows: 336 (Type A delay) + 827 (Type B delay) – 106 (portion of Type A delay occurring after the three-year mark) – 335 (applicant delay) = 772 days, 230 days more than the Patent Office calculation.[41]

B. The Wyeth Litigation

After filing unsuccessful petitions with the Patent Office for reconsideration of PTA for the '892 and '819 patents, Wyeth brought suit in the U.S. District Court for the District of Columbia seeking an order directing the Patent Office to grant PTA adjustments in accordance with Wyeth's calculations. Both parties filed motions for summary judgment.[42]

The Patent Office cited 35 U.S.C. §154(b)(3) as evidence that Congress had delegated rulemaking authority related to PTA determinations to the Patent Office. The Patent Office further relied on the precedent of *Chevron U.S.A., Inc. v. Natural Resources Def. Council, Inc.*[43] in arguing that deference should be given to its administrative interpretation of the AIPA legislation.

But, the District Court found in favor of Wyeth.[44] The District Court observed that the Patent Office "does not have the authority to issue substantive rules, only procedural regulations regarding the conduct of proceeding before the agency."[45] Furthermore, the District Court

[39] *Id.*
[40] *Id.*
[41] *Id.*
[42] *Wyeth v. Dudas*, 580 F. Supp. 2d 138 (D.D.C. 2008).
[43] 467 U.S. 837 (1984).
[44] 580 F. Supp. 2d 138, 141.
[45] *Id. Cf. Tafas v. Dudas*, 541 F. Supp. 2d 805 (E.D. Va. 2008) (holding that the Patent Office has only procedural, not substantive, rulemaking authority in a suit challenging the Patent Office's attempt to implement its controversial "Continuation and Claims Limitation" rules package).

determined that the Patent Office interpretation of the PTA legislation was contrary to the plain language of the statute:[46] "The problem with the PTO's interpretation is that it considers the application delayed under [the Type B guarantee] during the period <u>before it has been delayed</u>," (emphasis added).

On appeal, the Federal Circuit (CAFC) affirmed the District Court ruling in favor of Wyeth.[47] The CAFC determined that there was "no ambiguity in the terms 'periods of delay' and 'overlap'" as these terms are used in the statute.[48] The Court noted that "the A and B guarantees expressly designate when and for what period they each respectively apply."[49] Based on this statutory analysis, the CAFC concluded that: "Before the three-year mark, no 'overlap' can transpire between the A delay and the B delay because the B delay has yet to begin or take effect."[50]

The CAFC then turned to what it called "the PTO's strained interpretation" of the "overlap" provision.[51] According to the Patent Office PTA calculation procedure, the CAFC observed, a "B delay can occur <u>anytime</u> after the application is filed. [But,] the language of section 145(b) does not even permit B delay to start running until three years <u>after</u> the application is filed. [Thus,] the PTO's position cannot be reconciled with the language of the statute."[52] The CAFC then also summarily dismissed the Patent Office contention that Type A delay may ultimately contribute to Type B delay, and that can lead to double-counting, with the observation that "the statute requires as much" and that potentially perverse results could also occur applying the Patent Office approach.[53] Other Patent Office arguments defending its position including those based on the somewhat contorted legislative history of the AIPA, were similarly considered and rejected.[54] The Patent Office quickly announced that it would not appeal the CAFC decision.

C. After the Wyeth Litigation

Following Wyeth's successful challenge of Patent Office PTA determination practice, it can be expected that many patent owners will be reviewing their patents for PTA errors. 35 U.S.C. §154 and the

[46] 580 F. Supp. 2d at 141.

[47] 591 F.3d 1364, 1368 (Fed. Cir. 2010),. *See generally* John L. Rogitz, *Patent Term Adjustment: Wyeth v. Kappos*, INTELLECTUAL PROPERTY TODAY (March 2010) at 28.

[48] *Id.*

[49] *Id.*

[50] *Id.*

[51] *Id.*

[52] *Id.*

[53] *Id.*

[54] *Id.*

related implementing regulations specify the normal remedies and procedural route available to patent owners who are dissatisfied with a Patent Office PTA determination. In general, the recourse is to file a request for reconsideration with the Patent Office and, if necessary, proceed with a civil action against the Patent Office Director in U.S. District Court.[55]

After the *Wyeth* decision, however, the Patent Office announced that it would offer a particular group of patent owners a simplified interim procedure for requesting recalculation of the PTA.[56] Under this interim procedure, the Patent Office provided a form available online that could be used to request PTA recalculation for patents issued prior to March 2, 2010, but within 180 days of the patent issue date. The March 2, 2010, date was pegged to the date on which the Patent Office expected to have its computer system reprogrammed to accommodate PTA calculations consistent with the *Wyeth* decision.[57] Patents issuing on or after March 2, 2010, however, are not eligible for the interim procedure, and those requests for reconsideration of PTA must follow the regular procedures.

But, a plethora of difficult legal questions remain unanswered. First, some commentators have cautioned that the Patent Office's simplified interim procedure for requesting PTA reconsideration may not be authorized by statute. An extended PTA granted under that interim procedure could later be challenged in court by an alleged infringer accused of infringing the patent during the extended PTA term.

It has been reported that, since the *Wyeth* case was filed in the District Court, more than 140 lawsuits have been filed against the Patent Office challenging incorrect PTA calculations. Many of those have been remanded back to the Patent Office following the court decisions in *Wyeth*. It will clearly take some time for those cases to be resolved, and, in the meantime, many new cases are surely being filed. Thus, there are a number of U.S. patents issued since 2000 where the patent term will be in doubt for months, perhaps years, to come.

The statutory provision for recourse for an incorrect PTA determination requires that a lawsuit contesting the PTA determination be filed within 180 days of the patent issue date, which might seem to limit the scope of this issue. But, several lawsuits have already been filed relating to patents issued outside the 180 day limit asserting that the *Wyeth* decision constitutes a change in law sufficient to invoke the doctrine of "equitable tolling." "Equitable tolling " is a remedy that a

[55] 35 U.S.C. §154.

[56] A copy of the notice submitted to the Federal Register for publication and the form to be used appears on the Patent Office web site at http://www.uspto.gov/patents/announce/pta_wyeth.pdf.

[57] *Id.*

court can apply to avoid manifest injustice. It typically requires the party requesting this unusual remedy to demonstrate both diligence and extraordinary circumstances, but in an appropriate case it could be applied to allowing filing a complaint after a filing deadline has elapsed. It is also conceivable that, as part of currently pending patent law reform bills, Congress would address the incorrect PTA problem for patents outside the 180 day limit.

Moreover, other types of challenges to Patent Office PTA calculation practice have been raised. For example, the Patent Office has been calculating Type B delay for a U.S. national phase patent application based on an earlier-filed Patent Cooperation Treaty (PCT) application that designated the United States from what is known as the Sec. 371(c) date.[58] Sec. 371(c) requires the submission of an inventor's oath or declaration to complete an application filing if the oath or declaration did not accompany the original application papers.

Pending lawsuits, however, are contesting this practice and asserting that the application "filing date" for purposes of Type B delay calculations should begin when the minimum filing requirements under Sec. 371(b) or (f) have been met. Because the Sec. 371(b) or (f) date may be months, even years, before the Sec. 371(c) date, this would lead to a longer Type B delay and a longer PTA. Indeed, the argument has even been raised that, because the filing date of the international (PCT) application designating the United States is treated as the U.S. filing date for some purposes, that the international application filing date (potentially up to 30 months earlier than even the Sec. 371(b) or (f) date!) should be used for computing Type B delay.

V. CONCLUSION

The recent CAFC decision in the *Wyeth* case has thrown the computation of U.S. patent terms into turmoil. No longer is it possible to make a quick and easy determination of how long a U.S. patent will last. Patent legislation over the last fifteen years, coupled with the *Wyeth* case, has transformed patent term, once one of the few facets of the patent system that seemed decipherable, into a complex and uncertain morass.

It can be hoped that currently pending patent reform legislation will clarify and simplify the patent term issue. In the meantime, both patent owners assessing the duration of their rights and prospective competitors waiting for patent expirations should consult with

[58] 35 U.S.C. §371 sets forth the rules that govern U.S. national phase patent applications based on PCT applications.

experience patent counsel and not make possible unwarranted assumptions about how long a U.S. patent will remain in force.